Joint Committee on Employee Benefits Q&A
Technical Session with the SEC staff
May 9, 2001

The following questions and answers are based on informal discussions between private sector representatives of the JCEB and SEC staff members. The questions were submitted by ABA members and the responses were given at a meeting of JCEB and government representatives. The responses reflect the unofficial, individual views of the government representatives as of the time of the discussion, and do not necessarily represent the position of the agency. This report on the discussions was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting, and has not been reviewed by SEC staff members. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

Rule 701

1. **Sales in Excess of Rule 701 Limits.** If an issuer has sold shares in excess of the Rule 701 limits, has it lost the exemption for all shares sold that year or only those in excess of the limit? In other words, which shares are required to be subject to a rescission offer if no other exemption is available?

   Suggested Answer: Only sales in excess of the limit should be subject to rescission. The Preliminary Notes to Rule 701 provide that an issuer that attempts to comply with the Rule but fails to do so may claim any other available exemption. If another exemption was available, the failure to comply with Rule 701 would not taint the remainder of the 701 offering. Similarly, if no other exemption was available, sales which did meet the 701 requirements should not be tainted.

   SEC Response: The initial response was that Rule 701 should be viewed as a whole. If you've exceeded the limits, you've lost the benefit of the exemption for all grants/sales during that 12-month period. In the ensuing discussion, JCEB members suggested that Rule 701 should be treated in the same manner as Rule 504 – *i.e.*, that all sales (including grants treated as sales) up to the limit would be covered by the exemption and those over the limit would be viewed separately and not integrated with the earlier sales. The SEC staff said they would be willing to reconsider the question in the context of a more specific factual situation. The staff also indicated that although the Question seems to be suggesting there should be an "i and i" *[inadvertent and insignificant, as provided in Rule 508]* defense under Rule 701, the Rule as drafted does not provide for one.

2. **"Repricings" Under Rule 701.** An issuer with underwater options granted under Rule 701 wishes to reprice those options. How are the "repriced" options treated for purposes of Rule 701 under the following circumstances:

   a. The issuer unilaterally reduces the exercise price of the options, either by amendment or by cancellation of the original options and a grant of replacement options, where in either case the exercise price is the only provision that is changed?

   b. The optionee is given the ability to choose whether to accept the repricing because there is a change in the option in addition to a reduction of the exercise price, such as a change in the number of replacement options, the vesting schedule, or because the replacement options will be granted six months and a day later with an exercise price at the then-value of the shares?

   Suggested Answer: Because the amended or replacement option is granted in substitution for the underwater option, the original and repriced option should not both be counted for purposes of the Rule 701 limits. The amended or replacement grant should be used for purposes of calculating both the number of shares (% of the class) and aggregate exercise price limits, with a "credit" for the options given up. The 1999 Adopting Release for amended Rule 701 supports this approach in that footnote 16 says that if the exercise price of an option is later changed or repriced, a "recalculation" would be required. The absence of double counting is also supported by a Section 3(a)(9) analysis.

   SEC Response: Rule 701 is concerned with sales, not offers. The staff recognizes that calling the option grant a "sale" for purposes of Rule 701 is a fiction created for administrative convenience. As a result, the staff is willing to interpret the Rule to allow a company to disregard options that are cancelled or forfeited when applying the Rule 701 limits. This is the case both in the option repricing content and in the case of options that are forfeited for other reasons.

3. **Timing of Disclosure for 423 Plan.** A foreign private issuer is planning to offer a Section 423 stock purchase plan to its employees. The issuer is <u>not</u> planning to register under the Exchange Act, but will instead comply with the enhanced disclosure requirements of Rule 701 throughout the offering. Employees will sign up for payroll deductions at the start of the year and the payroll deductions accumulated over the course of a year will be applied to purchase shares on a single purchase date at the end of the year. Employees would have the right to withdraw from the plan and have their payroll deductions refunded to them at any time during the year until shortly before the purchase date. Is it sufficient for the company to provide the Rule 701 enhanced disclosure shortly before the purchase date (or must it also be provided at the time of enrollment)?

Suggested Answer: The disclosure only needs to be provided a reasonable period before the purchase date, since that is the only real investment decision. The staff's positions requiring full disclosure before a conditional purchase in a public offering should not be applicable in an offering under Rule 701.

SEC Response: The staff agrees with the suggested answer. Rule 701 requires that the disclosure be provided only once with respect to any given sale. The most appropriate time for providing that disclosure would be a reasonable period before the actual purchase (*i.e.,* before the end-of-year purchase date, when the decision is irrevocable). This response should not be generalized to the S-8 context. The staff continues to adhere to its position that if a plan will be registered on S-8 employees cannot make an election with respect to their participation until the S-8 has become effective. The difference between the staff positions in the 701 and S-8 contexts is that both offers and sales are regulated in the context of a registered offering, but Rule 701 is concerned only with sales (and not offers).

4. **Shares Held by Foreign Trusts.** At our meeting with the staff last year, the staff indicated that Rule 701 would not be available where a shareholder of the issuer offered shares of the issuer to employees of the issuer under an employee benefit plan of the issuer. The staff was concerned that this arrangement was a secondary offering, and thus not eligible for exemption under Rule 701. The staff indicated there was a limited exception to this position for certain foreign issuers where under their local law there are impediments to having the issuer fund the Plan. The staff cited to its letter to *Randstad Staffing* (8/31/95) where a Netherlands foundation was used to hold the shares, and indicated it would deal with these situations on a case by case basis. Recently, the staff issued a no-action letter to *Neopost Online, Inc.* (2/14/01) involving shares of a French parent held in a US trust. Are there other vehicles or entities that the staff is currently considering in this context? For example, a number of UK companies use offshore trusts to hold shares under plans benefiting US employees.

   SEC Response: The staff is currently considering a no-action letter involving facts similar to those in Question 5. Letters issued some years ago under Reg D involving trusts as surrogates for the issuer could provide a useful analogy in the Rule 701 context. The staff's concern in this area is that it doesn't want Rule 701 to be used for what are essentially secondary offerings (*e.g.*, resales from one participant to another).

5. **Broker-Assisted Open Market Stock Purchase Plan.** Under English Company Law, an issuer may not hold treasury stock (except in some very limited situations). Where a UK issuer establishes a stock purchase plan and does not wish to use newly issued shares, it may use a broker to purchase shares on the open market and hold them in a custodial account for delivery to employees under the Plan. Will Rule 701 be available for such an arrangement offered to US employees where (i) the issuer contracts with a UK broker to purchase the shares on the London Stock Exchange pursuant to employee elections, (ii) the shares will

be held in a custodial account or offshore trust, (iii) the employee is entitled to direct the voting of the shares, receive dividends, and direct the custodian or trustee to transfer the shares to his name at any time, and (iv) pursuant to the plan the issuer will provide a matching award in shares to each employee who participates and holds the shares he or she purchases through the plan for at least three years?

Suggested Answer: Yes, Rule 701 is available. The broker is acting as an agent in facilitating the purchase. Because of the match feature, this plan cannot qualify as an open market plan involving no "sale" by the issuer. However, notwithstanding the involvement of the broker, the plan sponsorship, plan administration and plan match all indicate that the shares are being offered pursuant to an employee benefit plan <u>of the issuer</u>, and therefore Rule 701 should be available.

SEC Response: Rule 701 is available. This is really a compensatory arrangement notwithstanding the involvement of a broker

<u>Rule 144</u>

6. **Definition of "person".** The definition of "person" in Rule 144 includes a corporation or other entity of which the insider and certain family members are the "beneficial owners" of 10% or more of a class of equity securities. What is the meaning of beneficial ownership for this purpose in the context of:

    i. a corporation?

    ii. a limited partnership?

    iii. a trust?

    Suggested Answer: Beneficial ownership for this purpose should require both investment control and pecuniary interest.

    SEC Response: The interpretive history gives little help in defining beneficial ownership in this context. In the trust context, the key factor is whether the affiliate has an economic interest in the trust assets. If this factor is present, the presence of an independent trustee is insufficient to permit treating the trust as a separate "person" from the settlor/beneficiary. However it is not clear how the 10% beneficial ownership under Rule 144 would be determined where the income beneficiary and remainder beneficiary were different. While not yet addressed, it is likely that investment or voting control without economic interest, although "beneficial ownership" for other reasons, would not trigger Rule 144(a)(2).

7. **Form 144 for Cashless Option Exercise.** Can a Form 144 be filed when an insider has exercisable stock options that he intends to exercise by means of a cashless exercise? The nature of such an exercise is that the broker is directed to sell the shares before they have been issued in the name of the insider. The broker delivers some or all of the sale proceeds to the issuer to pay the exercise price and any required tax withholding.

   Suggested Answer: An insider should be able to file a Form 144 prior to a cashless exercise of exercisable options. The insider is treated as the beneficial owner of the shares underlying exercisable options for purposes of other provisions of the securities laws, such as Sections 13(d) and 16, and similarly should be able to cover such shares on a Form 144 prior to the actual exercise.

   SEC Response: The staff agrees with the suggested answer, with one caveat. In order to file Form 144 with respect to as yet unexercised options, the affiliate must be able to supply the information called for by the Form with respect to the option shares (*e.g.*, date acquired and description of the acquisition transaction). It may be possible to provide this information with respect to shares which have not yet been purchased if the Form 144 discloses a schedule of anticipated option exercises and dates. (This information would also help meet the Rule 144(i) requirement that the insider have a good faith intention to sell the shares covered by the Form.) The staff referred to the recent Rule 10b5-1 guidance.

Section 12(g)

8. **Limitation on Transferability of Stock and Options.** The March 29, 2001 update to the Division of Corporation Finance's Current Issues and Rulemaking Projects Outline dated November 14, 2000 (the "March 29 Update") discusses the conditions under which the staff will permit an issuer with more than 500 optionholders to avoid Exchange Act registration of the options as a class of securities.

   . One of the conditions required to be satisfied is that stock received upon exercise of the options is not transferable, except to the company or in the event of death or disability. Will this condition be treated as satisfied where stock received upon exercise of an option is transferable in situations other than death or disability to:

      i. a corporation?

      ii. a limited partnership?

      iii. a trust?

SEC Response:

iv. and ii. As a general matter, transfers to a member of management or to another stockholder will not satisfy the condition of non-transferability. The only possible exception is where the purchase is in lieu of the Company's exercise of a right of first refusal. The staff is still considering this issue. The staff is concerned that allowing transfers to existing shareholders could create an intra-company market even in the absence of a trading market.

iii. The staff is likely to permit transfers that are permitted under Rule 701. This would require not only that the transferee be one of the family members or entities listed in Rule 701, but also that the transfer be the kind of transaction permitted by Rule 701 (i.e., a gift or a transfer pursuant to a Qualified Domestic Relations Order).

a. What is the staff's position with respect to outstanding options that do not provide that they are non-transferable, and thus as a matter of contract law cannot be made non-transferable without the consent of the optionee?

SEC Response: There are three possible approaches to deal with options that were granted without a non-transferability provision: (1) if the Company has a right of first refusal, exercise it to prevent other transfers; (2) amend the Company's charter to impose transfer restrictions on all shareholders; or (3) amend the option plan to impose transfer restrictions. *[Scrivener's Note: Depending on the terms of the plan and option, this third approach may not be possible without optionee consent.]* The no-action requests the staff has received to date have all made suggestions to deal with this problem and the staff is willing to work with the issuer on this.

9. **Options held by Employees of Related Entities.** The March 29 Update states that relief from the requirement to register under Section 12(g) due to 500 optionholders will be granted where certain conditions are satisfied.

. Is this relief available if some of the options are held by employees of parents or subsidiaries of an issuer seeking relief?

a. Is this relief available if some of the options are held by employees of brother-sister corporations of an issuer seeking relief?

SEC Response: Current letters have only involved options held by employees of wholly-owned subsidiaries (direct or indirect). The staff is thinking about

broadening its position to provide relief where options are held by the same group of holders who would be eligible for Rule 701.

10. **Required Information.** The March 29 Update states that relief will be granted from the requirement to register under Section 12(g) where certain conditions are satisfied. Among these conditions is the requirement that the company distribute to optionees certain Exchange Act information. We understand that this requires distributing to optionees audited annual financial statements, unaudited quarterly financial statements, and information that the issuer provides to its shareholders generally. Is any additional information required to be provided to optionees?

    SEC Response: The information described in the Question is what the staff required in the *Mitchell International Holding, Inc.* letter (Dec.27, 2000). Under the modified relief described in the March 29 Update, the staff will require significantly more. The staff starts from the position that absent this relief, the Company should have registered under the 1934 Act. Therefore, the optionees are entitled to get the same information they would have gotten if the Company had registered. The essence of the relief is that the Company doesn't have to make the information publicly available. But the information is otherwise generally the same as required for a 1934 Act registered company, including MD&A (except that 8-K event information is not required). The information must be provided to optionees at the time it would otherwise have been filed. It's not enough to provide information at the time of exercise.

11. **Extension of Filing Date.** The March 29 Update states that April 30, 2001 is the filing date for registration statements of issuers that met the Section 12(g) registration requirement as of December 31, 2000, but that the staff would consider extending that filing date to July 30 for any issuer that submitted a no-action request for relief from registration by April 30.

    . What does a company that missed the April 30 deadline do?

    a. How does the staff's position apply to an issuer whose fiscal year ended before December 31, 2000?

    b. How does the staff's position apply to an issuer whose fiscal year ended after December 31, 2000 (*e.g.*, January 31, 2001)?

    SEC Response: The staff received 12 requests for exemption before April 30 and none after the deadline. They feel the deadline was sufficiently well-publicized that there was no reason for companies to miss it. There is no staff policy regarding either calendar year companies that missed the April 30 deadline or companies whose fiscal year ended before December 31, 2000. The staff would consider these situations on a case by case basis. Companies with a fiscal year ending after December 31, 2000 will generally be given relief from 1934 Act

registration through July 30, 2001, but need to submit a no-action request for relief from registration soon so it can be acted on by that date.

Proxy Rules

12. **Signing Bonus.** Must a one-time "signing bonus" be taken into account for purposes of determining if a newly-hired officer is one of the five most highly compensated executive officers?

    Suggested Answer: If a bonus of that size is not expected to be paid to the officer in future years, it may be disregarded in determining the highest paid officers.

    SEC Response: The signing bonus must be included in the Bonus column and must be taken into account in determining the most highly compensated executive officers.

13. **Merger Proxy Compensation Disclosure.** A calendar year company is mailing a proxy statement in January for a special meeting to vote on a merger. At the time of preparing the proxy statement the company has not yet calculated all of the compensation information required by S-K Item 402 for the recently-ended fiscal year. Can the company ignore the most recently-ended year and instead provide disclosure based on the next preceding year? If so, would the most-recent year information be required to be provided by a supplemental mailing?

    Suggested Answer: If a proxy statement for a special meeting is being mailed within 60 days of the end of the fiscal year, the company should not be required to include Item 402 information for the just-ended fiscal year. Instead, it should be permitted to undertake in the proxy statement to send a copy of the information for the most recent year when (and if) prepared in the ordinary course to those shareholders who expressly request this information.

    SEC Response: The proxy statement must include the compensation for the most recently-ended fiscal year. The only exception is that if the bonuses for the year have not yet been determined, the proxy statement can so indicate.

14. **Reporting of Severance Payments.** An executive officer who qualifies as a named executive officer for 2001 terminated employment during 2001. At the time of his termination, a severance package was negotiated in settlement of obligations under his employment agreement, entitling him to payments in an amount equal to three times his salary, payable over the next three years. How should the severance payments be reported in the Summary Compensation Table for 2001?

SEC Response: The severance payments should be reported in the All Other Compensation column. The total amount payable over the three years should be shown, since the item calls for disclosure of amounts "paid, payable or accrued." The severance arrangement must also be described in the narrative text and should be discussed in the Compensation Committee Report and filed as an exhibit.

15. **Beneficial Ownership Table.** An executive has vested phantom stock units under a nonqualified deferred compensation plan. Under the plan, the executive has the right to have the units settled in stock on a date selected by him and has elected to have the units settled one year after his termination of employment. Can these units be included in the beneficial ownership table (with appropriate footnote disclosure) even though the executive's right to receive the underlying stock is more than 60 days in the future?

    Suggested Answer: The Telephone Interpretations Manual (March 1999 Supplement, Item 2S under the Section "Regulation S-K") indicates that units which are payable in stock upon termination of employment may be included in the table, since the executive could theoretically acquire the stock within 60 days by terminating employment. However, in light of the fact that most executives are not likely to terminate employment within this period, a company should be permitted to treat all participants in the plan in the same way, without a need to review each executive's deferral elections. Thus a company should be permitted to include in the table all phantom stock units which the employee can elect to settle in stock, regardless of the settlement date.

    SEC Response: Since under the facts presented the executive cannot get the stock within the 60-day period used to determine beneficial ownership, these phantom stock units should not be reported in the beneficial ownership table. The staff would not object if the units were referred to in a footnote to the table, but they should not be in the table itself, even in a separate column.

Section 16

16. **Sales by Charitable Remainder Trust.** An insider contributed company stock to a charitable remainder trust he established, with an independent trustee. The insider is the sole income beneficiary, and the charity is the remainderman. The trust requires annual distributions to the insider. Under applicable tax law, the first distribution is required to be made on or before the April after establishment of the trust. It is anticipated that the shares will be sold and the proceeds used to make the required distributions. The insider has no control or influence over the timing of the trust's sales.

    . Are sales by the trust required to be reported by the insider on Form 4?

a. Does it matter whether the trust requires cash distributions, or permits distributions to be made in cash or stock?

Suggested Answer:

b. Under Rule 16a-8, if the insider is the beneficiary of a trust, but not the trustee, and in fact exercises no control or influence over the trustee's sales, sales by the trust are not attributed to the insider. The only question here is whether the insider can be deemed to be influencing the trustee by virtue of contributing stock under a trust instrument that contemplates that the stock will be sold by a specified date. It would seem that this should not be enough to cause sales by the trustee to be deemed influenced by the insider if the trustee has sole discretion to determine the timing of the sales.

c. The fact that the trust requires cash distribution (rather than permitting distribution in either stock or cash) should not matter. One of the reasons for establishing this type of trust is that sales by the trust are taxed more favorably than sales by the insider, so the general expectation would be that the trustee would sell the shares rather than distribute them.

SEC Response: Sales by the trust are not required to be reported by the insider. The tax laws dictate when the distribution must be made, not when the shares will be sold. Therefore, under these facts the insider would not be viewed as controlling the timing of the sale. The result may be different if the insider directed the trustee to sell the shares by a specified date.

17. **Prepaid Forward.** What is the Section 16 treatment of a variable pre-paid forward transaction? Under this type of transaction, the insider contracts with a brokerage firm to sell a variable number of shares of his company on a future fixed date. At the time the arrangement is entered into, the insider pledges the maximum number of such shares to the broker, and the broker sells that same number of shares under Rule 144 and delivers cash to the insider. At the fixed settlement date, the insider delivers to the broker some or all of the pledged shares, depending on the then-price of the shares.

. How should the insider report the entry into the arrangement? Is it a sale of shares or a derivative transaction, since the cash received by the insider is known, but the number of shares ultimately deliverable by the insider is not? Alternatively, should it be reported as entry into two derivative securities transactions, as is the case with zero cost collars? Is it sufficient for the insider to report it as a single transaction showing the range of shares that could be delivered?

a. What, if anything, is reported upon settlement? Is there an additional 16(b) sale (if the insider delivers more than the minimum shares in the range) or purchase (if the insider delivers fewer than the maximum)? If the entry

into the arrangement was reported as two derivative securities, is the settlement treated as only a single sale for 16(b) purposes?

b. If the number of shares delivered on settlement is exactly either the minimum or the maximum, does the sale qualify for exemption under Rule 16b-6(b)?

c. If the number of shares delivered on settlement is between the minimum and the maximum, because the market price of the stock at that time is between the upper and lower limits specified in the contract, does the settlement involve a non-exempt sale?

SEC Response: This Question would be better addressed if submitted as a request for an interpretive letter. The staff's preliminary view is that the transaction should be viewed as the insider's acquisition of a put for the maximum number of shares potentially deliverable. Upon settlement, the put would either be exercised or expire, in an exempt transaction. To the extent the insider received some of the shares back upon settlement, this would be a non-exempt purchase.

18. **Transactions under Rule 10b5-1 Trading Plan.** If a Section 16 insider purchases or sells employer stock in the open market pursuant to a Rule 10b5-1 trading plan, is the relevant date for purposes of Sections 16(a) and (b) the date the trading plan was entered into by the insider or the date the purchase or sale was actually effected?

    Suggested Answer: The applicable date should be the trade date. Otherwise, the insider would be required to report transactions that may never occur, such as transactions subject to a limit order where the specified price is not attained. In addition, to the extent the transaction is subject to third party discretion, the transaction details would not be known by the insider at the time he establishes the trading plan. However, it may be appropriate for the Commission (or the staff by interpretation) to provide an exemption from Section 16(b) liability for certain transactions under 10b5-1 plans that are not subject to speculative abuse.

    SEC Response: Rule 10b5-1 isn't intended to change the timing requirements for filing Form 4. The filing should be based on the trade date, not the date the 10b5-1 plan was established. This is consistent with the staff's position in the Rule 144 context.

Miscellaneous

19. **Restricted Stock under 1933 Act.** Some plans of foreign issuers provide for an "option" to purchase shares with an exercise price of "0". They are termed

"options" under foreign law for tax reasons, but from a US perspective are really grants of restricted stock held in an offshore trust subject to vesting. When the employee vests, he may exercise the "option" and have the shares transferred to him or may leave them in the trust. If such "options" are awarded to US employees, they are subject to tax as compensation income when the options/shares vest. Does the SEC believe there is a "sale" occurring?

Suggested Answer: There is no "sale." No cash is being transferred. In addition, although services to the issuer or a subsidiary may be consideration, services are ignored where the award is under a plan benefiting a class of employees and there is no individual negotiation of awards under the U.S. plan See *Guiness, plc* (4/9/93).

SEC Response: The staff agrees with the Suggested Answer.

20. **Option Repricings/Schedule TO.** On March 21, 2001, the Division of Corporation Finance issued an exemptive order for issuer exchange offers that are conducted for compensatory purposes. Pursuant to this exemptive order, the staff exempts these exchange offers from Rule 13e-4(f)(8)(i) (the "all holders rule") and Rule 13e-4(f)(8)(ii) (the "best price rule").

. Does the staff intend to exempt these exchange offers from Rule 13e-4(f)(5) (the "prompt payment rule")?

SEC Response: No.

a. If not, how would "six month and one-day" exchange offers be able to satisfy this rule? For accounting reasons, companies want to grant the new options only after a six month and one-day period following the acceptance of the exchange offer.

SEC Response: The staff sees no problem with “six month and a day” exchange offers under the prompt payment rule since “prompt” means within customary practice, which in this case would mean after six months and a day. It could also be “customary practice” to have a grace period (e.g., 30 days) after the end of the six months and a day before the new options are granted. However, the staff is concerned about offers that don’t disclose how soon after the expiration of the six months and a day period the replacement options will be granted. The staff also has a problem with offers that don’t specify the number of replacement options that will be granted and the other “terms” of the exchange offer, but recognizes that for accounting reasons the exercise price cannot be more specific than market price on the date of future grant.

b. Does the staff intend to exempt repricing exchange offers from any of the other rules referred to in the letter submitted to the staff in March 2001 by certain members of

the Committee of Federal Regulation of Securities of the Business Law Section of the American Bar Association?

> **SEC Response:** The staff thinks there are no other problem areas in light of its position that the tender offer materials can exclude disclosure of information that is not pertinent to the situation. If any of the tender offer requirements provides a difficulty in a particular situation, the company should call the staff.

21. **Repricings that are Not Tender Offers.** The update to the Current Issues and Rulemaking Projects Outline that discusses option exchange offers suggests that certain option repricings would not be tender offers. Would the following types of repricings be viewed by the staff as not subject to the tender offer requirements:

   . a unilateral repricing by the issuer, either by amending the option to reduce the exercise price or by cancellation and regrant?

   > **SEC Response:** No, there is no decision by the employee in this situation.

i. an offer made to employees, where the only change in the option provisions was a reduction in the exercise price?

> **SEC Response:** This is probably a tender offer, assuming it's made to a broad group of employees. The staff view is that if employees are given a choice, it's a tender offer even if there is only a small change in the terms.

ii. an option exchange offer made solely to a small group of executives?

> **SEC Response:** Probably not a tender offer. An offer to a small group is generally seen as equivalent to individually-negotiated offers, and thus not a tender offer. The staff has not provided any guidance on the number of offerees that would be permitted. Sophistication of the offerees is an element to consider but not dispositive; the more sophisticated the offerees, the more it is like a negotiated deal.

22. **Participant Investment Direction Under 403(b) Plan.** A non-profit organization has established a plan for its employees under Section 403(b) of the Internal Revenue Code. Under the plan, participating employees can defer a portion of their pay, which is invested in a fund chosen by the employee from a menu of available funds. The plan specifies a default mechanism for investment (*i.e.*, a fund in which contributions are invested if the participant elects to contribute but fails to make a choice of investment). Some annuity providers/custodians under such a plan have rejected the default mechanism and refused to accept contributions unless the participant has made an affirmative investment election, claiming that this is required by the federal securities laws. Is there such a requirement under the securities laws?

Suggested Answer: There is no securities law requirement that a plan participant affirmatively direct the investment of his contributions under a 403(b) plan. The authorization of contributions to be invested under a properly-disclosed plan default provision is permitted.

SEC Response: Plans established by non-profits are not typically considered by the Division of Corporation Finance. This Question is more appropriate for the Division of Investment Management. One possible concern that the plan custodian may have is whether it would need to register as an investment adviser.

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