The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 11643

February 16, 2000

INSTITUTE SUBMITS COMMENT LETTER ON PASSIVE CROSS-TRADES AND TESTIFIES AT DEPARTMENT OF LABOR HEARING ON ACTIVE CROSS-TRADES

[11643] February 16, 2000 TO: INVESTMENT ADVISERS COMMITTEE No. 6-00 PENSION COMMITTEE No. 14-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 14-00 AD HOC COMMITTEE ON CROSS TRADES RE: INSTITUTE SUBMITS COMMENT LETTER ON PASSIVE CROSS-TRADES AND TESTIFIES AT DEPARTMENT OF LABOR HEARING ON ACTIVE CROSS-TRADES _____
Recently, the Institute submitted a comment letter on the Department of Labor's proposed class exemption for passive cross-trades and testified at the Department's hearing on active cross-trades issues. I. Department of Labor Hearing on Active Cross-Trades On Thursday, February 10 and Friday, February 11, 2000, the Department held hearings on active cross-trades. Craig Tyle, the Institute's General Counsel, testified on February 10. At the hearing, the Institute stated that cross-trades provide tangible and significant benefits to mutual funds and other clients of our investment adviser members. We noted that historically, pension plans have been denied the benefits associated with cross-trades. The Institute urged the Department to propose a class exemption for active cross-trades, noting that potential abuses identified by the Department could be addressed by imposing appropriate conditions in such an exemption. The testimony addressed the following four points: general background concerning the process of cross-trading, the benefits associated with cross-trade transactions, how overly restrictive conditions on cross-trades are harmful to ERISA-covered pension plans and the Institute's recommended conditions for a class exemption on cross-trades. Other witnesses at the hearing included the Association of Investment Management and Research, the Securities Industry Association, the AFL-CIO, the Investment Counsel Association of America, Credit Agricole Indosuez Luxembourg, Committee on Investment of Employee Benefit Assets and T. Rowe Price Associates. With the exception of the AFL-CIO, all of the witnesses were supportive of a class exemption for active cross-trades. In its testimony, the AFL-CIO supported a class exemption for passive cross-trades, but indicated its concern that plans would be unable to monitor active cross-trades transactions to ensure that an investment adviser was not favoring another client over the plan. With respect to questions and answers, the Department asked many of the same questions to each of the witnesses. Specifically, the Department was interested in information concerning specific disclosure requirements that would provide plan fiduciaries with adequate information in order to monitor active cross-trades, examples of adequate protections to ensure that an investment manager did not favor a non-ERISA account over an ERISA account, whether "triggering events" were applicable in the active cross-trades

context and how best to bring an “independent director” requirement similar to that under SEC Rule 17a-7 to a class exemption for active cross-trades. II. Institute Comment Letter on Proposed Class Exemption for Passive Cross-Trades In its comment letter on the passive cross-trades proposed class exemption, the Institute indicated its general support for the proposal, noting areas requiring modification and clarification. With respect to the requested modifications section, the Institute made the following points: (1) a black-out period is unnecessary and burdensome; (2) the requirements that equity securities be “widely-held” and “actively- traded” are not appropriate for inclusion in a passive cross-trades exemption; (3) the passive cross-trades class exemption should permit cross-trades between Large Accounts; (4) the definition of “Large Account” should not exclude investment companies managed or sponsored by the investment manager; and (5) the class exemption should permit cross-trades of manager-issued securities. With respect to suggested clarifications, we requested that the Department clarify the following issues: (1) that the disclosure provision for “new” funds requires investment advisers to provide disclosure of new Funds only to those “relevant” independent plan fiduciaries whose plans have invested in those Funds; (2) that the independent fiduciary authorization conditions do not apply to plans maintained by the investment manager; and (3) that the scope of disclosure and authorization requirements for Index and Model Funds and Large Accounts only apply if these accounts hold plan assets. Copies of the comment letter and testimony are attached. Kathryn A. Ricard Associate Counsel Attachments

---