Plans other than through the asset transfer transactions. In addition, Mellon may use a fee offset method that complies with Prohibited Transaction Exemption (PTE) 77–4 (42 FR 18732, April 8, 1977). Mellon states that Client Plans that use the Alternative Credit Method have the option to change to an offset method that complies with PTE 77–4.

However, Mellon represents that the Alternative Credit Method offers several advantages to a Client Plan. These advantages include the following:

(a) Plan Sponsor Paying Fees: With many Client Plans, the Plan sponsor pays the Plan-level fees. In such instances, if the offset method described in PTE 77–4 is used, the Client Plan pays all Fund-level fees in connection with the investments in the Funds. By contrast, under the Alternative Credit Method, the sponsor pays the entire Plan-level fee and the Client Plan does not pay any Fund-level fees. Thus, where the Plan sponsor pays the Client Plan's fees, the Client Plan's rate of return on its investments in the Funds is higher under the Alternative Credit Method.

(b) Timing of Credit: Plan-level trustee fees will generally be paid to Mellon quarterly, whereas Fund-level investment advisory fees are paid monthly. Consequently, the crediting may not occur for up to three months under PTE 77–4 credit method, so that Mellon receives the use of the amounts to be credited for the time period between the payment dates. In contrast, there is no such time delay under the Alternative Credit Method.

(c) Excess Credits: The amount of a Client Plan's pro rata share of Fund advisory fees may exceed the amount of its Plan-level fees, depending on the relative fee rates. Under the PTE 77–4 credit method, it is not clear how an investment adviser should handle the amount of a credit that exceeds the Plan-level fee. The problem of excess

credits does not arise under the Alternative Credit Method since the credit is made directly to the Client Plan, rather than as an offset against the Plan-level fees.

Mellon states that the Alternative Credit Method allows it to maintain without modification its fiduciary fee schedules for its services to the Client Plans, which is more efficient and less costly than a system which employs credits against such fiduciary fees. In addition, use of the Alternative Credit Method permits Mellon's existing Client Plans to retain their negotiated fiduciary fee structures despite the change to a new investment vehicle.

Mellon states further that where Client Plans are withdrawing assets from the CIFs and investing in the corresponding Funds, the CIFs and Funds would be forced to incur large transaction costs if the CIF assets could not be transferred via the Client Plan accounts to the Funds. The asset transfer transactions permit the CIFs and the Funds to avoid incurring any such transaction costs in connection with liquidating CIF investments and making investments for the Funds, enhancing the investment return of the Client Plans.

In-Kind Transfers of Securities From Individual Portfolios

11. Mellon represents that certain Client Plans may desire in the future to transfer securities from their individual portfolios to the Funds in exchange for shares of the Funds (i.e. an Exchange), as discussed in Section III above. The Exchange would involve assets as to which Mellon is a fiduciary which are not distributed from a CIF. All or a pro rata portion of the assets of a Client Plan held by Mellon in an investment account or portfolio that is selected by the Second Fiduciary of such Client Plan for an Exchange would be transferred in-kind to the Funds in exchange for shares of such Funds. Such Exchanges may occur when a Second Fiduciary of a Client Plan trusteed by Mellon selects Mellon to manage the Client Plan's assets on a collective rather than individual portfolio basis in order to achieve certain economies of scale and diversification. Mellon states that in such cases it may be less expensive for the Client Plan to exchange its existing investments in securities directly for Fund shares rather than liquidating the securities and investing the proceeds in the shares. The Exchange would avoid transaction costs, such as commissions and dealer mark-ups, as well as any adverse market impact from a sale of the securities at the time of the transaction.

The Exchange would have to comply with the requirements for an "in-kind" exchange of securities as stated in the Fund prospectus. Specifically, the securities to be exchanged must meet the investment objectives, policies and limitations of the particular Fund portfolio, must have a readily ascertainable market value, must be liquid and must not be subject to resale restrictions. Securities accepted by a Fund would be valued in the same manner as the Fund values its assets, and the number of Fund shares issued would depend on the relative net asset value of the shares purchased and securities exchanged.11 The Fund's procedures will protect any existing Fund shareholders while assuring that fair value is given to the Client Plan exchanging the securities. The Second Fiduciary would receive disclosures regarding the relevant Funds and their fees, including each Fund's prospectus and additional information regarding the fee structures which may be used to avoid duplicative investment advisory fees being paid to Mellon (see Section III(f) above). In such instances, Mellon represents that one of the following fee structures will be used: (i) The Client Plan will receive a cash credit of such Plan's proportionate share of all fees (including all investment advisory fees and all secondary service fees) charged to the Funds by Mellon, less any fees paid by Mellon to parties unrelated to Mellon for services other than investment advisory services provided to the Funds, no later than the same day as the receipt of such fees by Mellon; (ii) the assets of the Client Plan invested in the Funds will be excluded from the assets on which the investment management fees paid by the Client Plan to Mellon are determined; or (iii) the Client Plan will pay an investment management fee to Mellon based on total Plan assets from which a credit is subtracted representing only the Client Plan's pro rata share of the investment advisory fees paid by the Funds to Mellon.

Prior to the Exchange, the Second Fiduciary would receive in writing (i) the reasons why Mellon may consider the Exchange to be appropriate for the Client Plan and a list of the securities held by the Client Plan that would be accepted by one or more Funds in the Exchange, (ii) the date the Exchange is

 $^{^{10}\,\}mathrm{PTE}$ 77–4, in pertinent part, permits the purchase and sale by an employee benefit plan of shares of a registered, open-end investment company when a fiduciary with respect to the plan is also the investment adviser for the investment company, provided that, among other things, the plan does not pay an investment management, investment advisory or similar fee with respect to the plan assets invested in such shares for the entire period of such investment. Section II(c) of PTE 77 4 states that this condition does not preclude the payment of investment advisory fees by the investment company under the terms of an investment advisory agreement adopted in accordance with section 15 of the Investment Company Act of 1940. Section II(c) states further that this condition does not preclude payment of an investment advisory fee by the plan based on total plan assets from which a credit has been subtracted representing the plan's pro rata share of investment advisory fees paid by the investment company.

¹¹ In this regard, the Department assumes that the securities which are transferred to a Fund will have the same value at the time the securities become part of the Fund's portfolio as the value that was determined for the securities in the individual Client Plan portfolios, in accordance with procedures described in Rule 17a-7 under the 1940 Act, for purposes of the Exchange.