INDEPENDENT FIDUCIARY SERVICES, INC.

744 Broad Street
Suite 1120
Newark, NJ 07102
Phone: 973-424-6400
Fax: 973-424-6419
www.IndependentFiduciary.com

October 14, 2010

VIA E-MAIL TO e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Room N-5700
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20212

Attention: Prohibited Transaction Exemption Procedures Proposed Regulations

Ladies and Gentlemen:

Independent Fiduciary Services, Inc. ("IFS") submits the following comments with respect to the proposed regulation published August 30, 2010 (75 F.R. 53172) intended to update the Department of Labor's procedures for governing the filing and processing of applications to the Department for prohibited transaction exemptions ("PTEs") pursuant to Section 408(a) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and corresponding provisions of the Internal Revenue Code of 1986, as amended, and the Federal Employees' Retirement System Act of 1986.

IFS believes that the proposed regulation generally provides a workable and understandable presentation of the procedures and standards that will govern PTE applications. Our comments are limited to certain provisions relating to the "qualified independent fiduciary" acting on a plan's behalf with respect to the transaction that is the subject of the application. First, we focus on the portion of Section 2570.31(j) of the proposed regulation articulating the "*de minimis* amount of compensation" aspect of the evaluation of whether a fiduciary acting on a plan's behalf is independent of and unrelated to the parties in interest engaging in the exemption transaction. As set forth more fully below, IFS believes that the proposed rule imposes an unnecessarily restrictive view of independence that will adversely affect the ability of plans to engage qualified firms to act as independent fiduciaries with the expertise and resources necessary to make prudent decisions on their behalf. After explaining in more detail the reasons why we believe the *de minimis*/1% benchmark is not workable, we present a specific proposed revision of Section 2570.31(j).

We also comment on Section 2570.34(d)(8) of the Proposed Regulation, which sets the rule regarding a QIF's report concerning its income. In addition to suggesting changes to reflect our comments concerning Section 2570.31(j), we also suggest changes for calculating the percentage of a QIF's current income derived from a party in interest and its affiliates.

IFS's Background and Expertise Regarding PTE Applications

IFS is a registered investment adviser in business since 1986 that provides independent advisory and fiduciary decision-making services to institutional investors, including single employer and multiemployer benefit plans subject to ERISA. Our staff of 36 includes a combination of investment and fiduciary professionals, including attorneys deeply familiar with the interpretation and implementation of ERISA's fiduciary requirements. IFS's founder, and current Chairman and CEO, Francis X. Lilly, served as the Solicitor of Labor in the 1980s. IFS's President Samuel W. (Skip) Halpern, who joined Mr. Lilly in the business in 1987, was an enforcement attorney at the Department who personally litigated significant cases arising under ERISA's fiduciary provisions.

IFS has served as the independent fiduciary for plans in transactions that have been the subject of individual PTEs since 1989. A list of many of those engagements is attached as Exhibit 1. And IFS has served, sometimes with the Department's explicit concurrence, as the independent fiduciary with respect to numerous other transactions and assets for which PTEs were not required. IFS has never been sued with respect to any transaction for which we have served as the independent fiduciary decision-maker, and our independence has never been questioned, notwithstanding that from time to time IFS has received compensation for a particular transaction that has exceeded 1% of that year's annual income.

The 1% Benchmark in the Proposed Regulation is Not Appropriate

As the Supplementary Information introducing the proposed regulation points out, "Many of the exemptions previously issued by the Department have been conditioned on the designation of an independent fiduciary who is qualified to represent the interests of the plan, particularly where the plan's named or other fiduciary has interests with respect to a transaction which may conflict with its fiduciary duties to the plan." Of the five hypothetical examples of transactions for which an individual PTE would be required presented in the Department's 1995 publication, "*Exemption Procedures under Federal Pension Law*," (hereafter "*1995 Exemption Procedures*") four required that a qualified independent fiduciary act for the plan.

IFS concurs with the Department's view expressed in Section 2570.31(j) of the Proposed Regulation that a QIF must be "independent of and unrelated to any party in interest engaging in the exemption transaction and its affiliates" and that "the determination as to the independence of a fiduciary is made by the Department on the basis of all relevant facts and circumstances." As explained in *1995 Exemption Procedures*, the Department requires PTE applicants to demonstrate the QIF's independence so the Department may "determine whether such Fiduciary may be subject to improper influence by a party to the transaction other than the Plan, or whether

such Fiduciary has an interest that may conflict with the interests of the Plan for which it acts." A prospective QIF whose compensation from parties in interest with respect to the proposed transaction represents a significant portion of the QIF's income can be, or can be perceived to be, susceptible to improper influence in carrying out its fiduciary duties. Assisting plan sponsors and fiduciaries who select QIFs and the firms who serve as QIFs identify when a QIF's compensation may create a risk of such improper influence may be useful.

But the Proposed Regulation goes farther. First, Section 2570.31(j) uses the phrase "*de minimis*" to characterize the compensation that a QIF may generally receive from parties in interest. By contrast, *1995 Exemption Procedures* did not use that phrase. Second, that same section states, "Such *de minimis* amount will ordinarily constitute 1% or less of the annual income of the [QIF]." For the first time, then, the Department's formal regulations would generally bar a QIF from receiving more than *de minimis* compensation from parties in interest, and also provide that an otherwise qualified firm will "ordinarily" be deemed not independent if its income from parties in interest exceed the 1% threshold.[1] Perhaps by using the words "generally" and "ordinarily" the Department may be trying to indicate that it will apply these standards flexibly if the rule is adopted. But the community of plan sponsors and fiduciaries will likely see it differently. IFS believes that stating the *de minimis* and 1% tests in a formal regulation will effectively create a presumption that a firm whose compensation exceeds those thresholds is subject to improper influence. It will send a strong signal to the plan sponsors and named fiduciaries selecting firms to serve as the QIF for a transaction that they should limit their searches to firms that will limit their compensation to fall below the 1% test in order, at the very least, to limit the issues the Department will have to consider in evaluating the PTE Application. This is unnecessary and detrimental to the interests of plans and their participants.

1. It is simply not the case that a qualified firm willing to undertake the obligation to consider and decide on behalf of a plan whether to engage in a transaction subject to ERISA's demanding fiduciary requirements set forth in ERISA Section 404(a) can be presumed subject to improper influence unless it receives at least 99% of its income from sources other than the parties in interest with respect to the transaction. This is particularly true when the independent fiduciary assignment represents a single decision involving parties in interest with whom the fiduciary firm has no other relationship, so that the prospect of recurring income beyond the compensation for the individual assignment is simply not present.

2. The *de minimis* and 1% rules do not reflect the complexity of many transactions that are the subject of PTE applications and the resources a QIF must devote to evaluating them prudently on behalf of plans. The discussion of Section 2570.34(d) of the

[1] While *1995 Exemption Procedures* also articulated a 1% benchmark for judging independence, the Department there acknowledged (in footnote 5) that the Department has permitted a QIF to receive as much as 5% of its income from a party in interest and its affiliates, an acknowledgment not stated in the Proposed Regulation. Moreover, as a matter of administrative law, a formal regulation adopted through "notice and comment" rulemaking carries greater weight than a unilateral pronouncement such as *1995 Exemption Procedures*.

Proposed Regulation in the Summary of Background states that past PTEs granted by the Department "generally involv[e] non-complex transactions." Not so. Even an examination of PTEs limited to those granted in 2010 shows that many involve transactions that are quite complex. *See, e.g.*, PTE 2010-08 (Ford Motor Co.; management and disposition of complex securities); PTE 2010-12 (Chrysler LLC; management and disposition of complex securities); PTE 2010-18 (Boston Carpenters Apprenticeship and Training Fund; acquisition of condominium unit subject to intricate financing arrangements).

The *de minimis* and 1% standards do not reflect the dedication, expertise and thoughtfulness that plans deserve and the Department expects from QIFs. Evaluating complex transactions with the rigor that the law's fiduciary standards and the Department's thorough review of PTE applications require necessarily imposes a responsibility on the QIF to devote significant time and other resources to the evaluation of the transactions and preparation of the report that the Department regularly requires. Put another way, there is nothing *de minimis* about the work a QIF must do and the fiduciary risk a QIF assumes. Limiting the compensation available for assuming those burdens to a *de minimis* level that does not exceed a mere 1% of a firm's annual income is simply inconsistent with the nature of the QIF role.

3. If the Proposed Rule is adopted, it will have the inevitable effect of limiting competition for the role of independent fiduciary for a complex transaction to only a handful of large firms. For example, if a transaction by its nature could reasonably be expected to command a fee of $150,000 in a given year, only firms with annual income in excess of $15 million would be presumptively independent.

   This lack of competition will likely have the perverse effect of driving up the cost of engaging an independent fiduciary as plan sponsors and fiduciaries will likely limit their consideration of firms whose inability to satisfy the *de minimis*/1% standard would render them less attractive. Alternatively, and also perversely, the benchmark could lead plan sponsors and fiduciaries to cause plans, rather than parties in interest, to pay the fee of the independent fiduciary, since the *de minimis* compensation standard applies only to compensation from parties in interest and their affiliates.

4. As presented, the 1% benchmark in the Proposed Rule does not reflect the fact that a QIF's fee arrangement often requires that the QIF bear the costs of fees of outside professionals whom the QIF retains on behalf of the plan to assist it with the performance of its duties. A significant portion of a QIF's compensation from the parties in interest with respect to a project may in fact ultimately be paid to outside lawyers, actuaries and other consultants.

5. The 1% threshold is substantially lower than the test used in other contexts under ERISA for evaluating whether entities have a material relationship with each other that can create inappropriate influences or pressures. *See, e.g.*, ERISA Sec. 3(14)(H)

and (I) (10% shareholder, partner or joint venture relationship for "party in interest" purposes); PTE 84-14, Sec. V(d)(3) (5% partner or ownership relationship to constitute an "affiliate") PTE 84-14, Sec. I(e) (QPAM exemption not available if assets of related plans exceed 20% of total assets managed by the QPAM).[2]

IFS agrees with the Department that the Rule should give prospective applicants for PTEs and independent fiduciaries guidance on how the Department views the relationship between the QIF's compensation and its independence from the parties in interest. That guidance should take the form of outlining the factors that parties engaging a QIF and the QIF itself should consider when setting the compensation for the particular engagement. Therefore, IFS proposes that Section 2570.33(j) be revised to read as follows:

> A *qualified independent fiduciary* is any individual or entity with appropriate training, experience, and facilities to act on behalf of the plan regarding the exemption transaction in accordance with the fiduciary duties and responsibilities prescribed by ERISA, that is independent of and unrelated to any party in interest engaging in the exemption transaction and its affiliates; the determination as to the independence of a fiduciary is made by the Department on the basis of all relevant facts and circumstances including, but not limited to, the compensation the fiduciary receives from parties in interest to the transaction and their affiliates. An independent fiduciary retained in connection with an exemption transaction must not receive compensation (including amounts received for preparing fiduciary reports and other related duties) from the parties in interest to the transaction or their affiliates that is inconsistent with the appearance and reality of the fiduciary's independence or that may render the fiduciary subject to improper influence by a party to the transaction other than the Plan, or the appearance of such improper influence. For purposes of determining whether the compensation received by the fiduciary satisfies this standard, factors taken into account will include (i) all compensation received by the fiduciary, reduced by the reasonable fees and expenses the fiduciary pays from that compensation to unrelated third parties (such as attorneys, actuaries and other consultants) for services in connection with the fiduciary's performance of its duties, (ii) the complexity of the transaction, (iii) the amount of plan assets involved (in both absolute terms and as a percentage of the plan's total assets), (iv) the expected duration of the independent fiduciary engagement and whether the compensation therefrom will be ongoing, (v) the nature of any relationship separate from the exemption transaction the fiduciary has with the plan and the relevant parties in interest, and (vi) other elements

[2] Assets under management can be a proxy for income since many investment advisory firms' fee arrangements are calculated as a percentage of assets under management.

> specific to the exemption transaction. In all events, the burden is on the applicant to demonstrate the independence of the fiduciary.[3]

The Qualified Independent Fiduciary's Reporting Requirement Should be Modified

Section 2570.34(d) of the Proposed Regulation sets forth the information a QIF must submit to the Department when an exemption transaction requires the retention of a QIF. Section 2570.34(d)(8) addresses the disclosure that the QIF must make relating to its compensation from parties in interest. IFS proposes that Section 2570.34(d)(8) be modified to reflect our comments above concerning the *de minimis*/1% benchmark.

In addition, IFS recommends that the Proposed Regulation state explicitly that the independent fiduciary's gross business income (in the case of an entity service as QIF), the denominator in the percentage calculation, be calculated on the basis of the specific subsidiary or business unit serving as QIF, rather than the gross business income of the entire enterprise of which the QIF is a part. As explained in our comments above concerning Section 2570.31(j), the 1% threshold inappropriately burdens smaller firms from serving as a QIF on projects that reasonably command a substantial fee, leaving larger firms free from competition from such firms. This "big firm" bias of the rule is exacerbated if a firm may calculate the relevant percentage on the basis of an entire enterprise's annual income. Given that the purpose of examining the QIF's compensation from parties in interest is to assure the QIF's freedom from undue influences, business realities compel the conclusion that the financial picture of the QIF business unit is the relevant measure, since it is the leadership of that unit that needs to be free from undue influence. The fact that the fee earned on a particular engagement is only a tiny portion of the total income of a diversified financial services giant is far less significant than the fact that it is a major portion of the fiduciary unit's income.

Finally, IFS believes that the denominator should reflect the greater of the prior federal income tax year's income or the QIF's good faith estimate of the current year's income since the relationship between the compensation for the transaction in question and the current state of the business is at least as relevant as data that may be as much as a year old when the calculation is made in connection with a particular PTE application.

---

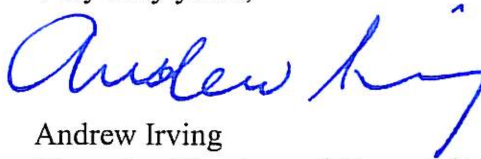
[3] If the Department is of the view that it is important to reference a specific percentage of annual revenue, IFS believes that identifying a benchmark in terms of a likely upper limit on the compensation that a QIF may receive from parties in interest will better serve the goal of assuring that QIFs are not subject to inappropriate outside influences when they do the work and avoiding the adverse impacts of the Proposed Rule described above. As the Department observed in *1995 Exemption Procedures*, the Department has approved of independent fiduciaries receiving as much as 5% of their annual income from parties in interest and their affiliates. IFS believes that a statement in the Preamble to the Final Rule rather than the Rule itself would be sufficient for that purpose. The statement could read as follows, "The Department will generally consider that a fiduciary is not independent if its net compensation from parties in interest to the transaction and their affiliates is equal to or greater than 5% of the annual revenue of the fiduciary."

Accordingly, IFS proposes that Section 2570.34(d)(8) be revised to read as follows[4]:

> (8) The qualified independent fiduciary shall submit a written representation disclosing the percentage of such fiduciary's current compensation that was derived from a party in interest involved in the transaction or its affiliates; in general, such percentage shall be computed by comparing, in fractional form:
>
> (i) The amount of the fiduciary's projected compensation that will be derived from the party in interest or its affiliates for the current federal income tax year, minus the reasonable fees and expenses the fiduciary is projected to pay from that compensation to unrelated third parties (such as attorneys, actuaries and other consultants) for services in connection with the fiduciary's performance of its duties (expressed as a numerator); and
>
> (ii) The fiduciary's gross personal or business revenue (excluding fixed, non-discretionary retirement income) for the prior federal income tax year, or revenue as reasonably projected by the fiduciary for its current federal income tax year, whichever is greater (expressed as a denominator).
>
> For purposes of this subsection, the revenue of a fiduciary that is a business within or affiliated with another business or entity shall be calculated solely with respect to the fiduciary business itself.

IFS hopes that these comments are helpful to the Department in formulating its final regulation on this important subject. Please do not hesitate to contact the undersigned with any questions you may have.

Very truly yours,



Andrew Irving
Managing Director and General Counsel

Enclosure

AI/klw

---

[4] The revised version of the Rule set forth below uses the word "compensation" instead of "income" in subparagraph (i) and the word "revenue" instead of "income" in subparagraph (ii) since the word "income" has a technical meaning not necessarily appropriate in this context.

Exhibit 1

IFS PTE Transactions since 1989

	Client	PTE No.	Date DoL Granted Exemption
1	Pan American World Airways, Inc.	89-66	08/08/1989
2	Independent Fiduciary Services, Inc. (Plumbers and Pipefitters National Pension Fund)	2001-39	10/17/2001
3	Bank of America Corporation	2001-46	12/06/2001
4	Louisville Electrical Joint Apprentice and Training Committee Trust Fund	2002-34	06/17/2002
5	ARINC Incorporated Retirement Income Plan	2004-19	11/19/2004
6	Kaiser Aluminum Corporation	2006-19	01/04/2006
7	Fortunoff	2006-08	06/02/2006
8	The Plumbers and Pipefitters National Pension Fund (PPNP/ Diplomat Properties)	2007-01	01/17/2007
9	American Maritime Officers Safety & Education Plan	2007-12	06/07/2007
10	Ford Motor Company	2010-08	03/24/2010
11	Boston Carpenters Apprenticeship and Training Fund	2010-18	06/11/2010