



INVESTMENT ADVISER
ASSOCIATION

October 4, 2007

Via Electronic Mail

Bradford P. Campbell
Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Dear Assistant Secretary Campbell:

We greatly appreciate your meeting with the Securities Industry and Financial Markets Association (SIFMA) and the Investment Adviser Association (IAA)¹ on July 12 to discuss the possibility of the Department issuing guidance under Section 406(b)(3) of ERISA. As we discussed, the LM-10 reporting changes, regional examination initiatives, and other developments have heightened the level of interest by members of our organizations to receive guidance from the Department on providing ordinary business-related meals, gifts, entertainment and conferences and the meals, travel, and accommodations associated with those conferences. We write to outline an approach to such guidance for your consideration, as well as to follow up on certain issues raised during the meeting.

Background and Need for Guidance

As you know, the provision of meals and entertainment to clients and prospective clients is a common, long-standing and entirely appropriate practice in the business community. In addition, it is a well-accepted practice in the benefit plan community for service providers to host educational conferences and meetings that are accompanied by reasonable meals, accommodations, travel arrangements, and entertainment. These

¹ SIFMA, established in 2006 through the merger of the Securities Industry Association and The Bond Market Association, brings together the shared interests of more than 650 securities firms, banks and asset managers. More information about SIFMA is available on its home page: www.sifma.org.

The Investment Adviser Association (formerly the Investment Counsel Association of America) is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the Association's current membership consists of about 500 firms that collectively manage in excess of \$8 trillion in assets for a wide variety of individual and institutional clients. For more information, please visit our web site: www.investmentadviser.org.

meetings and conferences serve important functions in the benefits community and provide valuable benefits to plans. First, they allow plan fiduciaries to meet personally with their financial services providers and thereby better monitor and discuss their investments and service agreements. Second, they benefit plan participants and beneficiaries by providing client plan fiduciaries with significant educational opportunities, including access to market experts and expanding clients' knowledge base about investment structures, the economy, and core concepts such as asset allocation, diversification and risk hedging. Third, they enhance opportunities for clients to build relationships with their investment managers, other providers, and other industry participants, which assists in the oversight of the plan's service providers and provides important information about industry best practices. Fourth, they provide clients with a better understanding of market conditions and trends in the industry, including the impact such trends may have on their portfolios, without a financial cost to their plans. Finally, they provide broad and continuing education regarding fiduciary obligations and duties, changes in the law and regulations, current initiatives, and other issues of legal significance.

Since ERISA was enacted, investment managers, broker-dealers and other financial services providers have operated under the understanding that reasonable and routine business-related expenses are permissible under ERISA. They understand that giving lavish or extravagant gratuities, including lavish business entertainment, travel unrelated to plan business, and gifts that operate as a *quid pro quo* or kickback, is prohibited by ERISA, securities laws, and criminal statutes. In light of this understanding, financial services providers generally have implemented policies and procedures reasonably designed to ensure that any expenses for meals, entertainment and gifts are reasonable, legitimately business-related, and are not offered as a bribe or improper payment.

Recently, however, issues have been raised regarding the Department's position with respect to the provision of reasonable meals and other entertainment to plan fiduciaries, including in the LM-10 context. Although the Department has never issued guidance in this area, some regional enforcement offices have indicated both to plan trustees and service providers that the Employee Benefits Security Administration will take a "zero tolerance" approach to routine business-related entertainment. This expression of a "zero-tolerance" approach has created uncertainty in the financial services community regarding whether *any* meals, entertainment, or other expenses are permissible, and if so, to what extent. This uncertainty impedes the ability of firms to establish and implement appropriate compliance controls, policies, and procedures regarding the provision of meals, entertainment, and conferences to plan fiduciaries. It is obviously difficult to create policies and procedures governing an activity that may not be permitted at all. Further, the lack of guidance in this area creates an unlevel playing field, which could be seen as disadvantaging firms that take a more conservative approach to such matters. It also may create an unlevel playing field with respect to positions taken by different regional offices of EBSA.

Accordingly, members of the investment management and broker-dealer communities would appreciate prospective written guidance from the Department.

Consistent with our earlier discussions, we outline a potential approach to such guidance below.

Approach to Guidance

We respectfully request that the Department confirm that it will not take enforcement action with respect to either (1) the provision of reasonable meals, entertainment, and conferences (including accompanying meals, travel and accommodations) to plan fiduciaries if the expenses constitute items that are fully disclosed to an appropriate plan fiduciary, and if those expenses could have been paid for by the plan under section 408(c)(2) of ERISA; *or* (2) the provision of entertainment, tokens, or gifts that, taken as a whole, are not such that they are intended to cause or would be reasonably judged to have the likely effect of causing a plan fiduciary to act in a manner that is not solely in the best interests of the plan. We understand that the “reasonableness” aspect of this principle-based approach may leave a gray area in which a facts-and-circumstances analysis must be conducted to determine whether the entertainment has improperly influenced a fiduciary. But, as you know, plan fiduciaries are accustomed to making these judgments under section 408(b)(2) and section 408(c)(2) of ERISA and there is no reason to assume that they will not exercise prudence in making these judgments in this area as well. Further, this approach is preferable to a detailed FAQ that attempts to cover every scenario that potentially could be presented.

The guidance we request is similar to other guidelines that that our members follow relating to gifts and entertainment. For example, NASD Conduct Rule 3060 as interpreted by the Financial Industry Regulatory Authority² permits ordinary and usual business entertainment “so long as it is neither so frequent nor so extensive as to raise any question of propriety.”³ Rule 3060 provides that no member may provide a gift that is valued at more than \$100.⁴ FINRA rules also require firms to have recordkeeping and supervisory systems in place to implement these guidelines.

A pending FINRA proposal to amend Rule 3060 specifically would require written policies and procedures reasonably designed to prevent the provision of business entertainment intended to cause or that would reasonably be judged to have the effect of

² FINRA guidance under Rule 3060 is available on the FINRA website at: http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000596. FINRA was created in July 2007 through the consolidation of NASD and certain operations of the New York Stock Exchange. Firms that were members of NASD only at the time of the consolidation continue to be governed by NASD rules until a consolidated rulebook is created. FINRA has stated that it will continue to apply the same interpretive materials that applied previous to the consolidation.

³ Letter to Henry H. Hopkins and Sarah McCafferty, T. Rowe Price Investment Services, Inc. from R. Clark Hooper, NASD (June 10, 1999). This guidance is available on FINRA’s web site at: http://www.nasd.com/RulesRegulation/PublicationsGuidance/InterpretiveLetters/ConductRules/NASDW_002715.

⁴ FINRA distinguishes between “gifts” and “entertainment.” Gifts are items provided to others, including tickets to events *if the recipient is not accompanied by an employee of the firm providing the tickets*. If an employee of the firm accompanies the client, the item is considered “entertainment,” not a gift. Similarly meals, receptions, and conferences at which firm personnel are present are considered entertainment.

causing a recipient to act inconsistently with the best interests of the client.⁵ Similarly, Investment Advisers Act Rule 206(4)-7 requires investment advisers to establish and implement written policies and procedures reasonably designed to prevent violations of the Act. Consistent with these rules, any guidance provided by the Department should also be crafted to have the effect of enhancing compliance efforts by requiring firms to have written policies and procedures in place to ensure that payments are not intended to improperly influence fiduciaries.

During our meeting, Department staff queried whether a *de minimis* dollar threshold similar to that used in LM-10 guidance would be preferable to a more general “reasonableness” standard. While a dollar amount has the conceptual appeal of specificity, it also has a number of drawbacks that the reasonableness approach avoids. First, a reasonableness analysis along the lines we propose would be consistent with other regulatory standards and therefore would enable service providers to establish and implement one uniform set of policies and procedures that applies to all of their clients, whether covered by ERISA or not. Second, this approach provides flexibility for the Department to take enforcement action whenever the facts and circumstances, taken as a whole, indicate improper influence. Third, a reasonableness approach recognizes geographical disparities in costs in a way that a specific dollar limit does not.⁶ Fourth, the reasonableness standard can apply separately to items such as meals and conferences that the plan could have paid for and to the token gifts that may not fall under section 408(c)(2) but would certainly be covered by any prudent person’s idea of reasonable tokens – such as a logoed pen, baseball cap, or bookbag. In our view, a “reasonableness” standard provides appropriate flexibility while preserving the purpose of ERISA to deter abusive kickbacks or quid pro quo practices.

Bases for Guidance

Section 406(b)(3) of ERISA prohibits a 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.” This section of ERISA is intended to prohibit “under the table” illicit kickbacks or quid pro quos. Thus, fully disclosed expenses that would be reimbursable by a plan (*e.g.*, reasonable travel, food and other expenses associated with meetings or conferences to learn about and/or assist in monitoring an investment provider or strategy) should be reimbursable by a third-party provider. These expenses are not for the fiduciary’s “own personal account” and generally do not arise “in connection with” a particular transaction. Rather, these types of expenses are permitted to be paid by the plan precisely because they reflect reasonable expenses incurred on behalf of the plan’s participants, not on behalf of the fiduciary’s personal account. In previous guidance related to section 406(b)(3), the Department has

⁵ See *Self-Regulatory Organizations, National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Interpretive Material to NASD Rule 3060 to Require Members to Adopt Policies and Procedures Addressing Business Entertainment*, SEC Rel. No. 34-55765 (May 15, 2007).

⁶ See *id.* at p. 24 (“Given the significant variation in broker-dealer business models and size, and regional differences in what may be considered appropriate business entertainment, NASD concluded that a fixed-dollar standard or similar specific mandate would prove unworkable”).

expressed the view that so long as a plan could compensate the service provider directly for such services, section 406(b)(3) did not preclude a third party from making payments to a plan fiduciary for what would otherwise be a valid plan expense.⁷

Similarly, under section 406(b)(3), reasonable and modest business entertainment should not be deemed to constitute a kickback because it is not likely to improperly influence the plan fiduciary's decision-making. During our meeting, a Department official expressed concern that the language of section 406(b)(3) may not provide room for this type of statutory interpretation. The Department itself, however, has recently acknowledged in the context of the LMRDA reporting requirements that "exceptions based on insubstantiality are commonly read into statutes that do not expressly contain them."⁸ Indeed, practitioners have for years interpreted section 406(b)(3) in the context of its anti-kickback intent to prohibit only those payments that are explicit or implicit quid pro quos, in amounts or type that any prudent person would find excessive. A hallmark of this type of payment is the fact that it is given furtively, without the knowledge or acquiescence of a senior plan fiduciary. We believe that the legislative history of ERISA is consistent with this transparent, reasonable approach. To interpret the statute otherwise would effectively result in section 406(b)(3) prohibiting behavior that, by definition, can have no adverse effect on a plan or fiduciary and that, to the contrary, facilitates the many important and beneficial functions described above.

Conclusion


For all of these reasons, we respectfully submit that Department guidance is appropriate and request that the Department clarify that reasonable meals, gifts and entertainment may be provided to plan fiduciaries under ERISA, as well as payments of expenses that the plan could have lawfully paid. This guidance may take the form of a no-enforcement position, field assistance bulletin, or other Department opinion.

We would appreciate the opportunity to meet with you again to discuss our approach to guidance. We look forward to working with you on this important issue.

Sincerely,



Elizabeth Varley



Karen L. Barr

cc: Virginia Smith, Director, Office of Enforcement
Alan D. Lebowitz, Deputy Assistant Secretary for Program Operations
Robert Doyle, Director, Office of Regulations and Interpretations

⁷ For example, in the preamble to Prohibited Transaction Exemption 82-63 dealing with compensation arrangements, the Department stated: "In the Department's opinion . . . , section 406(b)(3) is not violated by reason of a fiduciary's receiving on behalf of the plan the gross loan fees from the borrower, in his capacity as a fiduciary to the plan, and then allocating . . . a portion of those fees previously fully disclosed and agreed to as the compensation for the fiduciary's services In that situation, the payments to the lending fiduciary are, in effect, made from the assets of the plan and should be accounted for as such."

⁸ 72 Fed. Reg. 36106, 36115 (July 2, 2007).