MEMORANDUM

BY FAX

August 29, 1996

To: Nell Hennesy

From: Bob Plaze
Division of Investment Management
Securities and Exchange Commission

Subject: S. 1815

Attached is a copy of the Church Plan provisions.

Two points in addition to those I made during our telephone conversation:

1. The provision are only in the Senate bill. The House conferees are preparing to accept the provision (and I have been reading a joint draft of the bill, which led to my confusion).

2. Since the letter Michael and Kaye sent to Ellen, there have been changes to the bill that address our most serious concerns.

"(vi) solely for purposes of sections 12, 13, 14, and 16 of this title, any security issued by or any interest or participation in any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940; and".

(2) EXEMPTION FROM BROKER-DEALER PROVISIONS.—Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) is amended by adding at the end the following new subsection:

"(f) CHURCH PLANS.—No church plan described in section 414(e) of the Internal Revenue Code of 1986, no person or entity eligible to establish and maintain such a plan under the Internal Revenue Code of 1986, no company or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940, and no trustee, director, officer or employee of or volunteer for such plan, company, account person, or entity, acting within the scope of that person's employment or activities with respect to such plan, shall be deemed to be a 'broker', 'dealer', 'municipal securities broker', 'municipal securities dealer', 'government securities broker', 'government securities dealer', 'clearing agency', or 'transfer agent' for purposes of this title—

"(1) solely because such plan, company, person, or entity buys, holds, sells, trades in, or transfers securities or acts as an intermediary in making payments in connection with transactions in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of, or for the account of, any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment

Company Act of 1940; and

"(2) if no such person or entity receives a commission or other transaction-related sales compensation in connection with any activities conducted in reliance on the exemption provided by this subsection."

(d) AMENDMENT TO THE INVESTMENT ADVISERS ACT OF 1940.—Section 203(b) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(b)) is amended—

(1) in paragraph (3), by striking "or" at the end;

(2) in paragraph (4), by striking the period at the end and inserting "; or"; and

(3) by adding at the end the following new paragraph:

"(5) any plan described in section 414(e) of the Internal Revenue Code of 1986, any person or entity eligible to establish and maintain such a plan under the Internal Revenue Code of 1986, or any trustee, director, officer, or employee of or volunteer for any such plan or person, if such person or entity provides investment advice exclusively to any plan, person, or entity or any company, account, or fund that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940.".

(e) AMENDMENT TO THE TRUST INDENTURE ACT OF 1939.—Section 304(a)(4)(A) of the Trust Indenture Act of 1939 (15 U.S.C. 77ddd(4)(A)) is amended by striking "or (11)" and inserting "(11), or (14)".

(f) PROTECTION OF CHURCH EMPLOYEE BENEFIT PLANS UNDER STATE LAW.—

(1) REGISTRATION REQUIREMENTS.—Any security issued by or any interest or participation in any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940, as added by

subsection (a) of this section, and any offer, sale, or purchase thereof, shall be exempt from any law of a State that requires registration or qualification of securities.

(2) TREATMENT OF CHURCH PLANS.—No church plan described in section 414(e) of the Internal Revenue Code of 1986, no person or entity eligible to establish and maintain such a plan under the Internal Revenue Code of 1986, no company or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940, as added by subsection (a) of this section, and no trustee, director, officer, or employee of or volunteer for any such plan, person, entity, company, or account shall be required to qualify, register, or be subject to regulation as an investment company or as a broker, dealer, investment adviser, or agent under the laws of any State solely because such plan, person, entity, company, or account buys, holds, sells, or trades in securities for its own account or in its capacity as a trustee or administrator of or otherwise on behalf of, or for the account of, or provides investment advice to, for, or on behalf of, any such plan, person, or entity or any company or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940, as added by subsection (a) of this section.

(g) AMENDMENT TO THE INVESTMENT COMPANY ACT OF 1940.—Section 30 of the Investment Company Act of 1940 (15 U.S.C. 80a-29) is amended by adding at the end the following new subsections:

"(g) DISCLOSURE TO CHURCH PLAN PARTICIPANTS.—A person that maintains a church plan that is excluded from the definition of an investment company solely by reason of section 3(c)(14) shall provide disclosure to plan participants, in writing, and not less frequently than annually, and for new participants joining such a plan after May 31, 1996, prior to joining such plan, that—

"(1) the plan, or any company or account maintained to manage or hold plan assets and interests in such plan, company, or account, are not subject to registration, regulation, or reporting under this title, the Securities Act of 1933, the Securities Exchange Act of 1934, or State securities laws; and

"(2) plan participants and beneficiaries therefore will not be afforded the protections of those provisions.

"(h) NOTICE TO COMMISSION.—The Commission may issue rules and regulations to require any person that maintains a church plan that is excluded from the definition of an investment company solely by reason of section 3(c)(14) to file a notice with the Commission containing such information and in such form as the Commission may prescribe as necessary or appropriate in the public interest or consistent with the protection of investors.".

SEC. 316. PROMOTING GLOBAL PREEMINENCE OF AMERICAN SECURITIES MARKETS.

It is the sense of the Congress that—

(1) the United States and foreign securities markets are increasingly becoming international securities markets, as issuers and investors seek the benefits of new capital and secondary market opportunities without regard to national borders;

(2) as issuers seek to raise capital across national borders, they confront differing accounting requirements in the various regulatory jurisdictions;

(3) the establishment of a high-quality comprehensive set of generally accepted international accounting standards in cross-border securities offerings would greatly facilitate international financing activities and, most significantly, would enhance the ability of foreign corporations to access and list in United States markets;

(4) in addition to the efforts made before the date of enactment of this Act by the Commission to respond to the growing internationalization of securities

U. S. Department of Justice

Office of Legislative Affairs

Office of the Assistant General *Washington, D.C. 20530*

Draft

Honorable Alfonse D'Amato
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This sets forth the views of the Department of Justice on section 315 ("church employee pension plans") of H.R. 3005, the "Securities Investment Promotion Act of 1996," as passed by the Senate on June 27, 1996.

Section 315 of H.R. 3005, as passed by the Senate, would exempt church employee pension plans ("church plans") that meet certain specified criteria[1] from several federal statutes

[1] Section 315 is intended to provide exemptions to:

"Any church plan described in section 414(e) of the Internal Revenue Code of 1986, if, under any such plan, no part of the assets may be used for, or diverted to, purposes other than the exclusive benefit of plan participants or beneficiaries, or any company or account that is --

"(A) established by a person that is eligible to establish and maintain such a plan under section 414(e) of the Internal Revenue Code of 1986; and

"(B) substantially all of the activities of which consist of --

"(i) managing or holding assets contributed to such church plans or other assets which are permitted to be commingled with the assets of church plans under the Internal Revenue Code of 1986; or

"(ii) administering or providing benefits pursuant to church plans."

pertaining to the issuance of and investment in securities. Section 315 would also exempt church plans from state laws relating to such activity. Specifically, the Act would exempt church plans from the requirements of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1-80a-62, the registration and reporting requirements of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa,[2] the requirements of the Securities Exchange Act of 1934, 15 U.S.C. § 78a-78kk, the requirements of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1-80b-21, the requirements of the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa-77zzz, and all state laws requiring registration or qualification of securities. See H.R. 3005, § 315. Because it appears that similarly situated, non-religious employee pension plans would not receive a similar benefit under the various regulatory regimes affected, section 315 is unlikely to satisfy the requirements of the Establishment Clause of the United States Constitution.

1. General Standard

As a general matter, the Establishment Clause prohibits the government from singling out religious organizations for especially favorable -- or unfavorable -- treatment. *See*, e.g., Board of Educ. of Kiryas Joel v. Grumet, 114 S. Ct. 2481, 2487 (1994) (Establishment Clause requires that the government "pursue a course of neutrality toward religion, favoring neither one religion over others nor religious adherents collectively over nonadherents") (internal quotation omitted). This principle applies not only when the government seeks to confer a direct benefit exclusively on religion, but also when the government creates a religious-specific exemption from a regulatory requirement. For example, in Texas Monthly, Inc. v. Bullock, 489 U.S. 1 (1989), the Court held that the Establishment Clause prohibits a state from singling out for exemption from its sales tax periodicals sold by religious organizations, and no others. See id. (plurality opinion); id. at 26 (Blackmun, J., joined by O'Connor, J., concurring in judgment).[3]

The exemptions created by section 315 apply only to employee pension plans that are maintained by churches. Non-religious employee pension plans exhibiting otherwise identical characteristics would not qualify for the exemptions. In this respect, section 315 differs materially from the statute the Court upheld against an Establishment Clause challenge in Walz v. Tax Comm., 397 U.S. 664, 672 (1970). That statute exempted a broad range of non-religious organizations from New York's property tax based on the same criteria used to determine

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H.R. 3005, § 315(a).

[2] Under section 315, church plans would not be exempt from the provisions of the Securities Act pertaining to fraud. *See* 15 U.S.C. § 77g.

[3] The Court's plurality opinion stated that "Texas' sales tax exemption . . . lacks sufficient breadth to pass scrutiny under the Establishment Clause." Id. at 14. In his concurring opinion, Justice Blackmun stated that "[i]n this case, by confining the tax exemption exclusively to the sale of religious publications, Texas engaged in preferential support for the communication of religious messages." Id. at 28. Such a "statutory preference for the dissemination of religious ideas," stated Justice Blackmun, "offends our most basic understanding of what the Establishment Clause is all about and hence is constitutionally intolerable." Id.

exemptions for religious organizations.[4] The statutory exemption contained in section 315, by contrast, applies "exclusively to religious organizations," Bullock, 489 U.S. at 15, thereby advantaging church plans over other similarly situated employee pension plans.

Exemptions from the federal regulatory regimes affected by section 315 are available under existing law to a broad range of entities for a large number of activities. See, e.g., 15 U.S.C. § 80a-3(b) (delineating the exemptions under the Investment Company Act); 15 U.S.C. § 77c(a) (delineating the exemptions under the Securities Act); 15 U.S.C. § 78c(a)(12)(A) (delineating the exemptions under the Securities Exchange Act); 15 U.S.C. § 80b-3(b) (delineating the exemptions under the Investment Advisers Act).[5] Some of the exemptions currently available, moreover, expressly pertain to employee pension plans.[6] We understand from the SEC that, as a result, a large but undetermined number of non-religious, charitable, benevolent or fraternal organization employee pension plans are currently exempt from many of

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[4] The property tax exemption upheld in Walz provided:

> "Real property owned by a corporation or association organized exclusively for the moral or mental improvement of men and women, or for religious, bible, tract, charitable, benevolent, missionary, hospital, infirmary, educational, public playground, scientific, literary, bar association, medical society, library, patriotic, historical or cemetery purposes . . . and used exclusively for carrying out thereupon one or more of such purposes . . . shall be exempt from taxation as provided in this section."

Id. at 667, n. 1 (quoting § 420, subd. 1, of the New York Real Property Tax Law).

[5] In fact, exemptions from the federal regulatory statutes affected currently exist for securities issued and investments made by a broad range of charitable and benevolent organizations, including religious organizations, provided that no part of the earnings of such issuances or investments inure to the benefit of any private stockholder or individual. See, e.g., 15 U.S.C. § 80a-3(c)(10) ("Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes, no part of net earnings of which inure to the benefit of any private shareholder or individual.") (Investment Company Act); id., § 77c(a)(4) (Securities Act); id. § 80b-3(b)(4) (Investment Advisers Act).

[6] See, e.g., 15 U.S.C. § 78c(a)(12)(A)(iv)(West Supp. 1996) (exempting from the requirements of the Securities Exchange Act "any interest or participation in a single trust fund, or collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with a qualified plan." The term "qualified plan" includes "a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of Title 26…" Id. § 78c(a)(12(C)); id. § 80a-3(c)(11) (exempting from the requirements of the Investment Company Act "[a]ny employee's stock bonus, pension, or profit-sharing trust which meets the requirements for qualification under section 401 of Title 26…").

the statutory regimes affected by section 315. It can be argued, therefore, that section 315 represents merely an attempt to place church plans on an equal footing with those entities, and that the requirements of Bullock are satisfied because "the benefits derived by religious organizations [(i.e., exemption from a variety of laws regulating securities and investments)] flow[] to a large number of nonreligious groups as well." Bullock, 489 U.S. at 11.

Indeed, in Dayton Area Visually Impaired Persons, Inc. v. Fisher, 70 F.3d 1474, 1483 (6th Cir. 1995), cert. denied, 116 S.Ct 1421 (1996), the Sixth Circuit, without citing Bullock, rejected an Establishment Clause challenge to an Ohio statute that exempted all religious organizations, and other charitable organizations meeting certain specified criteria, from the requirement to register with the state prior to soliciting charitable contributions from the public. Although the court suggested that the blanket exemption for religious organizations was an attempt to "lift [] a regulation that burdens the exercise of religion," id., a purpose that is permissible as an accommodation to religion under Corporation of the Presiding Bishop v. Amos, 483 U.S. 327 (1987), it also apparently concluded that it was sufficient for purposes of the Establishment Clause that an exemption from which all religious organizations benefit also benefit "various secular groups." Fisher, 70 F.3d at 1483 (emphasis added).

Close scrutiny of the exemptions at issue, however, belies such an argument. Assuming, arguendo, that Fisher was correctly decided, that decision is distinguishable on the grounds that "'the vast majority of charitable organizations in Ohio [are] exempt from the registration and annual reporting requirements imposed by the (Ohio Solicitation Act).'" Id. (quoting the Ohio Attorney General's synopsis of the bill that eventually became the Ohio Solicitation Act). The exemption at issue in Fisher was crafted in such a way that most similarly situated, nonreligious charitable organizations are, like religious organizations, effectively exempted from the requirements of the affected statute. In contrast, we understand from the SEC that a number of similarly situated, non-religious, non-profit organization employee pension funds will continue to be ineligible for exemption from the statutory regimes affected by section 315. The exemptions at issue would, thus, advantage church plans that are currently covered by the statutes over non-religious employee pension plans in the same category, a distinction that is at odds with the purposes underlying the Establishment Clause.[7]

Moreover, the Court in Bullock held that the existence of other sales tax exemptions "for different purposes [other than the purposes motivating the exemption for periodicals distributed by religious organizations] [did] not rescue the exemption for religious periodicals from invalidation." Bullock 489 U.S. at 900, n. 4 (plurality opinion). "What is crucial," noted the Court, "is that any subsidy afforded religious organizations be warranted by some overarching secular purpose that justifies like benefits for nonreligious groups." Id. The fact that other similarly situated employee pension plans are not expressly granted the exemptions afforded

[7] As the Court stated in invalidating a New York statute creating a special school district for a religious community of Satmar Hasidim, "[b]ecause the religious community of Kiryas Joel did not receive its new governmental authority simply as one of many communities eligible for equal treatment under a general law, we have no assurance that the next similarly situated group seeking a school district on its own will receive one." Kiryas Joel, 114 S.Ct. at 2491. This statement reflects the concern animating the Establishment Clause that "the legislature itself may fail to exercise governmental authority in a religiously neutral way." Id.

church plans under section 315 suggests that no such overarching secular purpose can be shown.

2. Accommodation

As noted above, the Court has fashioned an exception to the general rule against singling out religious organizations for especially favorable or unfavorable treatment, which allows the government to "accommodate" religion -- and religion only -- in certain circumstances. See Amos, supra (upholding exemption regarding secular, nonprofit activities of religious organizations from Title VII's prohibition against employment discrimination based on religion). This accommodation exception, however, allows religion an exclusive exemption from a regulatory regime only when, at a minimum, the exemption "remov[es] a significant state-imposed deterrent to the free exercise of religion." Bullock, 489 U.S. at 15. Unlike the statutory exemption upheld in Amos, section 315 "cannot reasonably be seen as removing a significant state-imposed deterrent to the free exercise of religion." Id., 489 U.S. at 14 (citing Amos, 483 U.S. at 348). Assuming, arguendo, that issuing participations in and investing the assets of church plans might constitute the kind of religious exercise that can be the subject of accommodation, it does not appear that the requirements of the statutes affected by section 315 rise to the level of "significant" deterrents to such activity. Cf. Bullock, 489 U.S. at 21 (compliance with recordkeeping and reporting requirements "would generally not impede the evangelical activities of religious groups"). But see Fisher, 70 F.3d at 1483 (quoting Amos, 107 S. Ct. at 2869) (suggesting as a basis for its decision that a blanket exemption from the registration requirements of an Ohio statute covering charitable solicitations for religious organizations did not violate the Establishment Clause that the exemption represented an attempt to "lift [] a regulation that burdens the exercise of religion.".

3. Entanglement

Nor can the exemptions be justified on the grounds that they prevent the kind of "entanglement" between government and religious organizations against which the Establishment Clause was intended to protect. In Bullock, the Court rejected a similar claim with respect to the sales tax exemption, concluding that the "routine and factual inquiries" in question did not create a risk of entanglement sufficient to justify the exemption. See Bullock, 489 U.S. at 21 (plurality opinion). See also Swaggart Ministries v. Board of Equalization, 493 U.S. 378, 394-96 (1990) (upholding administrative and recordkeeping regulations associated with the collection of sales and use tax, where no inquiry into religious doctrine or motivation was made); Tony and Susan Alamo Foundation v. Secretary of Labor, 471 U.S. 290, 305 (1985) (holding in response to an Establishment Clause challenge that the commercial activities of a religious organization are subject to the recordkeeping and reporting requirements of the Fair Labor Standards Act). For these reasons, we believe section 315 is unlikely to satisfy the requirements of the Establishment Clause.

Thank you for the opportunity to comment on this matter. The Office of Management and Budget has advised that there is no objection from the standpoint of the Administration's program to the presentation of this report.

Sincerely,

Andrew Fois
Assistant Attorney General

cc: The Honorable Paul S. Sarbanes
Ranking Minority Member