

DEPARTMENT OF LABOR**Pension and Welfare Benefits Administration****Proposed Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds**

AGENCY: Pension and Welfare Benefits Administration, Department of Labor.
ACTION: Notice of proposed class exemption.

SUMMARY: This document contains a notice of pendency before the Department of Labor (the Department) of a proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (the Act or ERISA), the Federal Employees' Retirement System Act (FERSA), and from certain taxes imposed by the Internal Revenue Code of 1986 (the Code). If granted, the proposed exemption would permit cross-trades of securities among Index and Model-Driven Funds (Funds) managed by investment managers and among such Funds and certain large accounts to which such investment managers act as a "trading adviser" in connection with a specific portfolio restructuring program. The proposed exemption, if granted, would affect participants and beneficiaries of employee benefit plans whose assets are invested in Index or Model-Driven Funds, large pension plans involved in portfolio restructuring programs, as well as the Funds and the investment managers.

DATES: Written comments and requests for a public hearing must be received by the Department on or before February 14, 2000.

ADDRESSES: All written comments and requests for a public hearing (preferably 3 copies) should be sent to: Office of Exemption Determinations, Pension and Welfare Benefits Administration, Room N-5649, 200 Constitution Avenue N.W., Washington, DC 20210, (Attention: "Class Exemption for Securities Cross-Traded by Index/Model-Driven Funds"). All comments received from interested persons will be available for public inspection in the Public Documents Room, Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N-5638, 200 Constitution Avenue N.W., Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: Mr. Louis J. Campagna, or Mr. E. F. Williams, of the Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor, Washington, DC 20210 at (202) 219-8883 or 219-8194,

respectively, or Mr. Michael Schloss, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, DC 20210, at (202) 219-4600, ext. 105. (These are not toll-free numbers.)

SUPPLEMENTARY INFORMATION: This document contains a notice of pendency before the Department of a proposed class exemption from the restrictions of sections 406(a)(1)(A) and 406(b)(2) of the Act, section 8477(c)(2)(B) of FERSA,¹ and from the taxes imposed by section 4975(a) and (b) of the Code, by reason of section 4975(c)(1)(A) of the Code. The Department is proposing the class exemption on its own motion pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, August 10, 1990).²

I. Paperwork Reduction Act Analysis

The Department, as part of its continuing effort to reduce paperwork and respondent burden, conducts a pre-clearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA 95), 44 U.S.C. 3506(c)(2)(A). This helps to ensure that requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements on respondents can be properly assessed.

Currently, the Pension and Welfare Benefits Administration (PWBA) is soliciting comments concerning the proposed information collection request (ICR) included in the Proposed Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds. A copy of the ICR may be obtained by contacting the PWBA

¹ The Department has responsibility for the administration and enforcement of section 8477 of FERSA. Section 8477 establishes the standards of fiduciary responsibility and requirements relating to the activities of fiduciaries with respect to the Federal Thrift Savings Fund. All references herein to the fiduciary responsibility provisions of Part 4 of Title I of ERISA also apply to the corresponding provisions of FERSA. Accordingly, any relief that would be provided under this proposed class exemption, if granted, would also apply to cross-trades of securities by the Federal Thrift Savings Fund.

² Section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996) generally transferred the authority of the Secretary of the Treasury to issue exemptions under section 4975(c)(2) of the Code to the Secretary of Labor.

In the discussion of the exemption, references to specific provisions of the Act should be read to refer as well to the corresponding provisions of section 4975 of the Code.

official identified below in this Notice of Proposed Class Exemption.

The Department has submitted a copy of the proposed information collection to the Office of Management and Budget (OMB) for its review in accordance with 44 U.S.C. 3507(d) of PRA 95. The Department and OMB are particularly interested in comments that:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of the responses.

Dates: Written comments concerning the proposed collection of information should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington DC 20503; Attention: Desk Officer for the Pension and Welfare Benefits Administration. Although comments may be submitted through February 14, 2000, OMB requests the comments be received within 30 days of the publication of the Notice of Proposed Class Exemption to ensure their consideration.

Requests for copies of the ICR may be addressed to: Gerald B. Lindrew, Office of Policy and Research, U.S. Department of Labor, Pension and Welfare Benefits Administration, 200 Constitution Avenue, NW, Room N-5647, Washington, D.C. 20210. Telephone: (202) 219-4782 (this is not a toll-free number); Fax: (202) 219-4745.

Title: Notice of Proposed Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds.

Type of Review: New.

AGENCY: Department of Labor, Pension and Welfare Benefits Administration.

Affected Entities: Business or other for-profit.

SUMMARY: The proposed class exemption would permit cross-trades by Funds in which plans invest and among

such Funds and Large Accounts pursuant to portfolio restructuring programs which, in absence of the exemption, would be prohibited by ERISA. The information collection requirements incorporated within the proposed class exemption are designed as appropriate safeguards to ensure, among other things, prior approval by a plan of its participation in a cross-trading program, proper disclosures of information about a cross-trading program to plan investors, fair pricing procedures for securities cross-traded between the Funds or between such Funds and other Large Accounts managed by the investment manager, and the absence of a significant degree of investment discretion by the investment manager in the selection of particular securities for the Funds.

Needs and Uses: In order for the Department to grant an exemption for a transaction that would otherwise be impermissible under ERISA, the statute requires that the Department make a finding that the proposed exemption meets the statutory requirements of section 408(a). Section 408(a) requires a finding that the exemption is administratively feasible, in the interest of the plan and its participants and beneficiaries, and protective of the rights of the participants and beneficiaries. In order to ensure that this exemption meets the statutory requirements, the Department finds it necessary that certain information be provided to an independent fiduciary of each plan that invests in an Index or Model-Driven Fund, and that the independent fiduciary approve the plan's participation in a cross-trading program.

Respondents and Total Responses: The Department estimates that approximately 10 entities will seek to take advantage of the class exemption in a given year. The respondents will be banks and other investment managers acting as fiduciaries of plans investing in Index and Model-Driven Funds managed by such entities. There are expected to be 61,800 responses per year or 6,180 responses per entity per year.

Estimated Annual Burdens: The Department staff estimates the annual burden for preparing the materials required under the proposed class exemption to be a total of 68,150 hours or 6,815 hours per entity. The total annual burden cost (operating/maintenance) is estimated to be \$116,184 or \$11,618 per entity.

Comments submitted in response to this Notice of Proposed Class Exemption will be summarized and/or included in the request for OMB approval of the

information collection request; they will also become a matter of public record.

II. Background

On March 20, 1998, a Notice was published in the **Federal Register** [63 FR 13696] to announce that the Department has under consideration certain applications for exemptions relating to cross-trades of securities by investment managers with respect to any account, portfolio or fund holding "plan assets"³ subject to the fiduciary responsibility provisions of Part 4 of Title I of ERISA. The Department published the Notice to request information which would assist it in determining what standards and safeguards are appropriate for future exemptions for cross-trades of securities.

The Department understands that securities cross-trading is a common practice among investment managers and advisers as a means for executing securities transactions for client accounts that are not subject to the fiduciary responsibility provisions of ERISA.⁴ Such cross-trades could be either direct cross-trades or brokered cross-trades.

Direct cross-trades occur whenever an investment manager causes the purchase and sale of a particular security to be made directly between two or more accounts under its management without a broker acting as intermediary. Under this practice, the manager executes a securities transaction between its managed accounts without going into the "open market"—such as a national securities exchange (e.g. the New York Stock Exchange—"NYSE") or an automated broker-dealer quotation system (e.g. the National Association of Securities Dealers Automated Quotation National Market System—"NASDAQ").

Brokered cross-trades occur whenever an investment manager places simultaneous purchase and sale orders for the same security with an

independent broker-dealer under an arrangement whereby such broker-dealer's normal commission costs are reduced. In such instances, brokers are often willing to accept a lower commission because the transaction will be easier to execute where there are shares already available to complete the order for both the buyer and the seller.

In the Notice published on March 20, 1998, the Department noted that cross-trading transactions could result in violations of one or more provisions of Part 4 of Title I of ERISA. For example, section 406(b)(2) provides that an ERISA fiduciary may not act in any transaction involving a plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries. Where an investment manager has investment discretion with respect to both sides of a cross-trade of securities and at least one side is an employee benefit plan account, the Department has previously taken the position that a violation of section 406(b)(2) of ERISA would occur.⁵ The Department has taken the position that by representing the buyer on one side and the seller on the other in a cross-trade, a fiduciary acts on behalf of parties that have adverse interests to each other.⁶ Moreover, the prohibitions embodied in section 406(b)(2) of ERISA are per se in nature. Merely representing both sides of a transaction presents an adversity of interests that violates section 406(b)(2) even absent fiduciary misconduct reflecting harm to a plan's beneficiaries.⁷

In addition, violations of section 406(b)(1) or (b)(3) of ERISA may occur when an investment manager has discretion for both sides of a cross-trade. Section 406(b)(1) of ERISA prohibits a plan fiduciary from dealing with the assets of the plan in his own interest or for his own account. Section 406(b)(3) prohibits a plan fiduciary from receiving any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

It should also be noted that violations of section 403 and 404 could arise where the investment manager represents both sides in a cross-trade.

⁵ *Reich v. Strong Capital Management Inc.*, No. 96-C-0669, USDC E.D. Wis. (June 6, 1996).

⁶ See *Strong Capital Management Inc.*, supra.

⁷ See, *Cutaiar v. Marshall*, 590 F.2d 523 (3d Cir. 1979). In *Cutaiar*, the court held that, "[W]hen identical trustees of two employee benefit plans whose participants and beneficiaries are not identical effect a loan between the plans without a section 408 exemption, a per se violation of ERISA exists." *Cutaiar*, 590 F.2d at 529.

³ See 29 CFR Part 2510.3-101, Definition of "plan assets"—plan investments.

⁴ The Department is expressing no opinion herein as to whether such cross-trade practices are in compliance with the relevant federal securities laws regulating securities transactions and/or the provision of investment advisory or management services by an investment manager. For example, cross-trading of securities between mutual funds and other accounts that use the same or affiliated investment advisers is permitted if the transactions are accomplished in accordance with SEC Rule 17a-7, an exemption from the prohibited transaction provisions of section 17(a) of the Investment Company Act of 1940 (see 17 CFR 270.17a-7). For a discussion of the issues relating to the use of SEC Rule 17a-7 for ERISA plan accounts, see the Notice published on March 20, 1998 (63 FR 13696, 13698-13700).

Section 404(a)(1)(A) of ERISA requires, in part, that a plan fiduciary must discharge its duties solely in the interests of the participants and beneficiaries of that plan and "for the exclusive purpose" of providing benefits to participants and beneficiaries and defraying reasonable plan expenses. Similarly, section 403(c)(1) of ERISA requires, in part, that the assets of a plan must be "[H]eld for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan."

In the Department's view, conflicts of interest in cross-trading occur because a manager is exercising investment and trading discretion over both sides to the same transaction and making decisions as to: which securities to buy or sell; how much of each security to buy or sell; when to execute a sale or purchase of each security; where to conduct a trade (*i.e.*, on a market or through a cross-trade); and at what price to conduct a trade.

In the Notice published on March 20, 1998, the Department discussed the types of individual exemptions previously granted for cross-trades of securities.⁸ As noted therein, these past exemptions fall generally into two categories: (1) Those for Index and Model-Driven Funds; and (2) those for actively-managed or discretionary asset management arrangements.⁹

The trading decisions made for the Index and Model-Driven Funds

involved are "passive" or "process-driven." In the case of an Index Fund, the investment manager has been hired to invest money according to a formula that, for example, tracks the rate of return, risk profile, and other characteristics of an independently maintained index by either replicating the entire portfolio of the index or by investing in a representative sample of such portfolio designed to match the projected risk/return profile of that index. Model-Driven Funds are based upon formulae by which an "optimal" portfolio is created to implement some specific investment strategy that is either based upon or measured by an independently maintained index of securities. These "process driven" programs are implemented only by investment in an index replicating portfolio (in the case of index funds) or a set "optimum" portfolio (in the case of model-driven funds). In granting these exemptions, the Department did not believe, based on the representations made by the applicants requesting the prior exemptions, that the selection of individual securities for Index and Model-Driven Funds using such "process-driven" strategies would involve any significant exercise of investment discretion by the investment manager managing the Funds. In actively-managed programs, trading decisions are made by individuals hired to select particular securities as professional investment managers.

In the exemption applications, the applicants have represented to the Department that cross-trading provides certain benefits to employee benefit plans as Fund investors. For example, when one Fund needs to sell the same securities that another Fund needs to buy on the same day, a cross-trade saves both the selling Fund and the buying Fund the transaction costs (*e.g.*, brokerage commissions or the bid-offer spread) that would otherwise have been paid to a broker-dealer for executing the transaction on the open market.

While recognizing the advantages of cross-trading to plans, the Department has particular concerns where managers have investment discretion over both sides of a cross-trade transaction. The conditions contained in the Department's prior individual exemptions for cross-trades by Index and Model-Driven Funds and actively-managed funds were intended to address these concerns and to safeguard plans against the inherent conflict of interest which exists when there is a common investment manager for both sides of a transaction. In this regard, the conditions incorporated into these exemptions were designed to protect

plans against the potential that an investment manager may exercise discretion to favor one account over another; *e.g.*, in the pricing of a particular cross-trade, in the decision to either buy and/or sell particular securities for an ERISA account, or to allocate securities among accounts, including ERISA accounts.

The Department recognizes that its concerns are more apparent in situations involving actively-managed accounts or funds, where an investment manager has total investment discretion to choose particular securities for such accounts or funds at any time, subject only to general investment guidelines or objectives established by the client plan fiduciaries. As a result, the Department is not proposing relief for transactions involving actively-managed cross-trading at this time. Information obtained by the Department in response to the Notice with respect to cross-trades of securities by actively-managed funds is currently under consideration by the Department.¹⁰ Publication of the proposed exemption does not foreclose future consideration of additional exemptive relief for actively-managed programs. However, the Department believes that it has developed a sufficient record, through consideration of past individual exemptions and comments to the Notice, to propose relief for passive and process-driven cross-trading, subject to certain restrictions and limitations regarding the exercise of fiduciary discretion.

With respect to this exemptive relief for cross-trades by Index and Model-Driven Funds, it should be noted that, through the development of past cross-trading exemptions and enforcement proceedings, the Department became aware of issues that have caused it to reexamine its exemption policy for such transactions. As a result, certain of the conditions and definitions contained in this proposal differ from a number of the conditions and definitions developed over time for the previously granted passive and process-driven individual exemptions. These proposed modifications reflect the importance to the Department of retaining flexibility to review its exemption policy in the context of changed circumstances or new facts brought to its attention.

For example, in the "process-driven" context, it was represented to the Department in past exemption applications that investment managers who manage accounts or pooled funds

¹⁰ In this regard, the Department directs interested persons to a notice of public hearing which the Department is also publishing in today's **Federal Register**.

⁸ The individual exemptions generally have focused on direct cross-trading transactions. These exemptions have provided relief from the prohibitions of section 406(b)(2) of ERISA, but have not provided relief for any violations of section 406(b)(1) or (b)(3) of ERISA. It should also be noted that the Department does not have authority under section 408(a) of ERISA to exempt a plan fiduciary from any violations of sections 403 and 404 of ERISA. Thus, even when proceeding under an individual exemption, an investment manager remains fully liable under sections 403 and 404 of ERISA for the investment decisions relating to cross-trades.

⁹ In this regard, see the following Prohibited Transaction Exemptions (PTEs): PTE 95-83, Mercury Asset Management (60 FR 47610, September 13, 1995); PTE 95-66, BlackRock Financial Management L.P., (60 FR 39012, July 31, 1995); PTE 95-56, Mellon Bank, N.A. (60 FR 35933, July 12, 1995); PTE 94-61, Batterymarch Financial Management (59 FR 42309, August 17, 1994); PTE 94-47, Bank of America National Trust and Savings Association (59 FR 32021, June 21, 1994); PTE 94-43, Fidelity Management Trust Company (59 FR 30041, June 10, 1994); PTE 94-36, The Northern Trust Company (59 FR 19249, April 22, 1994); PTE 92-11, Wells Fargo Bank, N.A. (57 FR 7801, March 4, 1992)—which replaced PTE 87-51 noted below; PTE 89-116, Capital Guardian Trust Company (54 FR 53397, December 28, 1989); PTE 89-9, State Street Bank and Trust Company (54 FR 8018, February 24, 1989); PTE 87-51, Wells Fargo Bank, N.A. (52 FR 22558, June 12, 1987); and PTE 82-133, Chase Manhattan Bank, N.A. (47 FR 35375, August 13, 1982).

often attempt to track the rate of return, risk profile and other characteristics of an independently maintained third party index (e.g., the Standard & Poors 500 Composite Stock Price Index a/k/a the S&P 500 Index, the Wilshire 5000 Index, the Russell 2000 Index). These pooled funds are usually collective investment funds established and trusted by large banks that manage money for institutional investors, including employee benefit plans. Under the Department's past exemptions, such funds may cross-trade pursuant to certain narrowly-defined "triggering events" which involve little, if any, discretion on the part of the investment manager.

In the past, various applicants represented to the Department that the investment strategy of most Index Funds merely involved replicating the capitalization-weighted composition of a particular index. In this regard, FERSA itself requires that the Common Stock Index Investment Fund (an S&P 500 Fund) be invested in a portfolio that is "* * * designed such that, to the extent practicable, the percentage of the Common Stock Index Investment Fund that is invested in each stock is the same as the percentage determined by dividing the aggregate market value of all shares of that stock by the aggregate market value of all shares of all stocks included in such index."¹¹ 5 U.S.C. § 8438(b)(2)(B).¹¹ Consequently, in the past, the Department generally focused on issues relating to Index Funds which simply replicated the capitalization-weighted composition of a particular index.

However, the Department now understands that the process that Index Funds use to replicate the returns of an index may not be limited to replicating the exact composition of the index and that many, if not most, Index Funds do not totally replicate the exact composition of the index that is being tracked. In many instances, the manager maintains some discretion to select particular securities to track the rate of return, risk profile and other characteristics of the overall index without actually holding all of the securities included in the index. Some Index Funds are designed to exceed the rate of return and/or deviate from the risk profile of the index by altering the composition or weighting of securities within the index as designated by the organization that maintains the index. These "enhanced" Index Funds often

have strategies that resemble actively-managed accounts. Therefore, the Department believes that the definition of an "Index Fund" that is permitted to cross-trade pursuant to certain narrowly-defined "triggering events" needs to be modified under the proposal from that contained in prior individual exemptions.

In addition, Model-Driven Funds are portfolios that apply specific investment philosophies and criteria in formulaic fashion to create a specialized portfolio. Model-Driven Funds may come in many different forms. Some Model-Driven Funds seek to transform the capitalization-weighted or other specified composition of an index in order to accomplish certain goals. Such goals may include client-initiated instructions to delete certain stocks from an index that is otherwise being tracked, or investment management styles which incorporate mathematical formulae designed to focus on certain investment criteria (e.g., price-earnings ratios) at certain times in order to achieve a rate of return for the model-driven portfolio that exceeds that of the underlying index. Thus, some Model-Driven Funds appear to be a more sophisticated type of "enhanced" Index Fund.

The Department notes that the proposed exemption would not be available to a Fund if the manager has modified the index or design of the model to produce cross-trade opportunities. For example, the exemption would not be available to a Fund if the manager has modified the index or design of the model to generate buy or sell orders based on the availability of a security within the control of the manager. Such a modification or design would cause a Fund to engage in cross-trades solely for the purpose of providing matching trades suited to another Fund's needs rather than for the investment purposes of the Fund whose trading criteria have been modified.

The Department believes that the definition of a "Model-Driven Fund" that cross-trades pursuant to "triggering events" also needs to be modified from that contained in prior exemptions. Further, the Department is of the view that the definition of a "triggering event" should be modified to reduce the amount of discretion that an investment manager may exercise in connection with a cross-trading decision on behalf of a Model-Driven Fund.

III. Discussion of the Comments on the Notice

The Department received a total of twenty-nine (29) comment letters on the

Notice, approximately half of which addressed cross-trades by Index and Model-Driven Funds. Some of these comments were from major industry groups, such as associations representing investment managers that act as fiduciaries for employee benefit plans.

Many of these comments responded directly to the specific questions posed by the Department in the Notice. These comments, as they relate to cross-trades by Index and Model-Driven Funds, are summarized below.

The comments almost universally endorsed the idea of the Department proposing additional exemptive relief for cross-trades of securities by Index and Model-Driven Funds. All of the comments noted that, under appropriate conditions, cross-trading can provide numerous benefits to client accounts and funds, including the avoidance of brokerage commissions and bid-offer spreads that would otherwise be incurred, and the avoidance of adverse market impact costs if such trades were transacted on the open market. In addition, many of the commenters noted that in international markets there are benefits from cross-trading associated with avoiding other related transaction costs, such as settlement charges, registration fees, and certain taxes. As noted above, the Department questions whether avoiding adverse market impact costs is favorable to the party that would have received a better price had the market price moved in its favor prior to engaging in the transaction. The Department invites comments regarding this concern.

A commenter stated that the advantages provided by cross-trading securities are magnified in the case of "passively" managed accounts or funds, primarily because of the relatively large account sizes and overlap in portfolio composition. For example, because Index and Model-Driven Funds must maintain certain weighting and parameters, cash inflows into one Fund essentially mandate the acquisition of an array of securities, while cash outflows in another Fund may require the simultaneous disposition of many of the same securities.

With respect to the size of the market attributable to assets of employee benefit plans that cross-trade, one comment from a large investment manager estimated that over \$700 billion of pension and retirement funds are invested in "passive" strategies (e.g., Index and Model-Driven Funds) which rely heavily on cross-trading to minimize transaction costs. Another comment from a major bank that manages Index and Model-Driven Funds

¹¹ In addition, section 8438 (b)(3)(B) and (b)(4)(B) of FERSA contain similar requirements for the Small Capitalization Stock Index Investment Fund and International Stock Index Investment Fund.

stated that the bank estimates that cross-trading saves its clients hundreds of millions of dollars each year by substantially reducing transaction costs. Other comments from major corporations with large pension plans that invest in Index and Model-Driven Funds also noted transaction cost savings of over \$1,000,000 for each of their plans over a two-year period. Similar comments were made by other institutional investors, such as governmental plans.

The Department is concerned that the savings mentioned by the commenters may not only be reflective of transaction cost savings, but may also reflect "savings" attributable to the avoidance of market impact by cross-trading securities rather than engaging in open market transactions. The Department seeks further comments and data regarding the savings which may be expected from cross-trades and the basis for such savings.

Some commenters further asserted that clients demand cross-trading capabilities as a condition for the investment manager to handle their accounts. With "passive" investment management strategies that seek to replicate the rate of return, risk profile and other characteristics of a designated index (e.g., the S&P 500 Index), the success of an investment manager is often measured by the tracking error of the managed portfolio vis-a-vis the index. Cross-trades of securities help reduce an investment manager's overall transaction costs, which are otherwise a major source of tracking error in relation to the index because the index is valued without taking into consideration transaction costs. Thus, it is virtually impossible for an investment manager to replicate the rate of return, risk profile and other characteristics of an index, or to accurately track the designated composition and weighting of the securities contained therein, when the organization maintaining such index establishes the value of the index exclusive of such transaction costs. In addition, the comments note that every dollar a portfolio spends on transaction costs (either as spreads or commissions) detracts from the investment strategy guideline that has been mandated by the independent plan fiduciary—*i.e.*, to come as close as possible to the rate of return, risk profile and other characteristics of the designated index.

Moreover, cross-trades of securities by Model-Driven Funds that are designed to exceed the rate of return of a designated index also achieve better results by reducing transaction costs. A commenter noted that the computer models, which create the portfolios for

a Model-Driven Fund by transforming an index, dictate the securities to be purchased and sold in precise quantities. Thus, the commenter stated that the types of passive strategies used by these Funds do not work as effectively if an investment manager must make decisions with respect to purchases or sales of individual securities which override the selections made by the computer model.

In this regard, one commenter asserted that cross-trading enables an investment manager to obtain, or dispose of, the necessary amounts of such securities without having to alter a model's investment strategy because of transaction costs associated with achieving the desired goal. Other comments asserted that cross-trading is merely another method of executing the purchase or sale of a security that has already been included on the trade list of a Model-Driven Fund for a particular day. Thus, the decision to buy or sell a security through cross-trades, rather than on the open market, is made after the trade list for the purchase or sale of that security has been prepared. Such trade lists are developed by computer models which use prescribed objective factors and external data to automatically generate a model-prescribed portfolio, or use a client's instructions to buy or sell particular securities to facilitate a client-initiated portfolio restructuring.

Still other commenters noted that the computer models or optimization programs that drive a Model-Driven Fund are designed to keep the Fund's portfolio of securities balanced with the projected return, risk profile and other characteristics of the appropriate model or index. One major bank that manages such Funds commented that these models are not designed to increase the frequency of cross-trades, but rather to apply quantitative techniques to achieve a predetermined investment strategy. This comment stated that investment managers do not let the "tail wag the dog" by weighting or manipulating the investment models to produce more cross-trades.

With respect to the degree of investment discretion exercised by an investment manager in creating and operating a Model-Driven Fund, one comment asserted that, while the creation of a computer model may require human intervention, the operation of a Model-Driven Fund in accordance with the dictates of the model involves the same type of "passive" investment strategy and human intervention as an Index Fund. In addition, the comments state that these computer models are rarely

changed and their operations are free of any overt or subtle discretion exercised by the investment manager. When such models are changed, clients are often provided with prior notice of the change and objective criteria are used to design the new "passive" investment strategy. The comments maintain that the mere ability to change the model, exercised infrequently, does not change a strategy from passive to active. In this regard, some of the comments state that an investment manager for an Index or Model-Driven Fund is not hired by its clients to subjectively analyze individual securities or a range of securities, and that the compensation paid to the investment manager for implementing a "passive" investment strategy is much less than that required for active management. Thus, these comments note that the level of compensation paid to a "passive" investment manager reflects the role that such manager has in operating a Model-Driven Fund.

In any event, all of the comments state that the benefits of cross-trading override any concerns the Department may have regarding the degree of discretion a particular investment manager may exercise in the design and implementation of a computer model used for a Model-Driven Fund. The comments assert that these concerns are further mitigated by the conditions of the Department's past exemptions which require, among other things, that: (1) cross-trades by the Funds can occur only in response to various "triggering events" which are not within the manager's control or discretion; (2) a large plan or other large account can only engage in cross-trades with an Index or Model-Driven Fund where the investment decisions relating to a particular portfolio restructuring program for the large plan/account are made by a fiduciary or other appropriate decision-maker who is independent of the investment manager; (3) all cross-trade transactions will occur within three business days of the "triggering event" necessitating the purchase or sale; (4) all cross-traded securities must be securities for which there is a generally recognized market; (5) the price for all securities involved in the cross-trade will be the current market value for the securities on the close of the trading day in which the transaction occurs; and (6) the investment manager may not receive additional compensation as a result of the cross-trade.

After consideration of the information contained in the comments relating to cross-trades of securities by Index and Model-Driven Funds and the current

cross-trade practices utilized by investment managers that manage such Funds, the Department has determined to propose this class exemption. As discussed in further detail below, this proposed class exemption for cross-trades of securities by Index and Model-Driven Funds contains many of the same conditions that appear in the individual exemptions previously granted by the Department, with certain modifications. In addition, the proposal contains a number of new conditions and definitions which attempt to address concerns that have been raised since those exemptions were granted.

IV. Description of the Proposed Exemption

A. Scope and General Rule

The proposed exemption consists of four parts. Section I sets forth the general exemption and describes the transactions covered by the exemption. Sections II and III contain specific and general conditions applicable to transactions described in section I. Section IV contains definitions for certain terms used in the proposed exemption.

The exemption set forth in section I would provide relief from the restrictions of sections 406(a)(1)(A) and 406(b)(2) of ERISA and section 8477(c)(2)(B) of FERSA for: (a) the purchase and sale of securities between an Index or Model-Driven Fund and another such Fund, at least one of which holds "plan assets" subject to the Act; and (b) the purchase and sale of securities between such Funds and certain large accounts (Large Accounts) pursuant to portfolio restructuring programs of the Large Accounts.

The proposed exemption under section I(a) applies to cross-trades of securities among Index or Model-Driven Funds managed by the same investment manager where both Funds contain plan assets. However, as stated above, a violation of section 406(b)(2) occurs when an investment manager has investment discretion with respect to both sides of a cross-trade of securities and at least one side is an entity which contains plan assets. As a result, the proposed exemption is also applicable to situations where the investment manager has investment discretion for both Funds involved in a cross-trade but one Fund does not contain plan assets because, for example, it is registered as an investment company under the Investment Company Act of 1940 (e.g., a mutual fund). Any mutual fund or other institutional investor covered by the proposed exemption under section I(a) must meet the definition of an Index

Fund or a Model-Driven Fund, contained in section IV(a) and (b). Institutional investors which meet the definition contained in section IV(a) and (b) may include, but are not limited to, entities such as insurance company separate accounts or general accounts, governmental plans, university endowment funds, charitable foundation funds, trusts or other funds exempt from taxation under section 501(a) of the Code.

The proposed exemption under section I(b) would apply to the purchase and sale of securities between a Fund and a Large Account, at least one of which holds "plan assets" subject to ERISA or FERSA, pursuant to portfolio restructuring programs initiated on behalf of certain Large Accounts. The term "Large Accounts" is defined in section IV(e) as certain large employee benefit plans or other large institutional investors with at least \$50 million in total assets, including certain insurance company separate and general accounts and registered investment companies. A portfolio restructuring program, as defined in section IV(f), involves the buying and selling of securities on behalf of a Large Account in order to produce a portfolio of securities which either becomes an Index Fund or a Model-Driven Fund or resembles such a Fund, or to carry out a liquidation of a specified portfolio of securities for a Large Account. The definition of a Large Account requires that an independent fiduciary authorize an investment manager (i.e., a Manager, as defined in section IV(i)) to restructure all or part of the portfolio or to act as a "trading adviser" as defined in section IV(g) with respect to the restructuring of such portfolio. The trading adviser's role is limited under the proposed exemption to the disposition within a stated period of time of a securities portfolio of a Large Account and the creation of the required portfolio. Under this definition, the manager may not have any discretionary authority for any asset allocation, security selection, restructuring or liquidation decisions or otherwise provide investment advice with respect to such transactions. It has been represented to the Department that, in such restructuring transactions, commissions and other costs are saved by not having to liquidate all of the securities contained in the Large Account's portfolio on the open market. In this regard, the Department notes that it expects the investment manager to comply with the applicable securities laws in connection with any portfolio restructuring program.

Section IV(a) and (b) require that the Index or Model-Driven Fund be based

upon an index which represents the investment performance of a specific segment of the public market for equity or debt securities. Section IV(c) requires that the index be established and maintained by an independent organization which is: in the business of providing financial information or brokerage services to institutional clients; a publisher of financial news or information; or a public stock exchange or association of securities dealers. The index must be a standardized index of securities which is not specifically tailored for the use of the manager. The Department seeks comments directed to the proposed definition of an index.

Section IV(a) and (b) specifically define Index and Model-Driven Funds for purposes of the proposed exemption. These definitions are designed to limit the amount of discretion the manager can exercise to affect the identity or amount of securities to be purchased or sold and to assure that the purchase or sale of any security is not part of an arrangement, agreement or understanding designed to benefit the manager. Under the definition of "Index Fund" contained in section IV(a), the investment manager must track the rate of return of an independently maintained securities index by either replicating the same combination of securities which compose such index or by investing in a representative sample of such portfolio based on objective criteria and data designed to recreate the projected return, risk profile and other characteristics of the index. Under the definition of "Model-Driven Fund" contained in section IV(b), trading decisions are passive or process-driven since the identity and the amount of the securities contained in the Fund must be selected by a computer model. Although the manager can use its discretion to design the computer model, the model must be based on prescribed objective criteria using third party data, not within the control of the manager, to transform an independently maintained index. Thus, for example, no exemptive relief would be available if the manager designed the computer model to consider the liquidity or the availability of a security based on information that was solely within the control of the manager. In such instances, the computer model would be considering data that was not from a third party source, and that was within the control of the manager.

B. Price and Securities

Section II(a) requires that the cross-trade must be executed at the closing price for that security. "Closing price" is defined in section IV(h) as the price

for the security on the date of the transaction, as determined by objective procedures disclosed to Fund investors in advance and consistently applied with respect to securities traded in the same market. The procedures shall indicate the independent pricing source (and alternates, if the designated pricing source is unavailable) used to establish the closing price and the time frame after the close of the market in which the closing price will be determined. The pricing source must be independent of the manager and must be engaged in the ordinary course of business of providing financial news and pricing information to institutional investors and/or the general public, and must be widely recognized as an accurate and reliable source for such information. In this regard, some managers use one pricing service for pricing domestic securities and another pricing service for pricing foreign securities. With respect to foreign securities, the applicable independent pricing source should provide the price in local currency rates and, if that currency is other than U.S. dollars, also provide the U.S. dollar exchange rate. Thus, securities would be cross-traded in all cases at the closing prices received by the manager from the relevant independent pricing source.

The Department has adopted this definition in an effort to be consistent with the methods for determining the price of cross-traded securities currently utilized by Index and Model-Driven Fund investment managers, according to the comments to the Notice published on March 20, 1998. In addition, the Department believes that this pricing approach will ensure that the pricing procedures utilized are objective and not subject to the discretion or manipulation of any of the involved parties. The comments received indicated that passive managers generally utilize independent pricing services which collect information on closing prices of securities. However, the Department realizes that passive fund managers have an ever present need to retain the flexibility to consider advanced trading or pricing techniques which could reduce costs that generate tracking error or which reflect a more refined view of the market behavior of a specific security. Comments are invited as to whether the definition of the price for a cross-traded security contained in this proposal is responsive to that need.

Section II(f) requires that the cross-trades of either equity securities or fixed income securities involve only securities for which market quotations are readily available from independent

sources that are engaged in the ordinary course of business of providing financial news and pricing information to institutional investors and/or the general public, and are widely recognized as accurate and reliable sources for such information. Section II(f)(1) further requires that cross-trades of equity securities only involve securities which are widely-held and actively-traded. In this regard, the Department notes that equity securities will be deemed to be "widely-held" and "actively-traded" under this proposed exemption if such securities are included in an independently maintained index, as defined in section IV(c) herein. The Department invites comments from interested persons regarding the definitions of the types of allowable securities permitted to be cross-traded under the exemption. The Department's intent is to exclude those securities which are thinly-traded. This intent is based upon the underlying notion that the cross-trading of a security may avoid the market impact on the price of the security that a similar trade on the market would produce. This avoidance of market impact through cross-trading would be more dramatic with thinly-traded securities. The Department expects that managers, in making their determinations regarding the types of securities included within the scope of this condition, would consider information about the average daily trading volume for U.S. equities traded on a nationally recognized securities exchange or NASDAQ which would be readily available from independent pricing sources or other independent sources which publish financial news and information.

The Department also invites comments from interested persons as to whether Index Funds and Model-Driven Funds may hold significant amounts of the outstanding shares of a particular security which is included in an index used by a manager to design and operate a portfolio for its Funds. In addition, the Department invites comments as to whether cross-trades of securities by a manager's Funds, which may represent a high percentage of the average daily trading volume for the securities on the open market, avoids the market impact that the same trades would have if executed on the open market.

C. Triggering Events

Section II(b) of the proposed exemption requires that any purchase or sale of securities by a Fund in a cross-trade with another Fund or with a Large Account occur as a direct result of a "triggering event," as defined in section

IV(d), and that such cross-trade be executed no later than the close of the second business day following such "triggering event." The Department believes that trading pursuant to triggering events limits the discretion of the manager to affect the identity or amount of securities to be purchased or sold. Triggering events, as defined in section IV(d), are outside the control of the manager and will "automatically" cause the buy or sell decision to occur.

Triggering events are defined in section IV(d) as:

- (1) a change in the composition or weighting of the index underlying the Fund by the independent organization creating and maintaining the index;
- (2) A specific amount of net change in the overall level of assets in a Fund, as a result of investments in and withdrawals from the Fund, provided that: (A) Such specified amount has been disclosed in writing as a "triggering event" to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days after, its inclusion as a "triggering event" for such Fund; and (B) investments or withdrawals as a result of the manager's discretion to invest or withdraw assets of an employee benefit plan maintained by the manager for its own employees (a Manager Plan), other than a Manager Plan which is a defined contribution plan under which participants direct the investment of their accounts among various investment options, including such Fund, will not be taken into account in determining the specified amount of net change;
- (3) An accumulation in the Fund of a specified amount of either: (A) Cash which is attributable to interest or dividends on, and/or tender offers for, portfolio securities; or (B) stock attributable to dividends on portfolio securities; provided that such specified amount has been disclosed in writing as a "triggering event" to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days after, its inclusion as a "triggering event" for such Fund; or
- (4) A change in the composition of the portfolio of a Model-Driven Fund mandated solely by operation of the formulae contained in the computer model underlying the Fund where the basic factors for making such changes (and any fixed frequency for operating the formulae contained in the model) have been disclosed in writing to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days after, its inclusion as a "triggering event" for such Fund.

The first three triggering events have largely been adopted based upon those triggering events utilized in prior individual exemptions, with an additional requirement in the second and third triggering events for the amounts involved to be specified and disclosed to independent fiduciaries of plans investing in the Funds. In addition, the last triggering event has been added to the proposal in order to clarify that a triggering event also occurs as a result of a change in the composition of a Fund's portfolio mandated solely by operation of the computer model underlying the Fund. For example, if a model contained a formula for a Fund requiring only stocks with a certain price/earnings ratio and some of the originally prescribed stocks now were above the specified tolerances of the formula relating to that model, a triggering event would occur requiring that those stocks be sold by the Fund. The Department has added this triggering event under this proposed exemption in order to clarify that certain Model-Driven Funds may need to buy or sell securities to conform to changes to the portfolio prescribed by the model that differ from changes to a portfolio necessitated as a result of changes to the underlying index. The proposed exemption does not require that a computer model be operated according to any fixed frequency, but, the Department is of the view that the proposed exemption would not be available unless the formulae contained in the computer model underlying a Fund are operated by the manager on an objective basis rather than being used for the purpose of creating cross-trade opportunities in response to the needs of other Funds or certain Large Accounts.

The Department further notes that under section II(l), disclosures must be made to independent plan fiduciaries regarding the triggering events that would create cross-trading opportunities for Funds under the manager's cross-trading program. Under the model-driven triggering event contained in the proposal, the basic factors for making changes in the composition of the portfolio of a Model-Driven Fund mandated solely by operation of the formulae contained in the computer model must be included in these disclosures.

Finally, the Department notes that if a computer model used to create a portfolio for a Model-Driven Fund is designed to exclude particular stocks for reasons specified by the plan client or the plan's investment guidelines, such exclusions would not be considered a separate triggering event.

D. Modifications to the Computer Model

Section II(c) requires that, if the model or the computer program used to generate the model underlying the Fund is changed by the manager, no cross-trades of any securities can be engaged in pursuant to the proposed exemption for ten (10) business days following the change. This restriction recognizes the authority of the manager to change assumptions involving computer models after the model's activation.

The Department notes that the proposed ten (10) business day "blackout" period for cross-trades by a Fund after any change made by the manager to the model underlying the Fund is intended to prevent model changes which might be made by managers, in part, to deliberately create additional cross-trading activity. The 10-day period is based on a condition contained in a prior individual exemption for cross-trading by Index and Model-Driven Funds (e.g., Section I(d) of PTE 95-56, regarding Mellon Bank, 60 FR 35933, July 12, 1995) as well as representations made by applicants in a number of exemption applications currently under consideration.¹²

However, the Department now understands that, in order to keep pace with the demands of investors in Model-Driven Funds, the industry changed many of its past practices which may now make a "10-day blackout period" for cross-trades problematic for certain Fund managers. For example, many Model-Driven Funds have more frequent opening dates for accepting new contributions from investors than in the past. In some cases, a Model-Driven Fund may be open for new contributions every day. In such instances, decisions regarding the implementation of a model change which would require the 10-day blackout period for cross-trades may place the manager in a situation of conflict between investors who wish to make contributions at different times.

Therefore, the Department specifically requests comments from interested persons as to whether the proposed 10-day blackout period for cross-trades would be an acceptable approach to address our concerns regarding model changes that may be timed to create additional cross-trading opportunities or whether there are other approaches which would be equally effective, but less burdensome, to the manager's

¹² These exemption applications are: D-9584, Wells Fargo Bank, N.A.; D-10107, Bankers Trust Company of New York; D-10188, Barclays Bank PLC and Affiliates; and D-10507, ANB Investment Management and Trust Company.

operation of the Fund. The Department also requests specific comments as to how frequently changes to a model are made.

In addition, under section IV(b), a computer model for a Model-Driven Fund must use independent third party data, not within the control of the manager, to transform an index.

E. Allocation of Cross-Trade Opportunities

The Department notes that frequently the amount of a security which all of the Funds need to buy may be less than the amount of such security which all of the Funds will need to sell, or vice versa. Thus, section II(d) of the proposed exemption requires that all cross-trade opportunities be allocated by the manager among potential buyers, or sellers, on an objective basis. Under section II(d), this basis for allocation must have been previously disclosed to independent fiduciaries on behalf of each plan investor, and must not permit the exercise of any discretion by the manager. In previous individual exemptions, applicants have relied on different systems (e.g. pro rata or queue) to objectively allocate cross-trade opportunities. While it appears to the Department that a pro rata basis of allocation would be the method least subject to scrutiny, the Department recognizes the validity of other workable objective systems. However, the Department cautions that such systems may not permit the exercise of discretion by the manager.

F. Disclosures and Authorizations

Section II(i) of the proposed exemption requires that a plan's participation in a cross-trade program of a manager will be subject to the prior written authorization of a plan fiduciary who is independent of the manager. This authorization, once given, would apply to all Funds that comprise the manager's cross-trading program at the time of the authorization. Thus, a new authorization by an independent plan fiduciary for investment in a different Fund, in which the plan did not invest at the time of its initial written authorization, would not be necessary to the extent that such Funds were part of the program at the time of the original authorization. However, where a manager makes new Funds available for plan investors or changes triggering events relating to Funds subject to the initial authorization, and such Funds or triggering events were not previously disclosed as being part of the manager's cross-trading program, section II(l) of the proposal requires that in such instances the manager furnish

additional disclosures to an independent plan fiduciary. The Manager shall provide a notice to each relevant independent plan fiduciary prior to, or within ten (10) days following, such addition of Funds or change to, or addition of, triggering events, which contains a description of such Fund(s) or triggering event(s). Such notice will also include a statement that the plan has the right to terminate its participation in the cross-trading program and its investment in any Index Fund or Model-Driven Fund without penalty at any time, as soon as is necessary to effectuate the withdrawal in an orderly manner.

As noted below, section II(m) also requires that disclosures regarding any new Funds or triggering events be made as part of the notice required for a plan's annual re-authorization of its participation in the manager's cross-trading program, even though the plan receiving such notice has not invested in such new Funds.

Section II(j) clarifies the meaning of Section II(i) with respect to existing plan investors in any of the Funds prior to a manager's implementation of a cross-trading program. Under section II(j), the authorizing independent fiduciary must be furnished notice and an opportunity to object to that plan's participation in the program not less than forty-five (45) days prior to the implementation of the cross-trade program. Section II(j) further states that the failure of the authorizing fiduciary to return a special termination form provided in the notice within thirty (30) days of receipt shall be deemed to be approval of the plan's participation in the program. If the authorizing plan fiduciary objects to the plan's inclusion in the program, the plan will be given the opportunity to withdraw without penalty prior to the program's implementation.

Sections II(k) and II(l) describe the type of information that is required to be disclosed to a plan fiduciary prior to the authorization defined in sections II(i) and II(j). Important among these disclosures is a statement describing the conflicts that will exist as a result of the manager's cross-trading activities. This statement must also detail and explain how the manager's practices and procedures will mitigate such conflicts. Such writing must include a statement that:

Investment decisions will not be based in whole or in part by the manager on the availability of cross-trade opportunities. These investment decisions include:

- Which securities to buy or sell;

- How much of each security to buy or sell; and,
- When to execute a sale or purchase of each security.

Investment decisions will be made prior to the identification and determination of any cross-trade opportunities. In addition, all cross-trades by a Fund will be based solely upon triggering events set forth in the exemption. Records documenting each cross-trade transaction will be retained by the manager.

Section II(m) further requires that notice be provided to the authorizing plan fiduciary at least annually of the plan's right to terminate its participation in the cross-trading program and its investment in any of the Funds without penalty. Such notice must be accompanied by a special termination form. Failure to return the form (within at least thirty (30) days of the receipt) will be deemed approval of the plan's continued participation in the cross-trading program. Such annual re-authorization will contain disclosures regarding any new Funds that are added to the cross-trading program or any new "triggering events" (as defined in Section IV(d) below) that may have been added to existing Funds since the time of the initial authorization described in Section II(i), or the time of the notice described in Section II(j).

Section II(n) of the proposed exemption details specific requirements for cross-trades of securities which will occur in connection with a Large Account restructuring. In particular, section II(n)(2) requires that the authorization for such cross-trades must be made in writing prior to the cross-trade transactions by fiduciaries of the Large Account who are independent of the manager. Such authorization must follow full written disclosure of information regarding the cross-trading program. Such authorization may be terminated at will upon receipt by the manager of written notice of termination. A termination form must be supplied to the Large Account fiduciary concurrent with the written description of the cross-trading program. Under section II(n)(3), the portfolio restructuring program must be completed within thirty (30) days of the initial authorization made by the Large Account's fiduciary (or initial receipt of assets associated with the restructuring, if later), unless the Large Account's fiduciary agrees in writing to extend this period for another thirty (30) days. Large Account fiduciaries may utilize the termination form or any other written instrument at any time within this 30-day period to terminate their prior written authorization for cross-trading

related to the portfolio restructuring program. Under section II(n)(4), within thirty (30) days of the completion of the restructuring program, the Large Account fiduciary must be fully apprised in writing of the results of the transactions. Such writing may include, upon request by the Large Account fiduciary, additional information sufficient to allow the independent fiduciary for the Large Account to verify the need for each cross-trade and the determination of the above decisions. However, the manager may refuse to disclose to a Large Account fiduciary or other person any such information which is deemed confidential or privileged if the manager is otherwise permitted by law to withhold such information from such person and, by the close of the thirtieth (30th) day following the request, the manager gives a written notice to such person advising that person both the reasons for the refusal and that the Department may request such information.

G. Recordkeeping

Section III(a) requires that the manager maintain records necessary to allow a determination of whether the conditions of the proposed exemption have been met. These records must be maintained for a period of six (6) years from the date of the transactions. These records must include records which identify the following:

- (1) On a Fund by Fund basis, the specific triggering events which result in the creation of the model prescribed output or trade list of specific securities to be cross-traded;
- (2) On a Fund by Fund basis, the model prescribed output or trade list which describes: (A) Which securities to buy or sell; (B) how much of each security to buy or sell in detail sufficient to allow an independent plan fiduciary to verify that each of the above decisions for the Fund was made in response to specific triggering events; and
- (3) On a Fund by Fund basis, the actual trades executed by the Fund on a particular day and which of those trades were associated with triggering events.

As explained to the Department, the triggering event relating to net investments in, or withdrawals from, a Fund results in new cash to invest in the Fund or the need to liquidate securities from a Fund. The model or index underlying the Fund determines which securities to purchase or sell based on the amount of net investments or withdrawals. This process results in the creation of a trade list or a model prescribed output of securities to be

purchased or sold. The manager then applies its objective allocation system to the trade lists or model prescribed outputs used for other Funds participating in the cross-trade program to determine which particular cross-trades will occur between Funds. For those securities which cannot be cross-traded after application of the manager's allocation system, the necessary purchases and sales are made through other means.

In the view of the Department, records must be maintained of this cross-trading activity with enough specificity to allow an independent plan fiduciary to verify whether the safeguards of this exemption have been met. Section II(b) requires that any cross-trade of securities by a Fund occur as a direct result of a "triggering event" as defined in section IV(d) and is executed no later than the close of the second business day following such "triggering event." Among the records needed to verify that this condition has been satisfied, section III(a)(1) requires that, on a Fund by Fund basis, the manager maintain a record of the specific triggering events which result in the creation of the list of specific securities for the manager's cross-trading system. Section III(a)(2) further requires that, on a Fund by Fund basis, the manager maintain records of the model prescribed output or trade list, as well as the procedures utilized by the manager to determine which securities to buy or sell and how much of each security to buy or sell, in detail sufficient to allow an independent plan fiduciary to verify that each of the above decisions for the Fund was made in response to specific triggering events. As provided by section III(b)(2), if such material is viewed as a trade secret, or privileged or confidential, the manager may refuse to disclose such information if reasons for the refusal are given and the person is also notified that the Department of Labor may request such information.

This recordkeeping requirement is intended to assure that independent plan fiduciaries will be able to determine whether Funds and their underlying models or indexes operate consistently in following the input of triggering event information. The Department does not intend to prescribe a detailed list of records that are necessary to enable a determination of compliance with the exemption because the necessary records will depend on the nature of the Index or Model-Driven Funds involved and other factors. This information, however, should be kept in sufficient detail to enable a replication of specific historical events in order to satisfy an inquiry by persons identified

in section III(b)(1)(A). Section III(a)(3) requires that, on a Fund by Fund basis, records be maintained of the actual trades executed by the Fund on a particular day and which of those trades resulted from triggering events.

The Department recognizes that these requirements may require adjustments to a manager's record-keeping systems. Therefore, the Department seeks specific comments on these record-keeping requirements and any additional burdens that they may impose on Fund managers.

Further, Section III(a) requires that the records must be readily available to assure accessibility and maintained so that an independent fiduciary, or other persons identified in section III(b)(1)(A), may obtain them within a reasonable time. This requirement should permit the records to be retrieved and assembled quickly, regardless of the location in which they are maintained. For those records which are not maintained electronically, the records should be maintained in a central location to facilitate assembly and examination.

All records must be unconditionally available at their customary location for examination during normal business hours by the persons described in section III(b)(1). However, as noted with respect to information which may be disclosed to a Large Account fiduciary or other person, the manager may refuse to disclose to a person, other than a duly authorized employee or representative of the Department or the Internal Revenue Service, any such information which is deemed confidential or privileged if the manager is otherwise permitted by law to withhold such information from such person. In such instances, the manager shall provide, by the close of the thirtieth (30th) day following the request, a written notice to such person advising that person of the reasons for the refusal and that the Department may request such information.

H. Effect on Existing Exemptions

The proposed exemption is generally similar to a number of individual exemptions that previously have been granted by the Department for such transactions.¹³ However, the operative

¹³ The following individual exemptions involve cross-trades of securities by Index and Model-Driven Funds: PTE 95-56, Mellon Bank, N.A. (60 FR 35933, July 12, 1995); PTE 94-47, Bank of America National Trust and Savings Association (59 FR 32021, June 21, 1994); PTE 94-43, Fidelity Management Trust Company (59 FR 30041, June 10, 1994); PTE 94-36, The Northern Trust Company (59 FR 19249, April 22, 1994); PTE 92-11, Wells Fargo Bank, N.A. (57 FR 7801, March 4, 1992)—which replaced PTE 87-51 noted below; PTE 89-9, State

language of the proposal differs from that of the individual exemptions in a number of respects. For example, the proposal under section II(h) prohibits the cross-trade of any securities issued by the manager, unless the manager has obtained a separate prohibited transaction exemption for the acquisition of such securities by its Index and Model-Driven Funds. A number of prior individual exemptions allow such transactions in order to eliminate potential tracking error of the Fund associated with replicating the rate of return, risk profile and other characteristics of the index containing the manager's securities. The Department invites comments as to the effect that the continuation of current Index and Model-Driven Fund individual exemptions would have in offering an advantage to those investment managers granted such relief compared to those managers which would utilize this exemption, if granted. Finally, the Department is aware that a number of individuals have expressed concern regarding whether the Department would revoke past individual exemptions involving Index and Model-Driven Fund cross-trading programs in connection with the granting of this class exemption. The Department notes that under the Prohibited Transaction Exemption Procedures, 29 CFR Section 2570.50(b), before revoking or modifying an exemption, the Department must publish a notice of its proposed action in the **Federal Register** and provide interested persons with an opportunity to comment on the proposed revocation or modification.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act which require, among other things, that a fiduciary discharge his duties with respect to the plan solely in the interests of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the

Street Bank and Trust Company (54 FR 8018, February 24, 1989); and PTE 87-51, Wells Fargo Bank, N.A. (52 FR 22558, June 12, 1987).

requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) Before an exemption may be granted under section 408(a) of the Act and section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interests of the plans and their participants and beneficiaries and protective of the rights of participants and beneficiaries of such plans;

(3) If granted, the proposed exemption will be applicable to a transaction only if the conditions specified in the exemption are met; and

(4) The proposed exemption, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Written Comments and Hearing Requests

All interested persons are invited to submit written comments or requests for a public hearing on the proposed exemption to the address and within the time period set forth above. All comments will be made a part of the record. Comments and requests for a hearing should state the reasons for the writer's interest in the proposed exemption. Comments received will be available for public inspection with the referenced application at the above address.

Proposed Exemption

The Department has under consideration the grant of the following class exemption under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, 32847, August 10, 1990).

Section I—Exemption for Cross-Trading of Securities by Index and/or Model-Driven Funds

Effective [date of publication of final class exemption], the restrictions of sections 406(a)(1)(A) and 406(b)(2) of the Act, section 8477(c)(2)(B) of FERSA, and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) of the Code, shall not apply to:

(a) The purchase and sale of securities between an Index Fund or a Model-

Driven Fund (a "Fund"), as defined in Sections IV(a) and (b) below, and another Fund, at least one of which holds "plan assets" subject to the Act or FERSA; or

(b) The purchase and sale of securities between a Fund and a Large Account, as defined in Section IV(e) below, at least one of which holds "plan assets" subject to the Act or FERSA, pursuant to a portfolio restructuring program, as defined in Section IV(f) below, of the Large Account;

provided that, with respect to all such purchases and sales (referred to herein as "cross-trades"), the conditions set forth in Sections II and III below are met.

Section II—Specific Conditions

(a) The cross-trade is executed at the closing price, as defined in Section IV(h) below.

(b) Any cross-trade of securities by a Fund occurs as a direct result of a "triggering event," as defined in Section IV(d) below, and is executed no later than the close of the second business day following such "triggering event."

(c) If the cross-trade involves a Model-Driven Fund, the cross-trade does not take place within ten (10) business days following any change made by the Manager to the model underlying the Fund.

(d) The Manager has allocated the opportunity for all Funds or Large Accounts to engage in the cross-trade on an objective basis which has been previously disclosed to the authorizing fiduciaries of plan investors, and which does not permit the exercise of discretion by the Manager (e.g., a pro rata allocation system).

(e) No more than ten (10) percent of the assets of the Fund or Large Account at the time of the cross-trade are comprised of assets of employee benefit plans maintained by the Manager for its own employees (Manager Plans) for which the Manager exercises investment discretion.

(f)(1) Cross-trades of equity securities involve only securities that are widely-held, actively-traded, and for which market quotations are readily available from independent sources that are engaged in the ordinary course of business of providing financial news and pricing information to institutional investors and/or the general public, and are widely recognized as accurate and reliable sources for such information. For purposes of this requirement, the terms "widely-held" and "actively-traded" shall be deemed to include any security listed in an Index, as defined in Section IV(c) below; and

(2) Cross-trades of fixed-income securities involve only securities for which market quotations are readily available from independent sources that are engaged in the ordinary course of business of providing financial news and pricing information to institutional investors and/or the general public, and are widely recognized as accurate and reliable sources for such information.

(g) The Manager receives no brokerage fees or commissions as a result of the cross-trade.

(h) The cross-trade does not involve any security issued by the Manager unless the Manager has obtained a separate prohibited transaction exemption for the acquisition of such security.

(i) As of the date the proposed exemption is granted, a plan's participation in the Manager's cross-trading program as a result of investments made in any Index or Model-Driven Fund that holds plan assets is subject to a written authorization executed in advance of such investment by a fiduciary of the plan which is independent of the Manager engaging in the cross-trade transactions.

(j) With respect to existing plan investors in any Index or Model-Driven Fund as of the date the proposed exemption is granted, the independent fiduciary is furnished with a written notice, not less than forty-five (45) days prior to the implementation of the cross-trading program, that describes the Fund's participation in the Manager's cross-trading program, provided that:

(1) Such notice allows each plan an opportunity to object to the plan's participation in the cross-trading program as a Fund investor by providing the plan with a special termination form;

(2) The notice instructs the independent plan fiduciary that failure to return the termination form to the Manager by a specified date (which shall be at least 30 days following the plan's receipt of the form) shall be deemed to be an approval by the plan of its participation in the Manager's cross-trading program as a Fund investor; and

(3) If the independent plan fiduciary objects to the plan's participation in the cross-trading program as a Fund investor by returning the termination form to the Manager by the specified date, the plan is given the opportunity to withdraw from each Index or Model-Driven Fund without penalty prior to the implementation of the cross-trading program, within such time as may be reasonably necessary to effectuate the withdrawal in an orderly manner.

(k) Prior to obtaining the authorization described in Section II(i), and in the notice described in Section II(j), the following statement must be provided by the Manager to the independent plan fiduciary:

Investment decisions for the Fund (including decisions regarding which securities to buy or sell, how much of a security to buy or sell, and when to execute a sale or purchase of securities for the Fund) will not be based in whole or in part by the Manager on the availability of cross-trade opportunities and will be made prior to the identification and determination of any cross-trade opportunities. In addition, all cross-trades by a Fund will be based solely upon a "triggering event" set forth in this exemption. Records documenting each cross-trade transaction will be retained by the Manager.

(l) Prior to any authorization set forth in Section II(i), and at the time of any notice described in Section II(j) above, the independent plan fiduciary must be furnished with any reasonably available information necessary for the fiduciary to determine whether the authorization should be given, including (but not limited to) a copy of this exemption, an explanation of how the authorization may be terminated, detailed disclosure of the procedures to be implemented under the Manager's cross-trading practices (including the "triggering events" that will create the cross-trading opportunities, the independent pricing services that will be used by the manager to price the cross-traded securities, and the methods that will be used for determining closing price), and any other reasonably available information regarding the matter that the authorizing fiduciary requests. The independent plan fiduciary must also be provided with a statement that the Manager will have a potentially conflicting division of loyalties and responsibilities to the parties to any cross-trade transaction and must explain how the Manager's cross-trading practices and procedures will mitigate such conflicts.

With respect to Funds that are added to the Manager's cross-trading program or changes to, or additions of, triggering events regarding Funds, following the authorizations described in section II(i) or section II(j), the Manager shall provide a notice to each relevant independent plan fiduciary prior to, or within ten (10) days following such addition of Funds or change to, or addition of, triggering events, which contains a description of such Fund(s) or triggering event(s). Such notice will also include a statement that the plan

has the right to terminate its participation in the cross-trading program and its investment in any Index Fund or Model-Driven Fund without penalty at any time, as soon as is necessary to effectuate the withdrawal in an orderly manner.

(m) At least annually, the Manager notifies the independent fiduciary for each plan that has previously authorized participation in the Manager's cross-trading program as a Fund investor, that the plan has the right to terminate its participation in the cross-trading program and its investment in any Index Fund or Model-Driven Fund without penalty at any time, as soon as is necessary to effectuate the withdrawal in an orderly manner. This notice shall also provide each independent plan fiduciary with a special termination form and instruct the fiduciary that failure to return the form to the Manager by a specified date (which shall be at least thirty (30) days following the plan's receipt of the form) shall be deemed an approval of the subject plan's continued participation in the cross-trading program as a Fund investor. Such annual re-authorization must contain disclosures regarding any new Funds that are added to the cross-trading program or any new triggering events (as defined in Section IV(d) below) that may have been added to existing Funds since the time of the initial authorization described in Section II(i), or the time of the notice described in Section II(j).

(n) With respect to a cross-trade involving a Large Account:

(1) The cross-trade is executed in connection with a portfolio restructuring program, as defined in Section IV(f) below, with respect to all or a portion of the Large Account's investments which an independent fiduciary of the Large Account has authorized the Manager to carry out or to act as a "trading adviser," as defined in Section IV(g) below, in carrying out a Large Account-initiated liquidation or restructuring of its portfolio;

(2) Prior to the cross-trade, a fiduciary of the Large Account who is independent of the Manager has been fully informed of the Manager's cross-trading program, has been provided with the information required in Section II(l), and has provided the Manager with advance written authorization to engage in cross-trading in connection with the restructuring, provided that—

(A) Such authorization may be terminated at will by the Large Account upon receipt by the Manager of written notice of termination.

(B) A form expressly providing an election to terminate the authorization,

with instructions on the use of the form, is supplied to the authorizing Large Account fiduciary concurrent with the receipt of the written information describing the cross-trading program. The instructions for such form must specify that the authorization may be terminated at will by the Large Account, without penalty to the Large Account, upon receipt by the Manager of written notice from the authorizing Large Account fiduciary;

(3) The portfolio restructuring program must be completed by the Manager within thirty (30) days of the initial authorization (or initial receipt of assets associated with the restructuring, if later) to engage in such restructuring by the Large Account's independent fiduciary, unless such fiduciary agrees in writing to extend this period for another thirty (30) days; and,

(4) No later than thirty (30) days following the completion of the Large Account's portfolio restructuring program, the Large Account's independent fiduciary must be fully apprised in writing of all cross-trades executed in connection with the restructuring. Such writing shall include a notice that the Large Account's independent fiduciary may obtain, upon request, the information described in Section III(a), subject to the limitations described in Section III(b). However, if the program takes longer than thirty (30) days to complete, interim reports containing the transaction results must be provided to the Large Account fiduciary no later than fifteen (15) days following the end of each thirty (30) day period.

Section III—General Conditions

(a) The Manager maintains or causes to be maintained for a period of six (6) years from the date of each cross-trade the records necessary to enable the persons described in paragraph (b) of this Section to determine whether the conditions of the exemption have been met, including records which identify:

(1) On a Fund by Fund basis, the specific triggering events which result in the creation of the model prescribed output or trade list of specific securities to be cross-traded;

(2) On a Fund by Fund basis, the model prescribed output or trade list which describes: (A) which securities to buy or sell; and (B) how much of each security to buy or sell; in detail sufficient to allow an independent plan fiduciary to verify that each of the above decisions for the Fund was made in response to specific triggering events; and

(3) On a Fund by Fund basis, the actual trades executed by the Fund on

a particular day and which of those trades resulted from triggering events.

Such records must be readily available to assure accessibility and maintained so that an independent fiduciary, or other persons identified below in paragraph (b) of this Section, may obtain them within a reasonable period of time. However, a prohibited transaction will not be considered to have occurred if, due to circumstances beyond the control of the Manager, the records are lost or destroyed prior to the end of the six-year period, and no party in interest other than the Manager shall be subject to the civil penalty that may be assessed under section 502(i) of the Act or to the taxes imposed by sections 4975(a) and (b) of the Code if the records are not maintained or are not available for examination as required by paragraph (b) below.

(b)(1) Except as provided in paragraph (b)(2) and notwithstanding any provisions of sections 504(a)(2) and (b) of the Act, the records referred to in paragraph (a) of this Section are unconditionally available at their customary location for examination during normal business hours by—

(A) Any duly authorized employee or representative of the Department of Labor or the Internal Revenue Service,

(B) Any fiduciary of a Plan participating in a cross-trading program who has the authority to acquire or dispose of the assets of the Plan, or any duly authorized employee or representative of such fiduciary,

(C) Any contributing employer with respect to any Plan participating in a cross-trading program or any duly authorized employee or representative of such employer, and

(D) Any participant or beneficiary of any Plan participating in a cross-trading program, or any duly authorized employee or representative of such participant or beneficiary.

(2) If in the course of seeking to inspect records maintained by a Manager pursuant to this exemption, any person described in paragraph (b)(1)(B) through (D) seeks to examine trade secrets, or commercial or financial information of the Manager that is privileged or confidential, and the Manager is otherwise permitted by law to withhold such information from such person, the Manager may refuse to disclose such information provided that, by the close of the thirtieth (30th) day following the request, the Manager gives a written notice to such person advising the person of the reasons for the refusal and that the Department of Labor may request such information.

(3) The information required to be disclosed to persons described in

paragraph (b)(1)(B) through (D) shall be limited to information that pertains to cross-trades involving a Fund or Large Account in which they have an interest.

Section IV—Definitions

The following definitions apply for purposes of this proposed exemption:

(a) *Index Fund*—Any investment fund, account or portfolio sponsored, maintained, trustee, or managed by the Manager or an Affiliate, in which one or more investors invest, and—

(1) Which is designed to track the rate of return, risk profile and other characteristics of an independently maintained securities index, as defined in Section IV(c) below, by either (i) replicating the same combination of securities which compose such index or (ii) sampling the securities which compose such index based on objective criteria and data;

(2) For which the Manager does not use its discretion, or data within its control, to affect the identity or amount of securities to be purchased or sold;

(3) That either contains “plan assets” subject to the Act, is an investment company registered under the Investment Company Act of 1940, or is an institutional investor, which may include, but not be limited to, such entities as an insurance company separate account or general account, a governmental plan, a university endowment fund, a charitable foundation fund, a trust or other fund which is exempt from taxation under section 501(a) of the Code; and

(4) That involves no agreement, arrangement, or understanding regarding the design or operation of the Fund which is intended to benefit the Manager, its Affiliates, or any party in which the Manager or an Affiliate may have an interest.

(b) *Model-Driven Fund*—Any investment fund, account or portfolio sponsored, maintained, trustee, or managed by the Manager or an Affiliate, in which one or more investors invest, and—

(1) Which is composed of securities the identity of which and the amount of which are selected by a computer model that is based on prescribed objective criteria using independent third party data, not within the control of the Manager, to transform an Index, as defined in Section IV(c) below;

(2) Which either contains “plan assets” subject to the Act, is an investment company registered under the Investment Company Act of 1940, or is an institutional investor, which may include, but not be limited to, such entities as an insurance company separate account or general account, a

governmental plan, a university endowment fund, a charitable foundation fund, a trust or other fund which is exempt from taxation under section 501(a) of the Code; and

(3) That involves no agreement, arrangement, or understanding regarding the design or operation of the Fund or the utilization of any specific objective criteria which is intended to benefit the Manager, its Affiliates, or any party in which the Manager or an Affiliate may have an interest.

(c) *Index*—A securities index that represents the investment performance of a specific segment of the public market for equity or debt securities in the United States and/or foreign countries, but only if—

(1) The organization creating and maintaining the index is—

(A) Engaged in the business of providing financial information, evaluation, advice or securities brokerage services to institutional clients,

(B) A publisher of financial news or information, or

(C) A public stock exchange or association of securities dealers; and,

(2) The index is created and maintained by an organization independent of the Manager, as defined in Section IV(i) below; and,

(3) The index is a generally accepted standardized index of securities which is not specifically tailored for the use of the Manager.

(d) *Triggering Event*:

(1) A change in the composition or weighting of the Index underlying a Fund by the independent organization creating and maintaining the Index;

(2) A specific amount of net change in the overall level of assets in a Fund, as a result of investments in and withdrawals from the Fund, provided that: (A) Such specified amount has been disclosed in writing as a “triggering event” to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days following, its inclusion as a “triggering event” for such Fund; and (B) investments or withdrawals as a result of the manager’s discretion to invest or withdraw assets of a Manager Plan, other than a Manager Plan which is a defined contribution plan under which participants direct the investment of their accounts among various investment options, including such Fund, will not be taken into account in determining the specified amount of net change;

(3) An accumulation in the Fund of a specified amount of either:

(A) cash which is attributable to interest or dividends on, and/or tender offers for, portfolio securities; or

(B) Stock attributable to dividends on portfolio securities;

provided that such specified amount has been disclosed in writing as a "triggering event" to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days after, its inclusion as a "triggering event" for such Fund; or

(4) A change in the composition of the portfolio of a Model-Driven Fund mandated solely by operation of the formulae contained in the computer model underlying the Fund where the basic factors for making such changes (and any fixed frequency for operating the computer model) have been disclosed in writing to an independent fiduciary of each plan having assets held in the Fund prior to, or within ten (10) days after, its inclusion as a "triggering event" for such Fund.

(e) *Large Account*—Any investment fund, account or portfolio that is not an Index Fund or a Model-Driven Fund sponsored, maintained, trustee or managed by the Manager, which holds assets of either:

(1) An employee benefit plan within the meaning of section 3(3) of the Act that has \$50 million or more in total assets;

(2) An institutional investor that has total assets in excess of \$50 million, such as an insurance company separate account or general account, a governmental plan, a university endowment fund, a charitable foundation fund, a trust or other fund which is exempt from taxation under section 501(a) of the Code; or

(3) An investment company registered under the Investment Company Act of 1940 (e.g., a mutual fund) other than an investment company advised or sponsored by the Manager;

provided that the Manager has been authorized to restructure all or a portion of the portfolio for such Large Account or to act as a "trading adviser" (as defined in Section IV(g) below) in connection with a specific liquidation or restructuring program for the Large Account.

(f) *Portfolio restructuring program*—Buying and selling the securities on behalf of a Large Account in order to produce a portfolio of securities which will be an Index Fund or a Model-Driven Fund managed by the Manager, without regard to the requirements of Section IV(a)(3) or (b)(2), or to carry out a liquidation of a specified portfolio of securities for the Large Account.

(g) *Trading adviser*—A person whose role is limited with respect to a Large

Account to the disposition of a securities portfolio in connection with a Large Account-initiated liquidation or restructuring within a stated period of time in order to minimize transaction costs. The person does not have discretionary authority or control with respect to any underlying asset allocation, restructuring or liquidation decisions for the account in connection with such transactions and does not render investment advice [within the meaning of 29 CFR § 2510.3-21(c)] with respect to such transactions.

(h) *Closing price*—The price for a security on the date of the transaction, as determined by objective procedures disclosed to Fund investors in advance and consistently applied with respect to securities traded in the same market, which procedures shall indicate the independent pricing source (and alternates, if the designated pricing source is unavailable) used to establish the closing price and the time frame after the close of the market in which the closing price will be determined.

(i) *Manager*—A person who is:

(1) A bank or trust company, or any Affiliate thereof, as defined in Section IV(j) below, which is supervised by a state or federal agency; or

(2) An investment adviser or any Affiliate thereof, as defined in Section IV(j) below, which is registered under the Investment Advisers Act of 1940.

(j) *Affiliate*—An "affiliate" of a Manager includes:

(1) Any person, directly or indirectly, through one or more intermediaries, controlling, controlled by or under common control with the person;

(2) Any officer, director, employee or relative of such person, or partner of any such person; and

(3) Any corporation or partnership of which such person is an officer, director, partner or employee.

(k) *Control*—The power to exercise a controlling influence over the management or policies of a person other than an individual.

(l) *Relative*—A "relative" is a person that is defined in section 3(15) of the Act (or a "member of the family" as that term is defined in section 4975(e)(6) of the Code), or a brother, a sister, or a spouse of a brother or a sister.

Signed at Washington, D.C., this 9th day of December, 1999.

Alan D. Lebowitz,

Deputy Assistant Secretary for Program Operations, Pension and Welfare Benefits Administration, U.S. Department of Labor.

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DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

Cross-Trades of Securities by Investment Managers

AGENCY: Pension and Welfare Benefits Administration, Labor.

ACTION: Notice of hearing.

SUMMARY: This document provides notice of a public hearing regarding standards and safeguards upon which exemptive relief should be conditioned for cross-trades of securities by investment managers with respect to any account, portfolio or fund holding "plan assets" subject to the fiduciary responsibility provisions of Part 4 of Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA). The public hearing will focus primarily on the area of "active" cross-trading of securities by investment managers. The Department is also publishing today in the **Federal Register** a Notice of Proposed Class Exemption relating to cross-trades of securities by "passively" managed funds.

DATES: The hearing will be held on February 10, 2000, and on February 11th if necessary, beginning at 10 a.m. and ending at 4 p.m. each day.

ADDRESSES: The hearing will be held in Room N-5437, of the Department of Labor Building, 200 Constitution Avenue, NW, Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: Louis J. Campagna or E.F. Williams, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N-5649, 200 Constitution Avenue, NW, Washington, DC, 20210, (202) 219-8883 or 219-8194, respectively (these are not toll free numbers); or Michael Schloss, Plan Benefits Security Division, Office of Solicitor, (202) 219-4600, ext. 105 (not a toll-free number).

SUPPLEMENTARY INFORMATION: On March 20, 1998, the Department of Labor (the Department) published a notice (the Notice) in the **Federal Register** (63 FR 13696) requesting information to assist it in determining upon what standards and safeguards exemptive relief for cross-trades by investment managers should be conditioned. In that Notice, the Department invited all interested persons to submit written comments concerning its request for information on or before May 19, 1998. The Department received a total of 29 written comments on the Notice, many