U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

February 1, 2006

The Honorable George Miller
Senior Democratic Member
Committee on Education and the Workforce
U.S. House of Representatives
Washington, D.C. 20210

The Honorable Edward J. Markey
U.S. House of Representatives
Washington, D.C. 20210

Dear Congressmen Miller and Markey:

Thank you for your letter to the Secretary of Labor and to the Securities and Exchange Commission Chairman regarding concerns identified in the May 16, 2005 Securities and Exchange Commission (SEC) staff report on its examinations of selected pension consultants under the Investment Advisers Act of 1940 (Advisers Act). Your letter was referred to me for response on behalf of the Secretary.

The Department of Labor (DOL), in coordination with the SEC, has undertaken a number of actions to address the issues raised in the SEC's report. In considering this matter, it is important to keep in mind the distinction between the definition of a fiduciary under the Advisers Act and under the Employee Retirement Income Security Act (ERISA). While we and the SEC regulate the activities of pension consultants, we do so pursuant to statutes that contain differing definitions, authorities, and sanctions. Specifically, a pension consultant that is a registered investment adviser under the Advisers Act is by definition a fiduciary. As more fully described below, such a firm or individual, however, may not be a fiduciary under ERISA's functional definition of the term.

As you know, DOL shares responsibility with the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation (PBGC) for administering and enforcing ERISA. The Employee Benefits Security Administration (EBSA) is the DOL agency responsible for administering and enforcing the provisions of Title I. Among other provisions, Title I of ERISA requires that fiduciaries of covered employee benefit plans act prudently and solely in the interest of the plan's

participants and beneficiaries. In carrying out these responsibilities, plan fiduciaries typically rely heavily on pension consultants and other professionals for help.

The SEC is responsible for administering and enforcing securities laws, including the Advisers Act. Under the Advisers Act, investment advisers providing consulting services have a fiduciary duty to provide disinterested advice and disclose any material conflicts of interests to their clients. In this context, SEC staff examined the practices of registered investment advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plan's investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of "bundled" services. The SEC staff concluded in its May 16 report that the business alliances among pension consultants and money managers can give rise to serious conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.

As previously noted, while ERISA-covered plans and their fiduciaries often rely on consultants and other service providers to assist them in plan administration and asset management, not all of these consultants and service providers are plan fiduciaries under ERISA. In general, ERISA takes a "functional" approach to fiduciary status—a person is a fiduciary to the extent he or she engages in certain "fiduciary" activities, without regard to title or position. Under ERISA section 3(21), a person acts as a fiduciary when he or she (i) exercises discretionary authority or control over the management of a plan or exercises any authority or control over the management or disposition of its assets, (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan or has any authority or responsibility to do so, or (iii) has discretionary authority or responsibility in the administration of a plan.

The term "investment adviser" is not defined in ERISA. As noted in the SEC Report, the Advisers Act defines "investment adviser", but only for purpose of securities laws. Many persons who provide investment services to ERISA plans call themselves investment advisers as well as consultants, investment monitors, or performance monitors. Registered investment advisers who lack sufficient authority or control over plan assets are not fiduciaries under ERISA unless they

render investment advice for a fee or other compensation with respect to plan assets, in a manner described in the Department's regulations.

Under DOL regulations, a person renders investment advice only if he or she gives advice as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property. In addition, he or she must either (1) have discretionary authority or control over purchasing or selling securities or other property for the plan, or (2) render the advice on a regular basis pursuant to a mutual agreement or understanding that the advice will serve as a primary basis for the plan's investment decisions, and that the advice will be individualized to the plan based on the plan's particular need (DOL Reg 29 CFR 2510.3-21).

As the SEC noted in its report, many consultants believe that they have structured their arrangements with plans so that they are not ERISA fiduciaries. Even if a consultant is an SEC-registered investment adviser and, consequently, owes a fiduciary duty to its clients, including employee benefit plans, under the Advisers Act, the consultant is an ERISA fiduciary only if it meets the requirements set forth above. If, for example, the consultant provides advice on a single occasion, or does not provide advice specific to the particular needs of the plan, he or she is not an ERISA fiduciary. The consultant's status in any particular case depends on the specific facts and circumstances of that case.

Although an investment adviser may not be a plan fiduciary under ERISA, as a service provider to a plan the investment adviser is a "party in interest" to the plan as defined in ERISA section 3(14). ERISA prohibits transactions between a plan and a party in interest except under certain carefully defined circumstances. The plan fiduciary who hires or retains a service provider for the plan has a responsibility to ensure that the relationship between the plan and its service providers meets the requirements of ERISA, including the requirement that the services provided to the plan are necessary and appropriate, and that the plan pay no more than reasonable compensation to the service provider.

While DOL was not involved in the examination phase of the SEC study, SEC and DOL representatives coordinated extensively on the SEC Report during the March-May timeframe prior to its May 16 release. Following the issuance of the Report, the agencies coordinated on follow up actions, including together issuing guidance designed to assist employee benefit plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by pension consultants. DOL published the guidance as a May 2005 EBSA Fact Sheet in coordination with the release of the SEC Report. A copy is enclosed.

Pursuant to SEC and DOL investigative information disclosure policies, DOL requested that the SEC provide EBSA with copies of its Examination Reports on the selected pension consultants. In providing documents, the SEC made no recommendations with respect to identification of pension plan consultants as ERISA fiduciaries or DOL investigation or prosecution of any pension consultant. EBSA enforcement officials are currently reviewing the documents to determine what DOL investigative action may be necessary. Based on this review, several matters have been referred to EBSA regional offices for investigation.

With regard to your request for supporting information for the SEC Report, it is our understanding that you have received and reviewed the Report and your staff has met with SEC staff. In order to preserve the integrity of its investigative process, it is DOL and EBSA policy not to disclose substantive investigative information on any investigative matter until public action is taken or the matter is closed. Thus, I cannot, at this time, provide further substantive investigative information.

Please be aware that we are also reviewing existing DOL regulations relating to the disclosure of fees, including revenue sharing arrangements, by service providers to employee benefit plans. Fee disclosure is important in two respects. First, plan fiduciaries need to be able to assess whether fees are reasonable. Second, plan fiduciaries need to be able to assess whether revenue sharing arrangements might affect the recommendations provided by a service provider, such as a pension consultant.

In early 2005, we added projects to our regulatory agenda to ensure that plan fiduciaries have the information they need to determine whether an arrangement for services is reasonable, including information about fees, and that plan participants have adequate information about the fees associated with various investment options. We are also amending the ERISA Form 5500 Annual Report to expand the fee information that must be disclosed to plan fiduciaries and the DOL as part of the annual reporting process.

Lastly, you request that DOL initiate audits of the financial circumstances surrounding the underfunding of the defined benefit pension plans of companies, such as United Airlines, which file for federal bankruptcy protection and plan termination, and those companies currently considering termination of such plans, including Northwest Airlines.

DOL has limited authority to enforce ERISA's minimum funding requirements directly. Under ERISA section 502(b) (1), DOL can only enforce these provisions when requested to do so by the Secretary of the Treasury or by one or more

participants, beneficiaries, or fiduciaries. In the latter case, DOL may exercise enforcement authority only if it determines that a funding violation affects, or such enforcement is necessary to protect, claims of the participants or beneficiaries to benefits. DOL is working with Treasury, and the PBGC, to identify and pursue appropriate cases.

As you know, on April 22, 2005, the PBGC entered into a settlement with United Airlines over the termination of United's defined benefit pension plans. The agreement required approval by the bankruptcy court overseeing United's restructuring and provides that the PBGC would terminate and become trustee of United's four pension plans and the agency's claims against United would be settled. The settlement was reached based on PBGC and its financial advisers' belief that the settlement is superior to the recovery the PBGC would receive as an unsecured creditor in the United bankruptcy proceeding. That process was approved by the bankruptcy court and PBGC has assumed trusteeship of the four plans. As you may know, DOL had previously acted to ensure that the interests of the plans would be protected by demanding that United appoint an independent fiduciary with the authority to enforce the plans' contribution claims against United.

I have enclosed for your information a copy of the August 25, 2005 PBGC Executive Director's response to the Aircraft Mechanics Fraternal Association (AMFA) letter to the Secretary of Labor and the PBGC Executive Director referenced in your letter. The AMFA letter cited the SEC report and questioned if possible disclosure and conflict of interest issues impacted the funding of United's plans. As you will note in the PBGC response, when the PBGC becomes trustee for a terminated pension plan, it conducts a review that includes an audit of the plan and an audit of plan assets seeking to determine if the former plan fiduciaries have met the appropriate standards of conduct and fulfilled their obligations to the plan and, depending on the facts and circumstances, investigation and legal action may be initiated. If, during this process, the PBGC uncovers evidence of any wrongdoing, they notify the Department of Labor and we coordinate an appropriate response, including any investigative activity that may be necessary.

As previously noted, in situations involving companies such as Northwest Airlines, which are in bankruptcy court and have underfunded defined benefit pension plans which have not been terminated, EBSA can conduct an investigation to determine if fiduciaries have breached their responsibilities under ERISA. Such an investigation would include a review of the actions of plan trustees, investment managers, service providers, and consultants. It is our policy to neither confirm nor deny the existence of an investigation of a specific plan or entity.

I hope this information is helpful in identifying DOL's response to these issues.

Sincerely,

Ann L. Combs
Assistant Secretary

Enclosures

Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
May 2005

Selecting and Monitoring Pension Consultants - Tips for Plan Fiduciaries

The Employee Retirement Income Security Act (ERISA) requires that fiduciaries of employee benefit plans administer and manage their plans prudently and in the interest of the plans participants and beneficiaries. In carrying out these responsibilities, plan fiduciaries often rely heavily on pension consultants and other professionals for help. Findings included in a report by the staff of the U.S. Securities and Exchange Commission released in May 2005, however, raise serious questions concerning whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice they are providing to their pension plan clients.

Under the Investment Advisers Act of 1940 (Advisers Act), an investment adviser providing consulting services has a fiduciary duty to provide disinterested advice and disclose any material conflicts of interest to their clients. In this context, SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plans investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants also offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of bundled services. The SEC examination staff concluded in its report that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.

To encourage the disclosure and review of more and better information about potential conflicts of interest, the Department of Labor and the SEC have developed the following set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant.

1. Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?

   You can check yourself - and view the firms Form ADV - by searching the SECs Investment Adviser Public Disclosure Web site. At present, the IAPD database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository. In the future, the database will expand to encompass all registered investment advisers-individuals as well as firms-in every state. If you cant locate an investment adviser in IAPD, be sure to contact your state securities regulator or the SECs Public Reference Branch.

2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan? If so, describe those relationships.

   When pension consultants have alliances or financial or other relationships with money managers or other service providers, the potential for material conflicts of interest increases depending on the extent of the relationships. Knowing what relationships, if any, your pension consultant has with money managers may help you assess the objectivity of the advice the consultant provides.

3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?

   Payments from money managers to pension consultants could create material conflicts of interests. You may wish to assess the extent of potential conflicts.

4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being a factor when you provide advice to your clients?

   Probing how the consultant addresses these potential conflicts may help you determine whether the consultant is right for your plan.

5. If you allow plans to pay your consulting fees using the plans brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not over-pay its consulting fees?

   You may wish to avoid any payment arrangements that could cause the plan to pay more than it should in pension consultant fees.

6. If you allow plans to pay your consulting fees using the plans brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?

   Where and how brokerage orders are executed can impact the overall costs of the transaction, including the price the plan pays for the securities it purchases.

7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?

   As noted above, you may wish to explore the consultants relationships with other service providers to weigh the extent of any potential conflicts of interest.

8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?

   All investment advisers (whether registered with the SEC or not) owe their advisory clients a fiduciary duty. Among other things, this means that advisers must disclose to their clients

information about material conflicts of interest.

9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?

   If the consultant is a fiduciary under ERISA and receives fees from third parties as a result of their recommendations, a prohibited transaction under ERISA occurs unless the fees are used for the benefit of the plan (e.g., offset against the consulting fees charged the plan) or there is a relevant exemption.

10. What percentage of your plan clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?

   The answer may help in evaluating the objectivity of the recommendations or the fiduciary status of the consultant under ERISA.

For more information on the SEC staffs findings, please read Staff Report Concerning Examinations Of Select Pension Consultants. Plan trustees, pension consultants, and other service providers can learn about their fiduciary responsibilities under the Employee Retirement Income Security Act (ERISA) by visiting the Web site of the U.S. Department of Labor. Pension consultants who have questions concerning their obligations under the Investment Advisers Act of 1940 should either consult with an attorney who specializes in the federal securities laws or contact the staff of the SECs Division of Investment Management.

Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

Office of the Executive Director

AUG 25 2005

O.V. Delle-Femine
National Director
Aircraft Mechanics Fraternal Association
67 Water Street, Suite 208A
Laconia, NH 03246

Re: United Airlines' Pension Plans

Dear Mr. Delle-Femine:

I am writing to respond to your letter to Secretary Chao and to me dated June 20, 2005, in which you express concern about possible improper practices that may impact the assets held and invested by pension plans. You note that AMFA represents participants in the United Airlines and Northwest Airlines pension plans, and request that we undertake a special "forensic audit" of those plans.

As you note in your letter, ERISA requires that employee benefit plan fiduciaries meet a very high standard of conduct. We obviously share your interest that fiduciaries meet this standard and fulfill their responsibilities to the workers who participate in these plans. When fiduciaries of ongoing pension plans fail in this regard, it is the Department of Labor's responsibility to act to protect the interests of the workers.

For example, in 2004, after United Airlines decided to change the governance of its pension plans by substituting itself as fiduciary/plan administrator for the three executives who had served in that capacity at the same time that it announced that it would stop funding its pension plans, DOL intervened. By doing so, United put itself in an obvious conflict of interest situation. Following the Department's action, United agreed to appoint an independent fiduciary.

Under the agreement, the independent fiduciary was responsible for issues related to the funding of the pension plans, and was specifically authorized to review the funding policy of the plans; assert any claims; and bring litigation related to funding and contribution issues on behalf of the plans. The Department insisted on this agreement to protect the rights of the workers and retirees in the United plans.

When an underfunded pension plan terminates, the Pension Benefit Guaranty Corporation ("PBGC") becomes statutory trustee of the plan. PBGC took in 192 terminated pension plans in the last fiscal year alone. For each of these plans, PBGC undertakes an exhaustive review process that includes an audit of the plan and an audit of plan assets. In each case, PBGC seeks to determine if former plan fiduciaries have met the appropriate standards of conduct and fulfilled their obligations to the pension plans.

If that review discloses specific and credible evidence of wrongdoing, PBGC's practice has been to conduct a fuller, more targeted investigation. If our investigation finds that the wrongdoing has led to redressable harm to the pension plan, Title IV of ERISA authorizes PBGC to bring an action in the appropriate federal court on behalf of PBGC and the affected plan. The exact nature of PBGC's investigations and related actions concerning terminated plans depends upon the facts and circumstances of each case. Here, we are still evaluating whether a more comprehensive audit would be an appropriate component of our ongoing review of this matter. We invite AMFA to share with PBGC any specific information that you have suggesting wrongdoing with respect to United's pension plans.

You also suggest a similar audit for the plans sponsored by Northwest Airlines. As mentioned above, PBGC's authority to investigate potential fiduciary violations is limited to pension plans that have terminated, which is not the case with Northwest's plans. AMFA may have other avenues available to it to achieve its goals, of course, and nothing in this letter is intended to foreclose you from pursuing them. We also invite you to share any appropriate information you may have about Northwest's plans with DOL's Employee Benefits Security Administration.

Sincerely,

Bradley D. Belt