DechertOnPoint

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A legal update from Dechert's Employee Benefits and Executive Compensation and Financial Services Groups

DOL Issues Guidelines Under New ERISA Cross-Trading Exemption

The U.S. Department of Labor (DOL) has published an "interim" final regulation under the prohibited transaction exemption for cross-trades involving ERISA accounts.[1] The exemption was added to ERISA by the Pension Protection Act of 2006 (the "Act").

The new cross-trading exemption in ERISA section 408(b)(19)[2] allows cross-trades between ERISA accounts and other accounts managed by the same investment manager if certain conditions are satisfied, including the adoption of written cross-trading policies and procedures. The Act required the DOL to issue regulations regarding the content of such policies and procedures. The DOL's publication addresses the content of these policies but it does not address other interpretive issues raised by the exemption.

Under the new regulation, the investment manager's written cross-trading policies must include:

- A description of the criteria which will be applied by the manager in determining that the execution of the transaction as a cross-trade will be beneficial to both parties to the transaction
- A description of how the manager will determine that the cross-trades are effected at the "independent current market price" of the security, within the meaning of Rule 17a-7(b) under the Investment Company Act, including the identity of sources used to establish the prices
- A description of the procedures for insuring compliance with the requirement that each plan participating in the cross-trade have a minimum asset size of $100 million
- A description of how the manager will mitigate potential conflicts in its responsibilities to the parties involved in the cross-trade transaction
- A requirement that the manager allocate cross-trades among accounts in an objective and equitable manner and a description of the allocation method(s) that will be used by the manager (DOL states that it understands managers may rely on different systems, e.g., pro rata or queue systems, to allocate cross trading opportunities; the regulation requires that the procedures describe the circumstances that will dictate which methodology will be used if this is the case)
- The identity of the compliance officer responsible for reviewing the manager's compliance with its cross-trading policies and procedures (and the compliance officer's qualifications)
- A description of the scope of review to be conducted by the compliance

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1 29 C.F.R. 2550.408b-19, 72 FR 6473 (February 12, 2007).

2 A parallel exemption was added also to the Internal Revenue Code of 1986, as amended, at Section 4975(d)(22).

- officer; that is, whether the officer's review is limited to compliance with the manager's written policies and procedures or overall compliance with the statutory cross-trading exemption

Although styled as a interim final rule, DOL invites comments; the comment period on this rule expires on April 13, 2007. The DOL specifically requests comments on whether the scope of the compliance officer's responsibilities under the regulation should be expanded to encompass compliance with all of the requirements of the statutory exemption, and requests information regarding the current practices of compliance officers in determining compliance with applicable statutory or administrative exemptions under ERISA.

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