

**Securities Industry Association**

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Pension and Welfare Benefits Administration
Office of Exemption Determinations
Room N-5649
200 Constitution Avenue, N.W.
Washington, D.C. 20210

RE: Cross Trades of Securities

Ladies and Gentlemen:

The Investment Adviser, Investment Company, Federal Regulation and Retirement Products and Estate Services Committees (the "Committees") of the Securities Industry Association¹ ("SIA") are pleased to submit these comments on the Notice published by the Pension and Welfare Benefits Administration of the Department of Labor regarding cross trades of securities by investment managers.² The Notice states that the Department has under consideration a number of individual exemptive applications relating to cross trades by investment managers with respect to accounts, portfolios or funds 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 Department requests information regarding the appropriate standards and safeguards for exemptive relief.

The SIA Committees support the Department's efforts to develop responsible, rational and efficient standards governing cross trades, and appreciate the opportunity to comment on the issues raised in the Notice.

Our comments specifically are addressed to cross trades for actively managed accounts. With regard to cross trades for index and model-driven accounts, we understand that other industry participants will submit letters addressing these more specialized situations.

Summary

As described in the Notice, there are two types of cross trades of securities at issue direct cross trades and brokered cross trades. Direct cross trades occur when an investment manager causes a purchase and sale to be made between two accounts under its management

without a broker acting as intermediary. Brokered cross trades occur when an investment manager, acting on behalf of two accounts under its management, places simultaneous purchase and sale orders for the same security with an independent broker-dealer, which effects a transaction in the open market between the buyer and the seller and which generally receives reduced commissions for the transaction.³ Each type of cross trade is regulated both under ERISA and the federal securities laws.

A number of individual exemptions have been granted by the Department for these types of transactions.⁴ The SIA Committees respectfully submit that certain conditions set forth in these individual exemptions are not necessary to protect the interests of plans and their beneficiaries, are unduly burdensome, and needlessly deny ERISA plans and their participants the benefits of cross trades that are available to other market participants. We believe that the interests of ERISA plans and plan beneficiaries would be better served by the Department's issuance of a class exemption permitting investment managers to effect these types of cross trades for ERISA plans, subject to protective conditions. In the alternative (or pending the issuance of a class exemption,) we recommend that the Department establish standards and conditions pursuant to which individual exemptions may be granted on a "fast track" basis, as in Prohibited Transaction Class Exemption 96-62.⁵

The proposal of the SIA Committees set forth in this submission fully addresses the concerns of the Department with regard to price and non-price conflicts potentially raised by cross trades. First, our proposal incorporates a number of conditions from PTE 86-128 and prior individual exemptions granted by the Department. Second, our proposal incorporates many of the conditions of Rule 17a-7 under the Investment Company Act of 1940 ("Investment Company Act"), which address both price and non-price conflicts potentially raised by cross trades. Third, we suggest that the Department limit relief to cross trades initiated by investment managers subject to the strict fiduciary standards of the Investment Advisers Act of 1940 ("Advisers Act") or comparable regulation.⁶ We believe that this additional oversight by the SEC and/or other regulators would serve as a potent complement to the Department's administration of the fiduciary standards of ERISA.

The SIA Committees urge the Department to eliminate conditions in prior individual exemptions that require (1) prior authorization of an independent fiduciary for each cross trade; (2) that the cross trade price be within ten percent of the previous day's closing price; and (3) that the cross trade generally involve less than five percent of the average aggregate trading volume for the security involved during the week preceding the trade. We submit that these requirements are unnecessarily restrictive and needlessly deprive plans and their participants of beneficial cross trading opportunities.

Finally, the SIA Committees note that both the Department and the U.S. Securities and Exchange Commission ("SEC") have a strong regulatory interest in cross trades. Although the objectives of the two systems of regulation with regard to these trades is very similar both seek to ensure the highest fiduciary standards the rules developed to govern cross trades differ. The SIA Committees urge the Department to work with the SEC to develop a coordinated and consistent approach to the regulation of cross trades. We believe that our proposal offers a workable framework in this regard.

Reasons for Engaging in Cross Trades

In the view of the SIA Committees, the two principal reasons that an investment manager seeks to engage in cross trades for its client accounts are (1) the opportunity to save both clients transaction costs and market maker spreads, and (2) the efficiencies gained by avoiding the uncertainties of tracking down counterparties and/or breaking down or assembling blocks of securities. The ability to engage in a cross trade eliminates the inefficiencies, administrative costs, and time involved in breaking up a block of securities in order for them to be absorbed by the market, while at the same time seeking to (re)assemble the same or similar block for another client account.

The Notice seems to suggest that a cross trade in most instances involves an individual portfolio manager making corresponding purchase and sale decisions for two accounts under his or her management. It is also common, however, for a cross trade to involve an investment management firm with a number of individual portfolio managers. Manager A enters a sell order for a client, while, at the same time, Manager B enters a buy order for the same security for a different client. Managers A and B may be unaware of each other's order. The firm's trading desk, however, will receive the two orders and observe the opportunity for a cross trade between the two client accounts. Whether a trade involves one or two portfolio managers, however, the trader often will consult with both the portfolio manager(s) and the firm's appropriate supervisory personnel to determine if the firm is permitted to engage in the cross trade, and to ensure that the trade is conducted in accordance with all applicable legal and regulatory requirements.

An investment manager, for a number of reasons, may find that it is necessary to reduce one client's holding of a particular security. For example, a sale may be necessary to keep the account in compliance with the client's investment guidelines or asset allocation requirements, due to changes in the market value of a portfolio holding, withdrawals from the account by the client, or changes in the client's investment guidelines or asset allocation requirements. At the same time, the manager may find that the account of another client is under-weighted in the same security, or that the security being sold is an ideal investment for a newly-formed account. The manager may place separate orders in the open market, one to sell securities for the first client, the other to buy securities for the second client. Both clients will pay separate commissions and other transaction costs on their separate transactions. Alternatively, the manager can reduce or eliminate commissions for both clients by "crossing" their trades. Where the market value of the security is readily obtainable and thus the transaction price unquestionably is fair to both clients, the manager understandably will want to save clients money by crossing the trades.

In the context of cross trading, the Department's current interpretations of Section 406(b)(2) of ERISA, which are designed to ensure that ERISA plans and their beneficiaries are not disadvantaged, often cause an opposite result. Investment managers are placed in the anomalous position of having to forego transactions that they believe would be in the best interests of a plan in order to avoid violating existing Department interpretations. We believe that these situations have become more common in recent years. Increasingly sophisticated technology both increases efficiencies in the markets and permits investment managers to identify a broader range of investment opportunities. Thus, we are concerned that the adverse impact of the Department's interpretations on plans and their participants are increasing and will continue to increase in years to come.

The SIA Committees also note that the Department's interpretations were developed at a time when the securities markets were much less transparent, when financial services firms were structured far differently, and when reporting, auditing and surveillance standards and technologies were much less comprehensive and sophisticated than they are today. For example, technology has contributed greatly to market transparency by providing literally instant access to current quote information as well as detailed price histories that enable customers and regulators to review the quality of execution. These technological developments reduce the likelihood of abuse, and facilitate detection should it occur.⁷ Moreover, in the event that an abuse occurs, recordkeeping and reporting requirements would facilitate detection and violations would remain actionable under other fiduciary provisions of ERISA, under the antifraud provisions of the federal securities laws, and at common law.

We submit that the interests of ERISA plans and their beneficiaries in today's fast-moving markets would be better served by permitting investment managers to engage in cross trades on behalf of plans under conditions designed to ensure that both parties to the transaction receive at least as good or better prices than those available in the open market. The benefits of such a change in Department policy clearly outweigh any remote potential for abuse. Issuance of a class exemption also would benefit plans by eliminating the time and lost opportunity costs incurred in seeking an individual exemption.

In sum, the securities markets have evolved significantly since ERISA was enacted in 1974. We respectfully submit that the interests of plans and their participants necessitates a reconsideration of the merits of the Department's historical approach to cross trades, and we applaud the Department's willingness to undertake that effort.

Class Exemptive Relief

The SIA Committees believe that the Department should grant class exemptive relief from the prohibitions of ERISA Section 406(b)(2) for direct or brokered cross trades between two discretionary client accounts of an investment fiduciary or an affiliate of the fiduciary where one or both of the accounts is an employee benefit plan (or holds plan assets) subject to ERISA. No relief is requested at this time for transactions under ERISA Section 406(b)(1) or (3), *i.e.*, for transactions carried out on a principal basis, or for which the party directing the transaction, or any affiliate thereof, may receive transaction-based compensation.⁸

As noted above, we believe that the Department may wish to consider limiting class exemptive relief to SEC-registered investment managers subject to the antifraud standards of the Advisers Act and to certain other investment managers.⁹ The SEC regulates investment advisers comprehensively pursuant to the Advisers Act. Investment advisers owe their customers the highest duty of trust and fair dealing and must place their customers' interests ahead of their own.¹⁰ All investment advisers are subject to Section 206 of the Advisers Act, which prohibits an investment adviser from engaging in any fraudulent, deceptive or manipulative conduct.¹¹ The SEC has interpreted Section 206 to prohibit a wide variety of unethical and fraudulent practices such as scalping, dumping, and misleading advertising that adversely affect an advisory client's best interests.

An investment adviser's ability to engage in cross trades on behalf of accounts under its management is subject to the antifraud proscriptions in Section 206. The SEC's administration

of Section 206 is supported by an active and visible compliance, examination and enforcement program. The SIA Committees note that the SEC's administration and enforcement efforts under the Advisers Act are directed at the same abuses described in the Notice. We therefore believe that SEC oversight would be a useful adjunct to the Department's enforcement of the rigorous fiduciary standards required by ERISA.

The SIA Committees also believe that Rule 17a-7 under the Investment Company Act provides appropriate standards that could be incorporated by the Department into a class exemption. Rule 17a-7 sets forth the conditions pursuant to which mutual funds under common management may engage in cross trades with each other or with another managed account of the fund's adviser without violating the Investment Company Act's strict prohibitions on affiliated transactions.¹² The conditions of the rule are designed to limit the exemption to those situations where the Commission, upon the basis of its experience, considers that there is no likelihood of overreaching of the investment companies participating in the transaction.¹³

In fashioning conditions designed to eliminate overreaching, the SEC mandated that transactions permitted by Rule 17a-7 be limited to securities for which market quotations are readily available and be effected at the independent current market price for the security involved.¹⁴ Rule 17a-7 also, among other things, mandates that (a) purchases and sales may not be for any consideration other than cash; (b) the transaction must be consistent with the policy of each investment company participating in the transaction as set forth in its registration statement and reports; (c) no brokerage commission, fee (except for customary transfer fees) or other remuneration may be paid in connection with the transaction; and (d) the board of directors of the investment company must adopt policies and procedures to ensure that the conditions of the rule are complied with, make and approve such changes as the board deems necessary to these policies and procedures, and review all transactions conducted in reliance on the rule on a quarterly basis. Moreover, the investment company must maintain permanently in an easily accessible place a copy of the policies and procedures adopted by the board and any changes made, and preserve for at least six years a written record of each transaction made in reliance on the rule.

The requirements of Rule 17a-7 thus comprehensively address potential price and non-price conflicts presented by cross trades between investment companies and between investment companies and other accounts with the same investment manager. The rigorous conditions in Rule 17a-7 are in addition to an adviser's obligations under Section 206 and other applicable fiduciary laws to act in its client's best interests, to obtain best price and execution, and to make appropriate disclosure. Compliance with Rule 17a-7 thus in no way diminishes an adviser's obligations as a fiduciary.

Based on the above and the Department's prior class and individual exemptions, the SIA Committees suggest that the following conditions in a class exemption would provide appropriate safeguards:

PTE 86-128 procedures. The SIA Committees propose that certain of the conditions of PTE 86-128 (relating to agency cross-trades where the manager has discretion only on one side) be incorporated into a class exemption. These conditions are:

- (1) The transaction is performed under a written authorization executed in advance

by a fiduciary of each plan involved in the transaction. This plan fiduciary must be independent of the manager directing the transaction.

(2) The authorization is terminable at will by the plan, upon receipt by the manager of written notice of termination.

(3) A form providing an election to terminate the authorization, along with instructions as to the use of the form, must be supplied to the authorizing plan fiduciary at least annually.

(4) Within three months before an authorization is made, the authorizing fiduciary must be furnished with all available information that the manager seeking authorization reasonably believes to be necessary for the authorizing fiduciary to determine whether the authorization should be made, including the form for termination of authorization; a description of the manager's brokerage placement practices; and any other reasonably available information regarding the matter that the authorizing fiduciary requests.

(5) The manager directing the cross-trades must furnish the authorizing fiduciary with either:

- a confirmation slip for each cross-trade of securities within ten business days of the securities transaction; or
- at least once every three months, a report disclosing a compilation of the information that would have been provided to the plan if individual transaction confirmations had been delivered during the three-month period.

(6) The manager directing the cross-trades must furnish the authorizing fiduciary with a summary at least annually that identifies the total number of cross-trades during the period and includes a description of the manager's brokerage placement practices if such practices have materially changed during the period.

Valuation. The SIA Committees believe that the pricing requirements of paragraph (b) of Rule 17a-7 provide an appropriate means to ensure that the transaction price is fair and reasonable to both parties to the transaction and to minimize any conflict of interest in valuing the securities being traded. Use of Rule 17a-7 valuation procedures is appropriate for several reasons:

- (1) Its terms are objective and easily verified.
- (2) In many cases, the counterparty to a cross-trade may be an investment company subject to Rule 17a-7. Imposing different standards on a plan counterparty effectively may prevent cross-trading between such accounts, to the detriment of both.
- (3) The requirements of Rule 17a-7 that a sale take place at the "independent current market price" have worked well. Adoption of a different standard for ERISA plans will lead to confusion, duplication of records, and unnecessary administrative burdens.

Other. The following additional conditions generally are found in individual or generic cross-trade exemptions previously granted by the Department and also are set forth in Investment Company Act Rule 17a-7 or the Advisers Act:

- (1) Securities involved in a cross-trade must be those for which market quotations are readily available. [Rule 17a-7(a)] ¹⁵
- (2) The manager (or any affiliated broker) must not receive any commission in connection with the cross-trade. In the case of an affiliated broker, this condition would not preclude reimbursement for direct, out-of-pocket expenses, such as fees of unaffiliated clearing brokers. [Rule 17a-7(d)]
- (3) The manager must adopt a fair and objective system for allocating cross-trade opportunities among managed accounts. [Under Section 206 of the Advisers Act, all investment advisers must fairly allocate trades among client accounts.]
- (4) Records of all cross trades must be maintained for six years. [Rule 17a-7(f)]

The SIA Committees submit that the foregoing procedures and conditions would facilitate effective scrutiny by each plan's independent fiduciaries, the Department, the SEC, other applicable regulators, and the internal compliance staff and outside auditors of investment management firms. When combined with the oversight exerted by other regulators, these conditions will protect plans against the Department's concerns with respect to dumping, churning, and similar unlawful activities described in the Notice. In this respect, the SIA Committees note that, not only are these types of activities already illegal under the securities laws, but that SEC and other regulators' audit and enforcement policies focus heavily on uncovering these abuses.

Unnecessary Conditions of Previous Individual Exemptions. The Notice describes certain other conditions generally imposed in prior applications for individual exemptive relief:

Advance authorization for each trade. Generally, advance authorization for each transaction is impractical and adds relatively little protection over periodic reporting of transactions. Such a requirement would result in the loss of a significant percentage of cross-trading opportunities, to the direct detriment of affected plans. For example, the delay necessitated by a transaction-by-transaction consent may be unacceptable to the party on the other side of the transaction, which would result in a lost opportunity to the plan. Also, market conditions could change significantly between the time the investment manager seeks authorization and the time authorization is obtained, thus making the transaction less desirable for the plan. These issues may be further compounded in the case of a commingled investment fund holding "plan assets" of multiple employee benefit plans.

Volume limitations. Limiting cross-trading opportunities to those which involve less than 5 percent of the aggregate daily trading volume of a security for the week immediately preceding the authorization of the transaction eliminates a significant percentage of cross-trading opportunities. One of the chief benefits of cross-trading is to allow a manager to efficiently retain within its control institutional-size blocks of securities that otherwise would need to be broken and re-assembled. Such securities often are those that are traded in lower volumes and with less frequency.

Pricing Limits. A requirement that a cross trade take place at a price that is within ten percent of the closing price for the security on the day before the manager obtains authorization does not serve the interests of plans and their participants. The SIA Committees submit that in some circumstances, a change in excess of ten percent of the previous day's close may increase, rather than decrease, the desirability of the transaction. For the reasons discussed above, we believe that adherence to a "current market price" standard is preferable.

Wrap Fee and Certain Other Investment Programs

In developing class exemptive relief, the SIA Committees also urge the Department to confirm that its views are consistent with the views expressed by the SEC staff in Morgan, Lewis & Bockius LLP (pub. avail. April 16, 1997). This staff interpretive letter considered the application of Section 206(3) of the Advisers Act to securities transactions executed on behalf of clients participating in certain wrap fee and other investment advisory programs.

The letter involved registered broker-dealers that are also registered investment advisers ("Dual Registrants") that organize wrap fee and other investment programs. Under these programs, clients select a portfolio manager to manage their accounts, and the portfolio manager directs trades for these accounts to the Dual Registrant for execution. The portfolio manager is independent of the Dual Registrant and has sole discretionary authority to make specific investment decisions for the account. The Dual Registrant does not recommend, select or play any role, direct or indirect, in the portfolio manager's selection of securities to be purchased or sold on behalf of clients. The Dual Registrant may, however, assist the client in setting investment goals and risk tolerances and in selecting a portfolio manager, and may provide the client with periodic reviews of the manager's performance.

Under these circumstances, the SEC staff agreed that the Dual Registrant should not be deemed to be acting as an investment adviser with regard to specific trades for these clients. As noted by the staff, Section 206(3) expressly excludes transactions with a customer of a broker or dealer if the broker or dealer is not acting as an investment adviser "in relation to such transaction." (emphasis added) A copy of this SEC staff letter is enclosed.

The SIA Committees urge the Department to clarify that it interprets Section 406(b)(2) of ERISA in a manner consistent with these views of the SEC staff, and to incorporate this view into the class exemptive relief. We believe that whether the trades by such a Dual Registrant are executed on a principal or agency cross basis, the concerns that underlie Section 406(b)(2) clearly are not present.

Riskless Principal Transactions and PTE 86-128

On a related matter, the SIA Committees urge the Department to interpret PTE 86-128 to permit riskless principal transactions conducted in accordance with the conditions set forth in that class exemption.¹⁶ As noted earlier, PTE 86-128 permits agency cross trades where an investment manager has discretionary authority or renders investment advice with respect to only one side of a transaction. The SIA Committees believe that it would be in the best interest of plans if PTE 86-128 were interpreted or amended to permit riskless principal transactions under similar circumstances.

Riskless principal transactions are unlike other principal transactions because the broker-dealer does not execute the purchase or sale from the broker-dealer's own inventory. The "principal" nature of the transaction is purely technical in nature. The broker-dealer executes a customer order by engaging in simultaneous transactions after locating a counterparty in the open market. Because the broker-dealer bears no market risk, clients generally incur lower transaction costs. These transactions are similar in economic terms to agency transactions, because the broker-dealer involved simply facilitates execution between a buyer and a seller. As such, riskless principal transactions do not present the potential for abuse that may be presented by ordinary principal transactions. The broker-dealer's markup serves as the "commission" otherwise permitted by PTE 86-128.

The SIA Committees believe that plans would benefit if the Department permitted riskless principal transactions subject to the conditions in PTE 86-128. The inability to engage in riskless principal transactions on behalf of plans in reliance on PTE 86-128 forces investment managers to forego transactions that would benefit plans and results in higher transaction costs. These adverse consequences are not justified by any countervailing regulatory concern. We urge the Department to take appropriate action to correct this regulatory anomaly.

Conclusion

The proposed class exemption permitting cross trades involving ERISA plans subject to the strict conditions outlined above would be in the interest of plans and their participants and beneficiaries, and would allow transaction cost savings and additional efficiencies. The procedures and conditions that we suggest for the approval and oversight of an independent plan fiduciary and for pricing securities involved in cross trades would ensure that any cross trade covered by the exemption would be protective of the rights of plans and their participants. In addition, the interests of plans would be advanced if PTE 86-128 were interpreted to permit riskless principal transactions subject to the same conditions imposed on agency transactions.

We would be pleased to meet with the Department staff at any time to discuss the issues raised in this submission.

Respectfully Submitted,

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Footnotes:

¹ SIA is the trade association representing the shared interests of nearly 800 securities firms throughout North America. SIA members including investment banks, broker-dealers, specialists, and mutual fund companies are active in all markets and in all phases of corporate and public finance. Together, SIA members provide investors with a full spectrum of investment services; manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans; and account for \$270 billion of revenues in the U.S. economy. SIA members and their affiliates direct cross trades of securities between accounts under their management on both a direct and brokered basis, and also serve as brokers in cross trades directed by unrelated parties.

² 63 Fed. Reg. 13696 (March 20, 1998).

³ In some cases, cross trades may be directed to a broker-dealer affiliated with the investment manager. However, it is typical in such cases for the normal brokerage commissions to be waived or reimbursed. The SIA believes that these cross trades, for regulatory purposes and for purposes of the class exemptive relief requested in this submission, should be viewed as direct cross trades.

⁴ The Department also has granted a class exemption that provides relief for agency cross trades where an investment manager has discretion for, and/or provides investment advice to, either the buyer or the seller, but not both sides of a transaction. See PTE 86-128, 51 Fed. Reg. 41686 (November 18, 1986). PTE 86-128 thus allows plan brokerage to be transacted through an advisory affiliate or the adviser itself, subject to the conditions set forth in the class exemption.

⁵ 61 Fed. Reg. 39988 (July 31, 1996). For ease of reference, the requested relief will be referred to throughout the letter as a request for a class exemption.

⁶ For example, we believe that comparable protections may be provided by law and regulation applicable to banks, insurance companies, and state-registered advisers.

⁷ Abuse also is unlikely since an investment manager's success is dependent on achieving good performance for all client accounts. For example, under applicable SEC requirements and the performance presentation standards of the Association for Investment Management and Research, the performance of *all* client accounts must be included in one or more of the performance composites that the manager uses to promote its services. Individual account performance is closely watched by clients or their consultants, and clients do not hesitate to seek out other managers if account performance is poor. Thus, there are strong economic incentives for an investment manager never to seek to advantage one client account over

another.

⁸ Section 406(b)(1) prohibits a plan fiduciary from dealing with the assets of the plan in its own interest or for its own account. Section 406(b)(3) prohibits a plan fiduciary from receiving any consideration from any party in connection with a transaction involving assets of the plan. Because the prohibited transaction excise tax provisions of Internal Revenue Code Section 4975 do not contain a parallel to Section 406(b)(2), the relief requested relates only to Title I of ERISA.

⁹ While this letter focuses on the benefits of SEC oversight, we believe that it also would be appropriate for the Department to extend class exemptive relief to other investment managers that are subject to regulation that may provide protection comparable to that of the Advisers Act, such as banks, insurance companies or state-registered advisers.

¹⁰ The Supreme Court has stated that the Advisers Act "reflects a Congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a Congressional intent to eliminate, or at least expose, all conflicts of interest that might incline an investment adviser either consciously or unconsciously to render advice which was not disinterested." 375 U.S. 180 (1963). _

¹¹ Section 206 provides that it shall be unlawful for any investment adviser, directly or indirectly

1. to employ any device, scheme, or artifice to defraud any client or prospective client;
2. to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
3. acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;
4. to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

An investment adviser that is not a registered broker-dealer and that effects purchases and sale transactions directly between client accounts is subject to Section 206 with respect to agency cross trades. See *In Re Dimitri Balatsos*, Investment Advisers Act Rel. No. 1324 (Aug. 18, 1992) and *In Re Michael L. Smirlock*, Investment Advisers Act Rel. No. 1393 (November 29, 1993).

¹² Section 17(a) of the Investment Company Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such a person, acting as principal, from knowingly selling to or purchasing from the registered investment company any security or other property.

¹³ Investment Company Act Release No. 4697 (September 8, 1966). In adopting Rule 17a-7, the SEC noted that "the interests of investors will be served by the rule in that it permits affiliated investment companies which heretofore may have chosen to avoid the application procedures of Section 17(b) of the Act by purchasing or selling securities on the open market, thereby incurring duplicate brokerage charges, to avoid the payment of brokerage by effecting the transactions with each other." The SEC amended Rule 17a-7 in 1981 to allow, among other things, transactions between an investment company and another managed account of the fund's adviser. Investment Company Act Rel. No. 11676 (March 10, 1981).

¹⁴ Paragraph (b) of Rule 17a-7 states that "current market price" shall be:

1. If the security is a "reported security" as that term is defined in Rule 11Aa3-1 under the Securities Exchange Act of 1934 [17 CFR 240.11Aa3-1], the last sale price with respect to such security reported in the consolidated transaction reporting system ("consolidated system") or the average of the highest current independent bid and lowest current independent offer for such security (reported pursuant to rule 11Ac1-1 under the Securities Exchange Act of 1934 [17 CFR 240.11Ac1-1]) if there are no reported transactions in the consolidated system that day; or
2. If the security is not a reported security, and the principal market for such security is an exchange, then the last sale on such exchange or the average of the highest current independent bid and lowest current independent offer on such exchange if there are no reported transactions on such exchange that day; or
3. If the security is not a reported security and is quoted in the NASDAQ System, then the average of the highest current independent bid and lowest current independent offer reported on Level 1 of NASDAQ; or
4. For all other securities, the average of the highest current independent bid and lowest current independent offer determined on the basis of reasonable inquiry.

¹⁵. We believe that this requirement alleviates the Department's concerns with regard to market impact costs. The market impact costs of a transaction, which reflect the change in the price of a security that occurs as a result of a transaction, tend to be greater in the case of securities for which market quotations are not readily available. Moreover, we do not believe that a prohibition on cross trades ensures that a client is not disadvantaged vis a vis another client with regard to market impact costs. We submit that an investment manager's general fiduciary obligations under ERISA and the federal securities laws to act in the best interests of the plan, however, prevent a manager from seeking to benefit one client or another with regard to market impact costs.

¹⁶. In the alternative, we request that the Department include riskless principal transactions in the class exemption proposed in this submission.