



Section of Taxation

10th Floor
740 15th Street, N.W.
Washington, DC 20005-1022
202-662-8670
FAX: 202-662-8682
E-mail: tax@abanet.org

January 23, 2008

Hon. Elaine L. Chao
Secretary of Labor
U.S. Department of Labor
Frances Perkins Building
200 Constitution Avenue, NW
Washington, DC 20210

Re: Comments Concerning ERISA Bonding Rules

Dear Secretary Chao:

Enclosed are comments on the new ERISA bonding rules added by the Pension Protection Act of 2006. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stanley L. Blend
Chair, Section of Taxation

Enclosure

cc: Linda Stiff, Acting Commissioner, Internal Revenue Services
Donald L. Korb, Chief Counsel, Internal Revenue Service
Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
Bradford P. Campbell, Assistant Secretary of Labor for the Employee Benefits Security Administration, Department of Labor
Alan D. Lebowitz, Deputy Assistant Secretary for Program Operations, Department of Labor
Ivan Strasfeld, Director, Office of Exemption Determinations, Department of Labor
Robert Doyle, Director, Office of Regulations and Interpretations, Department of Labor
Joe Canary, Deputy Director, Office of Regulations and Interpretations, Department of Labor

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**COMMENTS ON THE NEW ERISA BONDING RULES
ADDED BY THE PENSION PROTECTION ACT OF 2006**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (“Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Andrew L. Oringer. Substantive contributions were made by Beth J. Dickstein, John J. Jacobsen, Jr. and Sharon Remmer. The comments were reviewed by David A. Mustone, Chair of the Section’s Employee Benefits Committee (the “Committee”). The Comments were further reviewed by Greta E. Cowart, Immediate Past Chair of the Committee; by the Quality Assurance Group of the Committee, which is chaired by Thomas R. Hoecker and whose members are former chairs of the Committee; by T. David Cowart of the Section’s Committee on Government Submissions; and by Priscilla E. Ryan, the Committee’s Council Director.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the rules addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contact Persons:

Andrew L. Oringer
Phone: (212) 819-8561
Email: andrew.oringer@whitecase.com

Greta E. Cowart
Phone: (214) 651-5592
Email: greta.cowart@haynesboone.com

Date: January 23, 2008

EXECUTIVE SUMMARY

The following comments pertain to the changes made in the Pension Protection Act of 2006¹ (“PPA ‘06”) to the bonding rules under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). These comments are in response to informal requests made by various representatives of Employee Benefits Security Administration (“EBSA”) of the Department of Labor at public meetings of the American Bar Association Section of Taxation and other public meetings seeking comments on those aspects of PPA ‘06 affecting ERISA.

We recommend that EBSA issue regulations that provide that:

- A. the increased bond amount does not apply to any plan official solely because a plan holds an interest in a diversified collective investment fund - such as a mutual fund, bank collective investment fund, insurance company separate account, hedge fund or any other diversified investment fund - that holds employer securities of sponsors of plans investing in the fund; and
- B. the increased bond amount applies only to those plan officials who actually handle employer securities.

¹ Pub. L. No. 109-280 (2006). PPA ‘06 also contains a new exemption for the bonding requirements for certain broker-dealers. *See* PPA ‘06 § 611(b).

BACKGROUND

Section 622(a) of PPA '06 amends Section 412 of ERISA to increase the maximum bond amount from \$500,000 to \$1 million “[i]n the case of a plan that holds employer securities (within the meaning of [S]ection 407(d)(1)),” effective for plan years beginning after December 31, 2007. Recently, a number of well-publicized class-action lawsuits have been filed alleging that plan fiduciaries breached their duties in connection with a plan’s investment in the securities of the employer sponsoring the plan. These lawsuits do not allege the theft of plan assets or other acts of fraud or dishonesty by fiduciaries or plan officials that the bonding rules are intended to address.² We believe this recent spate of lawsuits and other media attention to plan investments in employer securities should not lead to an inappropriate expansion of the underlying scope of the bonding requirement, and thus recommend that regulations implementing Section 622(a) of PPA '06 adhere to the original intent of the bonding requirement and Congress’ apparent intent to have the increased bonding requirement applied narrowly.

The changes to the bonding requirements have a potential impact on the day-to-day administration of plans and on the manner in which affected service providers need to structure their affairs. Discussed below are two areas as to which we recommend that regulations be issued.

A. Look-Through Vehicles

1. Summary

In general, Section 412 of ERISA requires that any plan fiduciary and any person who handles plan assets (hereinafter collectively referred to as “plan officials”) be bonded. Prior to the enactment of PPA '06, the maximum required bond was \$500,000 per plan.³ PPA '06 increased this limit to \$1 million for any plan holding employer securities. However, the Joint Committee on Taxation’s Technical Explanation of PPA '06⁴ (the “Technical Explanation”) states that “[a] plan would not be considered to hold employer securities within the meaning of this section where the only employer securities held by the plan are part of a broadly diversified fund of assets, such as a mutual or index fund.”⁵ By describing employer securities held indirectly by a diversified fund as being excluded from the scope of employer securities for purposes of the bonding rules, this statement indicates that the intended purpose of the change made to Section 412 of ERISA is to protect plans from acts of fraud or dishonesty that *directly involve* employer securities.

2. Recommendation

We recommend that EBSA issue regulations that provide that the increased bond amount does not apply to any plan official solely because a plan holds an interest in a diversified

² See, e.g., 29 C.F.R. § 2580.412-1 (“Such bond shall provide protection . . . against loss by reason of acts of fraud or dishonesty . . .”).

³ See ERISA § 412(a).

⁴ Joint Committee on Taxation, *Technical Explanation of H.R. 4, the “Pension Protection Act of 2006,” as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06), Aug. 3, 2006.

⁵ Technical Explanation, at p. 146.

collective investment fund - such as a mutual fund, bank collective investment fund, insurance company separate account, hedge fund or any other diversified investment fund - that holds employer securities of sponsors of plans investing in such a fund or account.

3. Explanation

The regulatory provision that we suggest would be consistent with the language in the Technical Explanation confirming that a plan is not considered to hold employer securities for purposes of the special bonding rule where the employer securities are held indirectly by the plan through an investment in a broadly diversified fund⁶ (such as might occur where the fund's assets are "plan assets" by virtue of a plan's investment therein⁷). Subjecting plan officials to the increased bond amount merely because the plan invests in a fund that acquires, as part of a diversified portfolio, employer securities appears to go beyond the intended purpose of the bond limit increase, as described in the Technical Explanation.

B. Scope of the Rule

1. Summary

Plans often have several managers, each of whom has responsibility to invest plan assets in a specified type of investment. For example, one manager may have authority to invest in equities, while a second manager may be authorized to invest in only fixed income instruments. Each of these managers is a fiduciary only to the extent of his or her delegated responsibility. Furthermore, one manager typically does not know whether, as a result of another manager's actions, the plan holds employer securities.

2. Recommendation

We recommend that regulations provide that the increased bond amount applies only to those plan officials who actually handle employer securities.

3. Explanation

The bonding requirement applies to fiduciaries and persons who handle plan funds or other property. The required bond amount is directly related to the amount of "funds handled."⁸ Requiring an increased bond amount for a plan official who has no control over the plan's acquisition or holding of employer securities would not bolster the protection for losses relating to those employer securities. Because an insurer of such a plan official would not cover a loss relating to employer securities handled by a party other than that plan official, we do not see why that other party's activities should be relevant to the amount of the bond for the plan official in question.

⁶ Technical Explanation, at p. 146.

⁷ We note that the increased bond amount would not apply to assets of a broadly diversified fund that are not "plan assets" within the meaning of Section 3(42) of ERISA.

⁸ See ERISA § 412(a)(3).

In this regard, the Technical Explanation states that “[t]he bond is intended to protect plans against loss from acts of fraud or dishonesty by plan officials.”⁹ As discussed under Section A(3) above, Congress intended the additional protection to apply to fraud or dishonesty that *directly* involves employer securities. Congress did not intend to apply this protection to plan officials who only handle employer securities as part of a diversified “plan asset” fund. It follows that Congress did not intend that the increased bond limits would apply to plan officials who do not handle employer securities at all. For example, the acquisition or holding of employer securities by one of the plan’s investment managers should not automatically mean that the higher bonding limit applies to the plan’s other managers, regardless of whether the other managers are aware of the employer securities held in some portfolio of the plan.

If a plan official is subject to the increased bond amount merely because another official has caused the plan to hold employer securities, the change made by PPA ’06 will, in practice, require the increased bond to cover every plan official whenever the plan potentially could acquire employer securities. Even if the plan does not hold employer securities at the time a plan official begins handling plan assets, the plan might later acquire employer securities, in which case the plan official would then become subject to the increased bond amount (even though the official may be unaware of the acquisition and have no control over the acquisition or holding of the employer securities). In light of these considerations, we make the recommendation set forth above.

⁹ Technical Explanation, at 146.