

**Securities Industry Association**

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Pension & Welfare Benefits Administration
U.S. Department of Labor
Room N-5649
200 Constitution Avenue, NW
Washington, D.C. 20210

Re: Foreign Exchange Class Exemption Proposal--Standing Instructions

Ladies and Gentlemen:

This letter is submitted on behalf of an ERISA Committee of the Securities Industry Association ("SIA")¹ in response to a request for comments issued by the Department of Labor with respect to the above-captioned proposed exemption (the "Proposed Exemption"). The proposal involves a class exemption from certain restrictions in Section 406 of ERISA and companion sections of the Internal Revenue Code of 1986 for transactions involving the acquisition and disposition by employee benefit plans of foreign exchange through banks and broker-dealers pursuant to standing instructions.

The SIA's comment must be considered in light of the realities of the foreign exchange markets. The foreign exchange markets are truly global, operating 24 hours a day, from 6 a.m. Monday, Sydney, Australia time to 5 p.m. Friday, New York time. Twenty-four hour participation in the foreign exchange markets may be the only effective way to protect against market moves or to most effectively execute transactions. As a result, the SIA believes that the Proposed Exemption should be expanded to provide an additional limited type of standing instruction (a "limited standing instruction") to permit transactions to occur at market prices within one business day after the instruction is given without the requirement that a specific amount of foreign currency and a specific exchange rate be directed, provided that a fiduciary independent of the broker-dealer specifies a price range and a quantity range in which the transaction should be conducted. Unlike "evergreen standing instructions" contemplated by the Proposed Exemption, the limited standing instructions discussed here involve the day-to-day involvement of an independent fiduciary affirmatively issuing instructions and monitoring the result of the execution of those instructions.

By way of background, PTCE 94-20 permits a plan to enter into a directed foreign exchange transaction with a bank or broker-dealer or their affiliates. A foreign exchange transaction is "directed" only where an independent plan fiduciary who has not been appointed by the bank or broker-dealer or affiliate directs such bank or broker-dealer or affiliate to effect the purchase or

sale of a *specific* amount of currency at a *specific* exchange rate. The "specific amount" and "specific exchange rate" requirements are contrary to the best interests of plans in connection with overnight transactions in foreign currency and inconsistent with existing best commercial practices of non-ERISA regulated customers. In these transactions, on behalf of customers other than plans subject to ERISA, a broker-dealer would typically be directed to: (a) buy or sell an amount of foreign currency in order to manage, hedge or convert a currency position in connection with an underlying transaction in securities or futures, or the payment or receipt of related margin; or (b) buy or sell an amount of foreign currency at or after the market reaches a certain level. In each of these cases, the broker-dealer or its foreign affiliate monitors the market, usually after the U.S. financial markets have closed, to effect the trades in accordance with the customer's direction. ² It is necessary that the broker-dealer be given this limited ability to trade within specific parameters so that decisions made by the plan can be executed in light of contemporaneous market conditions.

The Department of Labor has permitted this type of flexibility in the past. For example, a broker-dealer does not become a fiduciary to a plan if its trading discretion is limited to 5 business days and securities transactions are executed within a price and quantity *range* specified by the client. 29 CFR §2510.3-21(d). Similarly, futures commission merchants do not become fiduciaries if trading instructions are limited to one business day with respect to futures contracts. See *Letter from Jeffrey N. Clayton, Administrator, Pension & Welfare Benefits Program to Howard Pianko, Esq., Baer Marks & Upham (Sept. 21, 1982)*. The proposed expansion of the Proposed Exemption for limited standing instructions is merely another recognition of the need to permit broker-dealers or their affiliates to execute trades, within parameters specified by an independent fiduciary, based upon contemporaneous market conditions.

For limited standing instructions, the definition of foreign exchange transaction also needs to be amended from the Proposed Exemption to conform to that contained in PTCE 94-20. Thus, the definition should encompass currency forward and option contracts. The following simple example illustrates the necessity for the change. Assume that a plan decides to reduce its exposure to the French market and the French franc and therefore sells \$50 million worth of French securities to be settled in T + 5 (*i.e.*, 5 days after the trade date) in French francs. From the moment the trade is executed, the plan has the risk of converting the French francs to U.S. dollars, *i.e.*, the plan has currency exposure to French francs from the trade date through the settlement date. As a result, a plan would frequently sell French francs at trade date for delivery forward against U.S. dollars at settlement date.³ While not entirely clear, it appears that such a transaction may not be covered by the Proposed Exemption given the deletion of the language "or a contract for such exchange" that was contained in PTCE 94-20.

Finally, the SIA believes that the definition of broker-dealer should include all affiliates of the broker-dealer, whether foreign or domestic, so long as the foreign affiliates consent to service of process in the U.S. in connection with transactions subject to the exemption. For many global firms, foreign exchange trading is not conducted through the U.S. broker-dealer, but more likely conducted through an affiliate which specializes in the foreign currency markets. Moreover, it goes without saying that the most likely source of foreign currency when the U.S. markets are closed will be the broker-dealer's foreign affiliates. These affiliates may not be entities supervised by a state or the United States and are not necessarily subject to comparable U.S.

broker-dealer regulation. They are, however, frequently the most efficient source of foreign exchange. By eliminating affiliates of broker-dealers, the Department of Labor has eliminated the most likely source of best execution of the foreign currency transaction and places the plan at currency risk until U.S. markets open.

A draft of proposed changes to the Proposed Exemption is attached as [Appendix A](#). You will note that the proposed changes do not request Section 406(b)(1) or 406(b)(2) relief because the trading discretion described above does not rise to the level of fiduciary discretion for the reasons discussed above and the counterparties typically would not otherwise be acting as a trustee of the assets of the plan involved in the transaction.

The Department of Labor very prudently opened the door to competitive execution of foreign exchange transactions in PTCE 94-20 by permitting such transactions to be executed with the affiliates, foreign and domestic, of U.S. broker-dealers. The Department of Labor needs to take the additional step to protect plans against overnight currency risk by permitting these same broker-dealers and their affiliates to execute foreign currency trades pursuant to limited standing instructions that must be executed within one business day or lapse and that specify price and quantity ranges. This change will permit an independent fiduciary to authorize, on a day by day basis, transactions in which broker-dealers and their affiliates can react to market conditions to permit plans to manage, convert or hedge currency positions in contemporaneous overnight transactions or based upon market parameters established by an independent fiduciary. If the Department of Labor does not grant the relief requested, plans will be required to precisely control the quantity and price of their foreign exchange transactions; as a result of this requirement for precision, plans will not be able to appropriately manage, control or hedge their currency exposure on underlying transactions.

We have not incorporated the requirement of the Proposed Exemption that the time of the transaction be provided on a confirmation to the customer. The production of confirmations is a highly-automated process that is not easily changed, and involves technology that does not link the time of trade execution to the generation of the confirmation. Time stamping confirmations is not a current practice, nor a practice that can be easily implemented. Broker-dealers, however, can provide or make available to customers on request an approximate (but not a precise) time at which a transaction was executed.

After the Department of Labor has reviewed this comment, the SIA would welcome the opportunity to discuss its concerns in more detail. If you have any questions, please contact the undersigned at (212) 761-4633 or A. Richard Susko of Cleary, Gottlieb, Steen & Hamilton at (212) 225-2410.

Very truly yours,

Securities Industry Association
By Laura DeForest

Footnotes

1 The SIA is the trade association representing more than 750 securities firms headquartered

throughout North America. Its members include securities organizations of all types--investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities industry's revenue in the United States. SIA members' customers typically include employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA").

2 Many U.S. broker-dealers, through their foreign affiliates, effectively maintain trading in foreign currency 24 hours a day. In contrast, many plans and fiduciaries operate only during normal business hours in the U.S.

3 Spot contracts typically settle within 2 days after the trade date. Forward contracts are used to manage currency exposure and risk for periods in excess of 2 days.

Appendix A

- Amend Section I to add a new subsection (c) to read as follows: (c) Effective on and after June 18, 1991, the restrictions of sections 406(a)(1)(A) through (D) of the Employee Retirement Income Security Act of 1974 (the "Act") and the taxes imposed by Section 4975(a) and (b) of the Internal Revenue Code of 1986 (the "Code") by reason of Code section 4975(c)(1)(A) through (D), shall not apply to a foreign exchange transaction between a broker-dealer or its affiliates and an employee benefit plan with respect to which the broker-dealer or its affiliate is a party in interest pursuant to a limited standing instruction, if the conditions of Section II and Section III of PTCE 94-20 are met.
- Add a definition of "limited standing instruction" to Section IV to read as follows: A "limited standing instruction" shall mean a standing instruction to be executed within one business day that specifies: (a) a foreign exchange transaction to be executed; (b) a range of exchange rates within which such foreign exchange transaction is to be executed; and (c) a range of quantities of such foreign exchange transactions to be executed.