

**MEMO# 20866**

February 13, 2007

## **Department of Labor Issues Interim Final Guidance on Cross Trades for ERISA Plans**

[20866]

February 13, 2007

TO: PENSION COMMITTEE No. 5-07  
PENSION OPERATIONS ADVISORY COMMITTEE No. 5-07  
INVESTMENT ADVISERS COMMITTEE No. 3-07  
EQUITY MARKETS ADVISORY COMMITTEE No. 6-07  
SEC RULES COMMITTEE No. 14-07 RE: DEPARTMENT OF LABOR ISSUES INTERIM FINAL  
GUIDANCE ON CROSS TRADES FOR ERISA PLANS

The Department of Labor has released an interim final regulation on the prohibited transaction exemption for cross trading under section 408(b)(19) of ERISA. [\[1\]](#) The Pension Protection Act (PPA) added the exemption to allow an investment manager to cross trade securities on behalf of an employee benefit plan with assets of at least \$100 million and any other client managed by the same investment manager. [\[2\]](#) The exemption requires an investment manager to adopt written policies and procedures that are fair and equitable to all accounts and that include a description of the manager's pricing policies and procedures and the manager's policies and procedures for allocating cross trades in an objective manner among accounts participating in the cross trading program.

Under the PPA, the Department of Labor is required to consult with the SEC and issue regulations on the content of cross trade policies and procedures within 180 days of enactment of the PPA, or February 13, 2007. [\[3\]](#) The Department indicated that given the immediate need for guidance on cross trading, it determined to issue an interim final rule rather than a proposed rule. The rule is effective April 13, 2007. However, the Department has requested comments on the interim rule and will issue a final regulation that takes

those comments into account. Comments on the interim rule are due April 13, 2007.

## **Content of Policies and Procedures**

As a general matter, the interim rule requires cross trade policies and procedures to be clear and concise and written in a manner calculated to be understood by the plan fiduciary authorizing cross trading. No particular format is required. The policies and procedures must be fair and equitable to all accounts participating in the cross trading program and reasonably designed to ensure compliance with the requirements of exemption.

The interim rule requires the following information to be included in the written policies and procedures:

- A statement of policy describing the criteria that will be applied by the investment manager in determining that execution of a securities transaction as a cross trade will be beneficial to both parties to the transaction;
- A description of how the investment manager will determine that cross trades are effected at the “independent current market price” of the security (within the meaning of SEC Rule 17a-7(b) and SEC no-action and interpretative letters thereunder) as required by the PPA, including the identity of sources used to establish such price. In the preamble to the regulation, the Department stated that the pricing policies and procedures should be described in sufficient detail to enable the “compliance officer” (described below) to independently determine that the cross trade was effected at the independent current market price. Also in the preamble, the Department indicated that a cross trade will satisfy the exemption’s independent pricing requirement if the investment manager complies with SEC Rule 17a-7(b) and related SEC no-action and interpretive letters;
- A description of the procedures for ensuring compliance with the \$100 million minimum asset size requirement. The interim rule also provides guidance on determining whether the \$100 million threshold is met. A plan (or master trust) will be considered to meet the threshold if it has assets of at least \$100 million upon its initial participation in the cross trading program and on a quarterly basis thereafter;
- 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;
- A requirement that the investment manager allocate cross trades among accounts in an objective and equitable manner and a description of the allocation method(s) available to and used by the investment manager for assuring an objective allocation among accounts participating in the cross trading program. If more than one allocation methodology may be used by the investment manager, a description of what circumstances will dictate the use of a particular methodology; and
- Identification of the compliance officer<sup>[4]</sup> responsible for periodically reviewing the investment manager's compliance with the policies and procedures and a statement of the compliance officer's qualifications for this position.

The policies and procedures also must contain a statement of whether the annual compliance review is limited to compliance with the policies and procedures or extends to the overall level of compliance with the statutory exemption. The Department specifically requests comments on whether the annual compliance review should be limited to ensuring compliance with the written policies and procedures (as expressed in the PPA exemption) or expanded to cover compliance with all of the requirements of the statutory exemption. In particular, the Department has asked for information on the current practices of compliance officers in determining compliance with applicable statutory or administrative exemptions under ERISA.

## **Initial Disclosure Statement**

In addition to describing the elements to be included in policies and procedures, the interim rule requires that the initial disclosure to the authorizing plan fiduciary (regarding the conditions under which cross trades may take place) include a statement that any investment manager participating in a cross trading program will have a potentially conflicting division of loyalties and responsibilities to the parties involved in any cross trade transaction.

## **Institute Comments**

The Institute plans to submit a comment letter to the Department by April 13, 2007. We will schedule a conference call with members soon to discuss issues to be included in the comment letter. In the meantime, if you have comments, please contact me (202/326-5821 or [ebarone@ici.org](mailto:ebarone@ici.org)) or Mary Podesta (202/326-5826 or [podesta@ici.org](mailto:podesta@ici.org)).

Elena Barone  
Assistant Counsel

## **[Attachment](#)**

### **endnotes**

[1] The regulation is available at <http://www.dol.gov/ebsa/regs/fedreg/final/2007002290.pdf>.

[2] See [Memorandum](#) to Pension Members No. 48-06, Federal Legislation Members No. 5-06, and 529 Plan Members No. 13-06 [20250], dated August 4, 2006.

[3] The Institute testified on cross trading before the ERISA Advisory Council in 2006, recommending among other things that the Department issue regulations consistent with SEC Rule 17a-7. See [Memorandum](#) to Pension Members No. 61-06 [20433], dated October 3, 2006.

[4] ERISA section 408(b)(19)(H) requires the investment manager to designate an individual responsible for periodically reviewing cross trades to ensure compliance with the written policies and procedures. The interim rule defines this individual as the “compliance

officer.” Under the exemption, the compliance officer must issue an annual report to the authorizing plan fiduciary detailing the level of compliance.

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.