American Federation of Labor and Congress of Industrial Organizations

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

Attention: Cross-Trading Policies and Procedures Interim Final Rule

Ladies and Gentlemen:

On behalf of the more than 10 million working men and women of the AFL-CIO, we offer our comments on the Cross-Trading Policies and Procedures Interim Final Rule (the "Rule"), published on February 12, 2007 (72 Fed.Reg. 6473), and issued by the Department as directed by Section 611(g)(3) of the Pension Protection Act, Public Law 109-280, 120 Stat. 780 ("PPA").

The security of worker retirement assets is a primary concern of the AFL-CIO and the labor movement as a whole. The workers who belong to the unions affiliated with the AFL-CIO are participants in thousands of plans covered by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Millions of union members participate in single employer ERISA pension plans and there are more than 1,000 pension plans jointly sponsored by AFL-CIO member unions and their local and regional affiliates and contributing employers. Taken together, these two groups of pension plans have billions of dollars of assets and the appropriate investment of these assets is critical to the retirement security of workers.

Section 611(g)(1) of PPA, by adding Section 408(b)(19) to ERISA, created a new statutory prohibited transaction exemption permitting the cross-trades of securities, one that is broader than any previous exemption allowing such transactions granted by the Department.[1] More than six years before PPA was enacted, during its consideration of Prohibited Transaction

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[1] The Department has considered, and granted, numerous exemptions requesting authorization for the cross-trades of securities, including a class exemption, Prohibited Transaction Exemption 2002-12, allowing such trades by index and model-driven funds but subject to specific restrictions and limitations. *See* 67 Fed.Reg. 6614 (February 12, 2002).

Exemption 2002-12, the Department held a public hearing on potential exemptions for the cross-trades of securities by investment managers of actively-managed accounts. *See* 64 Fed. Reg. 70070 (December 15, 1999). At that hearing, the AFL-CIO expressed our concerns about creating any exemption, noting the risks involved and the difficulty of meaningful after-the-fact oversight of the transactions by plan fiduciaries.[2] As Congress looked at this issue during its consideration of PPA, the AFL-CIO again raised these concerns and opposed the new statutory exemption.

Paragraph (b)(3), the heart of the Rule, includes the items to be addressed in the investment manager's cross-trading policies and procedures. The Department appropriately requires the text to be written to be understandable by plan fiduciaries. We also agree that the policies and procedures must include sufficient detail to allow compliance officers to perform the required reviews and determine whether the transactions were made in accordance with the adopted policies and procedures. We do, however, have some concerns about matters that are not addressed in Paragraph (b)(3).

First, while Paragraph (b)(3) details the contents of the written policies and procedures, there is no requirement that the investment manager document its determination that a particular transaction complies with policies and procedures. Paragraph (b)(3)(i)(A) only requires that "… the criteria that will be applied … in determining that execution of a securities transaction as a cross-trade will be beneficial to both parties to the transaction …" be described. This determination is obviously a critical one, yet without any record memorializing the basis for it, the compliance officer, or a plan fiduciary, would face a difficult, if not impossible, task in reviewing the transaction and evaluating whether and how the criteria was applied. We suggest that the Rule be modified to require that written records showing the basis for each transaction and how it complies with the written policies and procedures be maintained.

Second, Paragraph (b)(3) does not include any substantive directives with respect to what must be included in the policies and procedures. In at least one instance, we believe it is important for the Department to modify the Rule to set standards and requirements that must be followed. Paragraph (b)(3)(D) requires the investment manager to describe how it "… will mitigate any potentially conflicting division of loyalties and responsibilities to the parties involved in any cross-trade transaction." More is required than a mere description. We suggest that the Rule be changed to require that each proposed transaction be evaluated by two qualified individuals employed at the investment manager firm, each acting for only one of the plans involved, who did not make the initial determination to engage in the cross-trade at issue. This additional level of review, even though not truly independent because the individuals are employees of the investment manager, provides some protection. In addition, the Rule should be modified so that the reviewing individuals, as well as their qualifications, are identified in the quarterly report that the investment manager is to provide the authorizing plan fiduciary pursuant to Section 408(b)(19) (F) of ERISA.

Last, Paragraph (b)(3) requires that the compliance officer be identified, and his or her qualifications described, in the written policies and procedures. In order to insure the

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[2] The Department never issued a class exemption permitting cross-trades of securities.

independence of the compliance officer, we strongly recommend an additional requirement: the compensation paid to the individual should not be materially affected by any trading resulting from the transactions that are reviewed.

In addition to providing guidance on the required written policies and procedures, the Rule also addresses the disclosure the investment manager must make to plan fiduciaries before authorization for cross-trades is given. This advance disclosure is vitally important as it may be the only time a plan fiduciary has the opportunity to fully consider whether authorizing the cross-trades of securities is appropriate for the plan in light of the inherent divided loyalties the investment manager will have and the difficulty of monitoring these transactions.

Paragraph (a)(3) of the Rule mandates that the advance disclosure to the plan fiduciary include an explicit "… 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." 72 Fed.Reg. at 6479. We agree with the Department's requirement and believe it should be strengthened so that the importance of the statement is unmistakable. We recommend that the Rule be modified to require that the statement about potential conflicts be prominent and in a bold font sufficiently large (at least 14 point) to be distinguishable from the rest of the text included in the disclosure. In addition, the Department should consider requiring that the font of the entire statement itself be no less than 12 point.

We also suggest that Rule be expanded to address the disclosure required in the annual written report provided to the plan fiduciaries by the compliance officer. Section 408(g)(19)(I) of ERISA requires that report to "… notify the plan fiduciary of the plan's right to terminate participation in the investment manager's cross-trading program at any time." This disclosure, like the statement required under Paragraph (a)(3) of the Rule, is an important one as it reminds the plan fiduciaries of their opportunity to opt out of the cross-trading program. We recommend that this notification be presented in the same way as we proposed with respect to the statement on the potential conflicting loyalties.

We continue to have significant concerns about the operation of new ERISA Section 408(g)(19) and its potential harm to the plans on which so many workers rely for retirement security and we urge the Department to consider how it will audit or otherwise monitor investment managers adopting cross-trading programs.

We hope our comments are helpful and should there be any questions about them, please do not hesitate to contact me at (202) 637-5907.

Sincerely,

Thea M. Lee

Thea Lee
Policy Director
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