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VIA ELECTRONIC MAIL

Office of Exemption Determinations
Employee Benefits Security Administration
Room N-5700
U.S. Department of Labor
Washington, DC 20210

Attention: Cross-Trading Policies and Procedures Interim Final Rule

Ladies and Gentlemen:

The Investment Company Institute[1] appreciates the opportunity to comment on behalf of its members on the Department's interim final rule on cross trading policies and procedures, adopted under the statutory exemption for cross trading enacted in the Pension Protection Act (PPA). The Institute's membership has a substantial interest in this exemption. Many Institute members manage separate accounts or collective funds that hold "plan assets" subject to ERISA fiduciary responsibility rules and that could benefit from the cross trading exemption.

As the Institute has consistently described, investment management clients can obtain significant benefits from cross trading by saving commissions and other transaction costs. These benefits accrue to both the selling and purchasing accounts, since no broker is involved and the investment manager derives no separate fee or other benefit from a cross trade. In adding the cross trades exemption to ERISA, Congress recognized both that cross trades can be beneficial and that cross trading can be implemented in a manner that protects plans.[2] Congress included in the ERISA

[1] Institute members include 8,821 open-end investment companies (mutual funds), 664 closed-end investment companies, 385 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the Institute have total assets of approximately $10.481 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

[2] Cross trading involves two separate decisions that occur in separate parts of an organization – the portfolio management decision to purchase or sell a security and the decision on how to execute the transaction. Portfolio management decisions are made based on what is in the interests of the particular accounts, driven by the investment strategies for the accounts and/or the cash flows in and out of the accounts, and are not influenced by whether there may be cross trading opportunities in buying or selling a particular security. The trading decisions relating to cross trading are largely automatic, based on matching buy and sell orders received from portfolio managers on particular securities.

exemption relevant conditions of the SEC rule governing cross trades by mutual funds, which has proved effective in governing mutual fund cross trades for 40 years.

We commend the Department for issuing prompt interim guidance on the cross trading exemption. The Department's rule will allow investment managers to extend their existing cross trading programs to ERISA plans that meet the requirements of the statutory exemption. We are pleased that in describing the requirements for an investment manager's policies and procedures on cross trading, the Department has followed, in many respects, the conditions of Rule 17a-7 under the Investment Company Act of 1940.

We believe certain aspects of the interim final rule warrant clarification or additional guidance. First, we urge the Department to clarify that the exemption applies to cross trading between accounts managed by affiliated investment managers and to pooled funds where at least one participating plan has assets of at least $100 million. Second, we make several suggestions to streamline the required policies and procedures and enhance their compatibility with Rule 17a-7. We also request that the Department revise the interim rule to permit annual determinations on whether a plan meets the $100 million asset requirement. Finally, we recommend that the Department use its existing exemptive authority to go beyond the statutory exemption and permit plans of all sizes to enjoy the benefits of cross trading.

I. The Department Should Clarify the Scope of the Exemption

We ask the Department to clarify that the exemption covers cross trades between affiliated managers and that the exemption is available to commingled funds that are subject to ERISA, where at least one participating plan satisfies the asset requirement.

A. Cross Trading with Accounts of Affiliated Advisers

The exemption in ERISA section 408(b)(19) covers transactions between a plan and any other account "managed by the same investment manager." Many cross trading programs cover trades between accounts of affiliated managers. For example, a financial institution may have one investment adviser subsidiary that manages mutual funds, another that manages separate account investments, and possibly also a trust company subsidiary that manages collective investment funds. To maximize the opportunities for clients to benefit from cross trading, the firm would want to consider all of its subsidiaries' managed accounts for this purpose.

There is no apparent reason for limiting the scope of the exemption to accounts of a single investment manager, as opposed to covering both that manager and its affiliates. Therefore, the Institute urges the Department to clarify that the term "same investment manager" as used in section 408(b)(19) covers both a single investment manager as well as affiliated investment managers, with

"affiliate" defined to cover an entity controlling, controlled by, or under common control with the investment manager.

B. Common or Collective Trusts

Another way to improve the utility of the exemption would be to clarify that the exemption is available to a common or collective trust or other pooled investment vehicle where at least one participating plan has assets of at least $100 million. This interpretation should extend to master-feeder trust arrangements, where the only investors in the "master" collective trust (the entity that would engage in cross trades) are other collective trusts. So long as one of the participating "feeder" trusts includes a plan with $100 million, the entire master trust should be permitted to cross trade with the consent of a fiduciary of the $100 million plan. Otherwise, it is unclear whether a plan that by itself meets the asset requirement can take advantage of cross trading if it participates in a collective trust or master-feeder arrangement. It would serve no purpose to restrict the ability of common or collective trusts to cross trade. The other participating plans would benefit from cross trading within the collective fund. Furthermore, while acting to protect its own interests, the qualifying plan will protect the other participants in the fund.

II. The Department Should Clarify Certain Content Requirements

A. Scope of Policies and Procedures Requirements

We make two suggestions with respect to the scope of the policies and procedures as outlined in subsection (b)(3) of the interim final rule. First, subsection (b)(3)(i) requires that the manager's policies and procedures, among other things, "be fair and equitable to all accounts participating in its cross-trading program." The meaning of this standard is somewhat unclear, but the goal should be for accounts to be treated fairly and equitably in the resulting transactions. That is, the fairness and equity of the policies and procedures should be judged based not on their terms, but on the results they achieve in transactions carried out pursuant to those terms. Policies and procedures should be reasonably designed to achieve such results. To give more precise meaning to this standard, subsection (i) should be reworded as follows (strike-through text indicating deletions and italicized text indicating insertions):

> (i) An investment manager's policies and procedures must be *reasonably designed (1) to ensure that transactions entered into pursuant to the policies and procedures are* fair and equitable to all accounts participating in its cross-trading program and *(2)* ~~reasonably designed~~ to ensure compliance with the requirements of section 408(b)(19)(H) of the Act *and the requirements of this regulation*.

Second, we ask the Department to clarify that non-compliance with the written policies and procedures required to be adopted under the interim final rule, in itself, would not mean that the exemption ceases to be available, either for a specific transaction or for all the cross trades of the particular manager. This interpretation is consistent with the statutory language requiring that the annual compliance report describe any specific instances of non-compliance with the manager's written policies and procedures (see section 408(b)(19)(I)). There is no indication that Congress intended that non-compliance with the policies and procedures, in itself, would cause the exemption not to be available for cross trades by a particular manager, so long as the non-compliance does not result in the failure to meet one of the conditions in subsections (A) through (G) of the statute. The statute contemplates, in subsection (I), a process by which an individual will monitor compliance with the policies and procedures, and will describe any specific instances of non-compliance in a report that is furnished to the authorizing plan fiduciary. The authorizing fiduciary can then determine, based on the information in the report, whether any action is warranted based on the described instance of non-compliance, including termination of the authorization.

B. Requirement to Describe How Manager Will Mitigate Conflicts

Under the interim final rule, policies and procedures are required to contain:

> (D) A description of how the investment manager will mitigate any potentially conflicting division of loyalties and responsibilities to the parties involved in any cross-trade transaction.

We believe this requirement is unnecessary because conflicts of interest are adequately addressed by other provisions in the regulation.[3] All the other required elements under the policies and procedures are designed to serve this same purpose. The principal protections for accounts participating in the cross trading program are the requirements that (1) the transaction be beneficial to both parties to the cross trade;[4] (2) the cross trade be effected at the independent current market price of the security;[5] and (3) the cross trading opportunities be allocated in an objective and equitable manner.[6] These enumerated protections address any potentially conflicting loyalties and responsibilities, by assuring that the underlying transaction is beneficial to both parties and that the

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[3] Also, as discussed in footnote 2 of this letter and the attached ERISA Advisory Council testimony, there are extensive existing safeguards that protect investment management clients from conflicts of interest.

[4] §2550.408b-19(b)(3)(i)(A)

[5] §2550.408b-19(b)(3)(i)(B)

[6] §2550.408b-19(b)(3)(i)(E)

trade is effected in a fair and equitable manner. Since the requirement in subparagraph (D) overlaps with other conditions in the exemption and interim final rule and does not provide any additional protection, it should be deleted to avoid confusion.

C. Role of Compliance Officer

The interim final rule describes the role of the compliance officer as being to determine whether the manager's cross trading program complies with the policies and procedures required by section 408(b)(19)(H), without describing the specific steps that the compliance officer should take. We support this approach because it allows an investment manager to integrate policies and procedures on cross trading for ERISA accounts with its over-all compliance policies and procedures.

In this regard, we request that the Department clarify that the compliance officer of an SEC-registered investment adviser may operate in a manner consistent with the SEC rules regarding the role of a chief compliance officer under the Investment Advisers Act of 1940 and the Investment Company Act of 1940. These rules permit a chief compliance officer to rely on others (including independent third parties such as an independent certified public accounting firm) to carry out the review of the adequacy and effectiveness of implementation of policies and procedures, and do not require the review to cover every transaction. The compliance review under section 408(b)(19)(I) should be under the oversight of the designated compliance officer but it should be possible for the compliance officer to delegate responsibility for specific segments of the review. The compliance officer also should be able to focus on the overall adequacy and effectiveness of the implementation of the policies and procedures, including reviewing a sampling of transactions rather than reviewing each individual transaction. This would be consistent with the statutory requirement, which describes the role of the designated compliance officer as "periodically reviewing" the purchases and sales effected under the procedures.

D. Verification of $100 Million Asset Requirement

Section 408(b)(19)(E) of ERISA requires that any plan (or master trust containing the assets of plans maintained by employers in the same controlled group) participating in a cross trade transaction have assets of at least $100 million. Subsection (b)(3)(i)(C) of the interim rule states that a plan or master trust will meet the minimum asset size requirement if it meets the requirement upon its initial participation in the cross trading program and on a quarterly basis thereafter. While it is helpful that the interim rule provides guidance on how frequently a manager must monitor plan size, we believe annual verification would be more suitable. Many managers only obtain updated information regarding their customers on an annual basis. It is not uncommon for an investment manager to manage only a portion of a plan's assets, in which case, the manager would not have continuous access to information on the client plan's overall asset level. Therefore, we urge the Department to permit annual verification of a plan's satisfaction of the asset requirement.

III. The Department Should Provide Administrative Exemptive Relief for Smaller Plans

Although the exemption for cross trading enacted by Congress is long overdue, the statutory exemption is too limited in one critical respect. In addition to the disclosure, consent, pricing, and reporting provisions, the PPA exemption is limited to plans with assets of at least $100 million – a standard met by only 3.9 percent of defined benefit plans.[7] In the Institute's view, this "belt and suspenders" approach is not necessary to protect plans and their participants and denies the benefits of cross trading to far too many plans. The disclosure, consent, pricing, compliance and reporting provisions of the PPA exemption are robust and the Department should rely on these conditions to fashion an administrative prohibitive transaction exemption for plans with assets below $100 million.

Investment managers enter into cross trades to benefit clients. Cross trading can reduce transaction costs for clients, implement orders more efficiently, and minimize the market impact of large orders. In a cross trade, the client avoids various charges and fees associated with purchasing or selling a security on the market. Both sides of a cross trade save on commissions or benefit from lower bid/ask spreads. These cost-savings are recognized in the mutual fund industry, where mutual funds have been able to engage in cross trades since 1966.[8] Reduced transaction costs will result in more money actually being invested (and generating earnings) for plans and their participants.

Cross trading also eliminates duplicative efforts (e.g., selling securities piecemeal for one account while simultaneously buying similar securities for another account) and results in faster implementation of orders.[9] Moreover, when a plan's trade involves a large amount of securities, an open market purchase or sale can disproportionately affect the market price of the security to the disadvantage of the plan. A large buy or sell order, by itself, can move the price of a security. Cross trades have little or no market impact and result in a fair price for both sides of the transaction, under the independent pricing requirement.

Plans below the $100 million limit may have less bargaining power to obtain lower commissions from brokers and potentially could benefit more from cross trading relative to larger plans. Particularly with respect to fixed income securities, smaller trades can be less efficient and have larger bid/ask spreads. Cross trading in these circumstances allows managers to achieve much lower spreads and best execution for their clients.

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[7] Private Pension Plan Bulletin, Abstract of 2001 Form 5500 Annual Reports, U.S. Dept. of Labor, EBSA, February 2006.

[8] In a recent year, one mutual fund organization has reported to us savings of approximately $1.2 million in transaction costs on $500 million in cross trading of equities. Another large mutual fund organization has informed us of estimates that its funds save between $75 million and $100 million annually in commission costs through cross trading.

[9] Of course, if a cross trade opportunity does not exist at the time a manager needs to buy or sell a security, the trade will be executed on the market.

Under section 408(a) of ERISA, the Department has clear authority to grant class exemptions from the prohibited transaction restrictions imposed by section 406. We urge the Department to exercise this authority to provide cross trading relief for plans with assets of less than $100 million. Attached is a statement submitted by the Institute to the ERISA Advisory Council in support of such an exemption. The statement describes various protections that will safeguard any plan that authorizes a cross trading program.

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We are pleased that the Department has published timely guidance on cross trading policies and procedures and we support the general approach taken in the interim regulation. The Institute has offered several suggestions for clarifying the scope of the statutory exemption and streamlining the information that must be included in the policies and procedures. We also strongly urge the Department to consider using its existing exemptive authority to allow smaller plans to benefit from cross trading. We hope the Department will give serious consideration to these recommendations.

The Institute would welcome the opportunity to provide further assistance to the Department in developing the final regulation and a class exemption for smaller plans. Please contact me at (202) 326-5826 with any comments or questions. Thank you for your consideration.

Sincerely,

/s/ Mary S. Podesta

Mary S. Podesta
Senior Counsel - Pension Regulation

Attachment

STATEMENT OF THE INVESTMENT COMPANY INSTITUTE
ERISA ADVISORY COUNCIL WORKING GROUP ON
PLAN ASSET RULES, EXEMPTIONS AND CROSS TRADING

Cross Trading Exemption for ERISA Plans

The Investment Company Institute, the national association of U.S. investment companies,[1] appreciates this opportunity to make recommendations about cross trading to the ERISA Advisory Council. Based on substantial experience in the mutual fund industry, cross trades can be effected with appropriate investor safeguards and save money for plans by reducing securities transaction costs.[2]

The Institute has supported an active cross-trades exemption for over twenty years and we applaud Congress for taking a decisive first step to provide this relief. The Pension Protection Act, signed into law by President Bush on August 17, 2006, includes a long-needed exemption from ERISA's prohibited transaction rules for cross trading by investment managers of certain actively-managed plans that will serve the interests of those plans and their participants. Appropriately, Congress included in the ERISA exemption relevant conditions of the SEC rule governing cross trades by mutual funds, which has proved effective in governing mutual fund cross trades for 40 years.

Our submission focuses on two courses of action we believe the Department of Labor should now take.

First, in drafting a mandated regulation under the Pension Protection Act governing the content of cross-trading policies and procedures, the Department should recognize the significant protections for plans and plan participants afforded by the specific conditions of the legislation, particularly the independent pricing requirement. The conditions address potential concerns that a manager might be tempted to use cross trades to "dump" securities or otherwise advantage one client at the expense of another. The Department's compliance regulation should require that a manager's policies and procedures be reasonably designed to meet the conditions of

[1] Institute members include 8,791 open-end investment companies (mutual funds), 652 closed-end investment companies, 195 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately $9.273 trillion (representing 98 percent of all assets of U.S. mutual funds); these funds serve approximately 89.5 million shareholders in more than 52.6 million households. Many of the Institute's 580 investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 171 associate members, which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers is managed by these ICI members and associate members.

[2] This submission supplements the testimony of Institute members at the ERISA Advisory Council hearing on September 20, 2006 and responds to questions raised by Advisory Council members at the hearing.

the exemption and periodically reviewed for adequacy and effectiveness of implementation. This approach is consistent with prior Department of Labor exemptions and SEC rule 17a-7, the mutual fund cross-trading rule.[3] It will achieve the legislation's objectives, while allowing managers to develop the policies and procedures that will be most effective in their organizations and consistent with their procedures for mutual fund cross trading.

Second, the Department should use its exemptive authority to allow all plans to enjoy the benefits of cross trading. The Pension Protection Act limits the statutory exemption to plans with assets of at least $100 million. As a consequence, many plans that could benefit from the cost savings associated with cross trading cannot use the exemption. The Institute believes that plans with assets below $100 million also should be permitted to engage in cross trades, with appropriate investor safeguards.

I. The Department's Rule on the Content of Cross-Trading Policies and Procedures

The Pension Protection Act requires investment managers to adopt and comply with written policies and procedures governing cross trading, including policies and procedures on pricing and allocating cross trades objectively among the manager's accounts. The Pension Protection Act directs the Department, after consultation with the SEC, to issue regulations on the content of the policies and procedures within 180 days after the Act's enactment. In exercising its mandate, the Department could issue a rule that prescribes additional, specific compliance methods or a rule that requires policies and procedures to be reasonably designed to meet the conditions of the exemption and periodically reviewed for adequacy and effectiveness of implementation. We strongly urge the latter approach.

The Pension Protection Act sets forth explicit standards for cross-trading programs for ERISA clients. Plan fiduciaries must consent in advance to a cross-trading program after separate disclosure and must be able to revoke consent at any time. Consenting to cross trades cannot be a condition to engaging the manager's services. As under Rule 17a-7, trades must be executed at the independent current market price[4] and no commission can be paid. In addition to adopting and complying with written policies and procedures on cross trading, managers must provide quarterly reports to plan fiduciaries detailing the cross trades in which the plan participated and provide an annual compliance report. The Department's compliance rule should direct managers

[3] Rule 17a-7 was issued under the Investment Company Act of 1940, which has prohibited transaction limitations similar to ERISA.

[4] Under Rule 17a-7, the execution price is based on the most recent sale price on an exchange or reporting system; if there are no reported sales for the day (or if the security is not reported or traded on an exchange), the price is determined by the average of the highest bid and lowest offer for the day. The Pension Protection Act incorporates Rule 17a-7 by reference so that any modifications to that rule – for example, to update the rule to reflect changes in the securities markets – will become applicable also to the ERISA exemption.

to adopt compliance policies and procedures that are reasonably designed to meet the conditions of the exemption.

The standard we articulate will allow managers to establish procedures that incorporate all of the requirements of the exemption, are tailored to their particular circumstances, and are consistent with their procedures for cross trades involving other types of accounts. Given the diversity of the investment management industry, to be most effective, the specific policies and procedures a manager will use to comply with the conditions of the exemption will reflect the scope and nature of that firm's operations, including the size and organization of the firm and other internal trading rules.[5] The Department should not specify the content of policies and procedures. A one-size-fits-all approach could result in a less effective compliance regime. There are also practical considerations. Investment managers will have difficulty maintaining cross-trading programs if different procedures apply to different types of clients.

The standard we recommend is consistent with the Department's previous guidance on cross-trading procedures. For example, the prohibited transaction class exemption for index and model-driven funds requires managers to disclose their cross-trading procedures to plan fiduciaries, but does not provide extensive detail on the content of those procedures.[6] In addition, in at least two individual prohibited transaction exemptions for cross trading involving actively-managed plans, the Department did not specify the content of the cross-trading procedures.[7] This approach is similar to the SEC's rule on cross trading, Rule 17a-7. The rule requires a mutual fund's board of directors to adopt "procedures [for cross trading] which are reasonably designed to provide that all of the conditions of [the rule] have been complied with." The Institute urges the Department to take a similar approach in fashioning the parameters of the policies and procedures required under the Pension Protection Act.

We do not believe that additional Department rulemaking is necessary to implement the exemption contained in the Pension Protection Act. We recommend that the Department provide guidance through an advisory opinion or field office assistance bulletin on when managers should determine compliance with the $100 million plan size test. Investment

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[5] The SEC has recognized the importance of flexibility in regulating compliance policies and procedures. In the final rule on compliance programs of investment companies and investment advisers, the SEC declined to enumerate specific elements that must be included in compliance policies and procedures, recognizing that "funds and advisers are too varied in their operations for the rules to impose a single set of universally applicable required elements." 68 Fed. Reg. 74714, 74716 (Dec. 24, 2003).

[6] Under PTE 2002-12, the manager must disclose the "triggering events" that will create the cross-trading opportunities, the independent pricing services that will be used by the manager to price cross-traded securities, and the methods used for determining the closing price. 67 Fed. Reg. 6614 (Feb. 12, 2002).

[7] *See* IPTE 94-43, 59 Fed. Reg. 30041 and IPTE 89-116, 54 Fed. Reg. 53397.

managers may be prevented from using the exemption for plans that are not substantially larger than $100 million for the practical reason that the burdens of monitoring plan asset size on a continuous basis, and the possible consequences should the plan fall below $100 million, would outweigh the benefit of cross trading for those plans. To avoid this unfortunate result, the Department should clarify that the test should be applied at the time of the plan's consent to enter into cross trades and annually thereafter, on a calendar or fiscal year basis.

II. The Department Should Provide Cross-Trade Relief to Plans with Assets Below $100 Million

The Pension Protection Act conditions the availability of the cross-trading exemption on compliance with specific disclosure, consent, pricing, and reporting provisions, but limits the exemption to plans with assets of at least $100 million – a standard met by only 3.9 percent of defined benefit plans.[8] In the Institute's view, this "belt and suspenders" approach is not necessary to protect plans and their participants and denies the benefits of cross trading to far too many plans. The disclosure, consent, pricing, compliance and reporting provisions of the Pension Protection Act exemption are robust. The Department should rely on these conditions to fashion an administrative prohibitive transaction exemption for plans with assets below $100 million.

All plans can benefit from cross trades

Investment managers enter into cross trades to benefit clients. Within an investment management firm, the decision to buy or sell a security generally is independent from the determination of how to execute the transaction. In executing a securities purchase or sale, cross trading can reduce transaction costs for clients, implement orders more efficiently, and minimize the market impact of large orders. In a cross trade, the client avoids various charges and fees associated with purchasing or selling a security on the market. Both sides of a cross trade save on commissions or benefit from lower bid/ask spreads. These cost-savings are recognized in the mutual fund industry, where mutual funds have been able to engage in cross trades since 1966. In a recent year, one mutual fund organization has reported to us savings of approximately $1.2 million in transaction costs on $500 million in cross trading of equities. Another large mutual fund organization has informed us of estimates that its funds save between $75 million and $100 million annually in commission costs through cross trading. Reduced transaction costs will result in more money actually being invested (and generating earnings) for plans and their participants.

Cross trading also eliminates duplicative efforts (*e.g.*, selling securities piecemeal for one account while simultaneously buying similar securities for another account) and results in faster

[8] *Private Pension Plan Bulletin, Abstract of 2001 Form 5500 Annual Reports*, U.S. Dept. of Labor, EBSA, February 2006.

implementation of orders.[9] Moreover, when a plan's trade involves a large amount of securities, an open market purchase or sale can disproportionately affect the market price of the security to the disadvantage of the plan. A large buy or sell order, by itself, can move the price of a security. Cross trades have little or no market impact and result in a fair price for both sides of the transaction, under the independent pricing requirement.

The $100 million limit denies the benefits of cross trading to far too many plans. According to Department of Labor statistics, the $100 million limit would prevent all but the largest 3.9 percent of defined benefit plans from cross trading.[10] Smaller plans may have less bargaining power to obtain lower commissions from brokers and potentially could benefit more from cross trading relative to larger plans. Particularly with respect to fixed income securities, smaller trades can be less efficient and have larger bid/ask spreads. Cross trading in these circumstances allows managers to achieve much lower spreads and best-execution for their clients.[11]

Protections exist to safeguard plans without a minimum asset test

In the past, the Department had been reluctant to permit actively-managed ERISA plans to engage in cross trades because of concerns that managers might use cross trades for their own benefit or to favor certain clients.[12] The Department also has questioned whether plan fiduciaries are in a position to monitor managers in connection with cross trades.[13] We believe these concerns are overstated, even for smaller plans. Public plans, mutual funds and other institutional investors participate in cross trades with no evidence of abuse. Significantly, there have been only three enforcement cases by the SEC in the forty-year period since cross trades have been permitted for mutual funds.[14] The Department should base an administrative exemption on the conditions included in the Pension Protection Act's exemption for active cross

[9] Of course, if a cross-trade opportunity does not exist at the time a manager needs to buy or sell a security, the trade will be executed on the market.

[10] *Private Pension Plan Bulletin, Abstract of 2001 Form 5500 Annual Reports*, U.S. Dept. of Labor, EBSA, February 2006.

[11] Unless the Department provides the practical guidance that we recommend above on when to determine that a plan meets the size test, the number of plans that can participate in cross trades will be further restricted. That is, plans with assets that hover around $100 million likely will be precluded from engaging in cross trades.

[12] *See* 63 Fed. Reg. 13696, 13697 (Mar. 20, 1998).

[13] This concern was raised by the Department at a public hearing on active cross trades held on February 10, 2000.

[14] *See* Gintel Asset Management, Inc. IC-25798 (Nov. 8, 2002); Back Bay Advisors, L.P. IC-25787 (Oct. 25, 2002); Strong/Corneliuson Capital Management, Inc. IC-20394 (July 12, 1994).

trades. These conditions, particularly the independent pricing requirement, together with the protections under existing law, as described below, will protect plans and their participants in connection with cross trades.

Under ERISA and the Internal Revenue Code, when a prohibited transaction exemption is granted, managers not only have the responsibility to comply with the conditions of the exemption, they also have a financial incentive. Noncompliance would result in a prohibited transaction under ERISA and, if the plan is tax-qualified, a prohibited transaction under the Internal Revenue Code. Under ERISA, if a prohibited transaction occurs, the manager would be liable for any losses to the plan and must restore any profit resulting from the transaction. Under the Internal Revenue Code, the manager would be subject to a 15 percent excise tax, and an additional 100 percent tax if the transaction is not corrected within a specified period. For nonqualified plans, the Department may assess a civil penalty, not to exceed five percent of the amount involved (or 100 percent if not corrected within 90 days of the initial assessment notice).

ERISA plans and participants also will be protected in connection with cross trades by the on-going duties imposed on investment managers under ERISA. A cross-trading exemption for ERISA plans would not relax the underlying fiduciary duty a manager owes to plan clients. Even with an exemption, a fiduciary who cross trades a security remains subject to the general fiduciary duties of loyalty and prudence. If a particular cross trade is imprudent and results in a loss to the plan, the manager could be liable to the plan for such loss.

Most ERISA plan managers are registered investment advisers under the Investment Advisers Act of 1940 and that Act provides another layer of protection for plans in connection with cross trades. Section 206 of the Investment Advisers Act, the Act's anti-fraud provision, protects against abuses such as parking illiquid securities in ERISA plan accounts, unfair allocation of favorable cross-trade opportunities, and other forms of favoritism. The United States Supreme Court has interpreted section 206 to establish a statutory fiduciary duty for investment advisers to act for the benefit of their clients.[15]

Since the Department last considered the feasibility of an exemption for active cross trades, the protections to advisory clients afforded by the Investment Advisers Act have been further strengthened. Rule 206(4)-7, effective in 2004, requires an investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act by the adviser and its supervised persons, to review the policies annually and to appoint a chief compliance officer, who is responsible for administering the compliance regime called for by the rule.

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[15] *Transamerica Mortgage Advisors, Inc., et al. v. Lewis*, 444 U.S. 11, 17 (1979).

Fiduciaries for plans of all sizes are capable of monitoring cross trades

The ability of plan fiduciaries to monitor cross trades does not depend on the size of the plan. Plan fiduciaries at many smaller employers are highly educated and financially knowledgeable, and are as capable of understanding information on cross trades as the largest and most sophisticated plans. Indeed, the Department itself has recognized that all plan fiduciaries have the capacity to review information on cross trading to determine whether the transactions are in the best interests of the plan.[16]

As is always the case, plan fiduciaries who believe they cannot effectively monitor cross trades should not authorize investment managers to engage in cross trading. This approach is consistent with the Department's guidance on other fiduciary sophistication matters. For example, the Department has stated with respect to investing in derivatives, that if a plan fiduciary does not have the requisite degree of sophistication and knowledge for a particular type of investment, the plan should not so invest.[17] Given this guidance, and the other conditions we recommend, we strongly believe it is not necessary for the Department to devise a sophistication test for an administrative exemption. Should the Department disagree, however, we would request the opportunity to work with financial industry representatives and plan sponsors to recommend an appropriate test.

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The Institute strongly supports the exemption for active cross trading contained in the Pension Protection Act. However, there is important work to be done to make the exemption a useful tool for plans and to allow a wider range of plans to obtain the benefits of cross trading. We urge the ERISA Advisory Council and the Department of Labor to adopt our recommendations and those of the persons testifying on behalf of the Institute on September 20, 2006. Specifically, we call on the Department to follow the approach we recommend in exercising its rulemaking mandate in connection with cross-trades compliance policies and procedures under the Pension Protection Act. The Institute also urges the Department to use its authority to fashion an administrative exemption for active cross trades based on the conditions of the exemption in the Pension Protection Act, but not limited to plans with assets of at least $100 million. We thank the Advisory Council for allowing us this opportunity to submit our views.

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[16] *See* PTE 86-128, 51 Fed. Reg. 41686 (Nov. 18, 1986) (exemption for agency cross trading when the investment manager has discretion over only one side of the transaction).

[17] Letter from Olena Berg, Asst. Sec. PWBA, to Eugene Ludwig, Comptroller of the Currency (March 21, 1996).