May 31, 2022

Submitted Electronically

Mr. Ali Khawar
Acting Assistant Secretary
Employee Benefits Security Administration
U.S Department of Labor
200 Constitution Ave NW
Washington, DC 20210

RE: Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications (RIN 1210-ACO5)

Dear Acting Assistant Secretary Khawar:

We write on behalf of a group of professional independent fiduciaries (the "Group") with respect to the Department of Labor's proposed rulemaking related to the "Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications" (the "Proposed Rule"). 87 Fed. Reg. 14722 (March 15, 2022). The Proposed Rule would, if finalized in its current form, impose significant new requirements on applicants seeking exemptions and the independent fiduciaries involved in exemptions. The group is concerned that the Proposed Rule will make it unnecessarily costly and difficult to apply for exemptive relief and would deprive plans of the benefits of transactions that are in the interests of the plans and participants and beneficiaries.

We appreciate the Department's decision to extend the comment deadline. The Proposed Rule raises novel legal and policy issues. The extension provided the Group and others with additional time to analyze the Department's proposed rule changes. We continue to believe that the Department's consideration of the Proposed Rule will benefit from an open, public dialogue, so we reiterate our prior request that the Department hold a hearing on the Proposed Rule. Our comments on the Proposed Rule are outlined in detail below.

I. Overview of Concerns

The class and individual exemptions granted by the Department are critical to the efficient operation of the private health and retirement systems. The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and the Internal Revenue Code of 1986, as amended (the "Code"), prohibit a wide array of transactions involving employee benefit plans and IRAs, including transactions that are necessary or advantageous for the ordinary operation of benefit plans and IRAs. Congress understood this and, in addition to creating certain statutory exemptions, provided the Department with authority to grant exemptions on either an individual or class basis, subject to certain conditions. The purpose of granting exemptive authority to the Department was to allow transactions so as "not to disrupt the established business practices of financial institutions which often perform[ ] fiduciary functions in connection with these plans consistent with adequate safeguards to protect employee benefit plans." H.R.Conf.Rep. No. 1280, 93d Cong., 2nd Sess., reprinted in 1974 U.S. Code Cong. & Admin. News 4639, 5038, 5089–90.

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The Proposed Rule is inconsistent with Congress's intent in granting the Department authority to issue prohibited transaction exemptions. The Department states that "[s]tructuring a transaction in a manner that is prohibited by ERISA and requires an exemption should not be the applicant's default approach." 87 Fed. Reg. at 14728. However, that position has no basis in ERISA and is, in fact, inconsistent with the idea that exemptions are to be granted to prevent the disruption of ordinary business practices, subject to adequate safeguards. There is simply no legal requirement that exemptions be issued as a last resort. Rather, as President Carter indicated in his message to Congress regarding Reorganization Plan No. 4 of 1978, which gave the Department exclusive jurisdiction over the prohibited transaction provisions of ERISA, the primary intent was to improve ERISA's administration and to "…eliminate almost all of the dual and overlapping authority in the two departments **and dramatically cut the time required to process applications for exemptions from prohibited transactions**." 14 Weekly Comp. Pres. Docs. 1401 (1978), Monday, August 14, 1978 (emphasis added). Both Congress and the Executive Branch, from the inception of ERISA, understood that an efficient, responsive and thorough exemption process was critical to the operation of employee benefit plans subject to ERISA. This is as true today as it was when ERISA was enacted.

Given these fundamental issues, the Group has grave concerns with the Proposed Rule. It would completely change the prohibited transaction exemption process and further discourage employers and service providers from working with the Department to structure transactions in the most beneficial manner possible. The Department has failed to demonstrate a need for the imposition of significant new compliance burdens on exemption applicants and other entities who may be involved with exemptions, including independent fiduciaries, and the proposal does not indicate any material changes in circumstances that would support a change in the Department's previously promulgated processes. The Proposed Rule will have material direct and indirect costs. This is not mere speculation, as the Department's informal practices over the past several years have already had a significant chilling effect on the filing of exemption applications. It is also, in our view, counterproductive to the Department's own interest in regulating fiduciary conduct in that it gives the Department less insight into, and less control over, industry practices.

II. Specific Comments

A. Revenue Test for Independence

Under current rules, a fiduciary or appraiser is presumed independent if less than 2% of its revenue is derived from parties in interest engaging in the exemption transaction, but the fiduciary or appraiser may nonetheless be independent if the revenue is less than 5%. 29 C.F.R. § 2570.31(i), (j). The Proposed Rule would modify these measures of independence by providing that a fiduciary or appraiser will not be treated as independent if the revenues it receives or is projected to receive from parties involved in the exemption exceeds 2%, unless the Department decides in its sole discretion otherwise. 87 Fed. Reg. at 14740.

The 2% threshold is inconsistent with the Department's prior positions on independence. For example, Department concluded in 2001 that an entity may be considered independent of another entity if the amount of revenue it receives in connection with the other entity is 5% or less. DOL Adv. Op. 2001-09A (Dec. 14, 2001). Recent exemptions proposed by the Department still reflect this view of independence. *See, e.g., Proposed Exemption involving Retirement System of the American National Red Cross*, 86 Fed. Reg. 64691 (Nov. 18, 2021) (independent fiduciary's revenue "that is derived from

any party in interest or its affiliates involved in the Transaction is less than five percent (5%) of its previous year's annual revenue from all sources").

The Department offers no explanation as to why it has now determined it is necessary to redefined independence. The purpose of the revenue test is to protect participants from the risk that a fiduciary's financial benefit from a particular transaction or relationship is so great that it could irreparably compromise the fiduciary's ability to make prudence decisions. However, we see no reason to believe that this risk is material at the current 5% threshold, and importantly, the Department has failed to provide any study or research justifying the change.

The Proposed Rule appears to allow the Department virtually unlimited discretion to determine whether a fiduciary meets the revenue test. Under the Proposed Rule, the Department can consider the amount of actual or projected revenue a fiduciary receives from a party to a transaction in a given year and/or the fiduciary's actual or projected total revenues for a given year when calculating the revenue threshold. The Group does not believe it is workable, appropriate or consistent with current practice to project revenue for purposes of these calculations. If the Proposed Rule is intended to bring further transparency to the exemptions process, then the elements necessary to establish the independence of a fiduciary should be clear and readily ascertainable by the parties proposing the exemption.

The Proposed Rule includes no analysis of the impact of excluding otherwise qualified fiduciaries from eligibility to serve. The Group believes it is probable that the reduced revenue test would lead to industry consolidation resulting in only a small handful of firms with the largest number of engagements potentially meeting the definition of "independent." The Department has not analyzed the risk of this type of concentration, and we fail to see how it serves the interests of participants and beneficiaries. Moreover, it creates an arbitrary barrier for fiduciaries with specialized expertise when, in fact, the benefit of specialization may greatly outweigh any theoretical risk of compromised judgment.

B. Parties from Whom Independence is Required

Currently, a fiduciary must be independent from "any party in interest engaging in the exemption transaction and its affiliates." 29 C.F.R. § 2570.31(i); (j). The Proposed Rule would expand the field of entities the fiduciary must be independent from to include all parties in interest and all entities providing services to the parties in interest with respect to the exemption transaction. 87 Fed. Reg. at 14740. Further, the Proposed Rule would require the independent fiduciary to be independent from an independent appraiser, thereby prohibiting the independent fiduciary from performing the appraisal even if otherwise qualified to do so. The Proposed Rule would essentially give the Department unfettered discretion to determine a fiduciary's independence, providing that, "In general, the determination as to the independence of a fiduciary will be made by the Department on the basis of all relevant facts and circumstances." Id.

The requirement that the fiduciary be independent from all parties in interest (and all entities providing services to parties in interest) is unreasonably overbroad, without basis, and impracticable. The definition of a "party in interest" under ERISA includes any service provider to the plan. ERISA § 3(14). Under the Proposed Rule, the fiduciary or appraiser would be required to be independent from all of the plan's service providers, including directed trustees, custodians, and recordkeepers, even if these service providers do not act as a fiduciary in connection with the exemption transaction or play a role in assisting in the development of the exemption application. A fiduciary's relationship with a service provider does not raise an issue as to the fiduciary's independence, and expanding the

independence requirement to include all plan service providers would result in fewer skilled independent fiduciary firms being available. We also note that the Department's prior rule was interpreted as excluding the plan itself from the definition of "affiliate" for purposes of the independence test; as written, the Proposed Rule does not clearly maintain this position. The Group requests that the Department clarify this point.

The Group believes that the requirement that an independent fiduciary be independent from the independent appraiser is entirely unnecessary. The Department's stated concern is that an independent fiduciary could exhibit undue influence on the independent appraiser. This has not been the experience of the members of the Group in dealing with appraisers at all (who have their own professional standards and approaches to appraisals). Further, the Department's view on a relationship having "undue influence" potentially inhibits fiduciaries from thoroughly reviewing and assessing the merits of a particular appraisal – in effect, making the fiduciary a rubber stamp of the appraisal. That is not, in the Group's view, the appropriate basis upon which to render a fiduciary judgment. In most cases, the rationale for an appraisal is to assist the independent fiduciary in making a ***fiduciary*** determination that a transaction is in the interest of the plan; the appraiser's role is to assist the fiduciary in doing so, not to substitute its judgment for that of the fiduciary, and the fiduciary has to be allowed to evaluate and understand the basis for the determination. Moreover, where an independent fiduciary has the internal resources to perform a valuation and can meet the requirements imposed on independent appraisers, it is unreasonable and unnecessary to require an additional company to perform the appraisal. The Proposed Rule would only serve to add cost and burden to exemption compliance, and notably, the Department has failed to provide any analysis demonstrating the appropriateness of such costs.

The Group also objects to the extent of discretion that the Proposed Rule affords the Department in determining a fiduciary's independence. By permitting the Department to determine independence "on the basis of all relevant facts and circumstances," the Proposed Rule would make it impossible for parties to an exemption to know in advance whether the Department will deem a fiduciary to be independent. The Group does not believe the Department has adequately documented concerns about fiduciary independence to warrant the proposed changes. As an example, PTE 2003-39 requires a fiduciary to authorize a plan's settlement agreement with a party in interest. In this regard, the conditions of PTE 2003-39 provide that the authorizing fiduciary, "have no relationship to, or interest in, any of the parties involved in the litigation, other than the plan, that might affect the exercise of such person's best judgment as a fiduciary." PTE 2003-39, §2(b). When the Department initially proposed and finalized the exemption in 2003, when the Department proposed additional changes to the exemption in 2007, and when it finalized the amendments in 2010, it did not identify any problems with fiduciaries acting in an independent manner.

In the preamble to the 2007 proposed amendments, the Department described concerns it had that some independent fiduciaries were construing their responsibilities more narrowly than the Department had intended. To address this, the Department proposed changes to the exemption that made clear the independent fiduciary must consider the entire settlement, including attorney's fees awards that would reduce the value of the settlement to the plan. 72 Fed. Reg. 65597, 65600-01 (Nov. 21, 2007); 75 Fed. Reg. 33830, 33832 (Jun. 15, 2018). As stated in the proposed changes, the Department had been talking with independent fiduciaries and practitioners using PTE 2003-39 and had reviewed numerous settlement agreements approved under the exemption. Indeed, the Department chose to add clarifying language to ensure that independent fiduciaries fully understood the scope of their responsibilities under the exemption. Notably, however, the Department did not seek to change

the standard under the exemption for establishing independence (i.e., that the independent fiduciary "have no relationship to, or interest in, any of the parties involved in the litigation, other than the plan, that might affect the exercise of such person's best judgment as a fiduciary.")

In fact, neither the Department nor a single commenter on the proposed amendments to PTE 2003-39 took issue with the standard used by the Department to establish the independence of the authorizing fiduciary. No issues were identified in the proposed exemption or the comments that indicated independent fiduciaries were not sufficiently qualified, sufficiently independent or that such persons were not exercising their responsibilities consistent with the fiduciary responsibility provisions of ERISA. PTE 2003-39 is still being used today and numerous courts have relied on PTE 2003-39 as evidence of the reasonableness of a settlement. *See, e.g.*, In re Marsh ERISA Litig., 265 F.R.D. 128 (S.D.N.Y. 2010); Johnson v Fujitsu Technology & Bus. Of Am., 2018 WL 2183253 (D.C. Cal. 2018).

Having worked with the Department on numerous exemptions over many years, the Group is at a loss to understand what actions prompted the Department to propose such extreme changes. Nor does the Proposed Rule explain the basis for the Department's concerns. Based on its collective experience, the Group suggests that the Department meet with stakeholders to discuss the role of independent fiduciaries in exempt transactions before re-proposing changes to the exemption application procedures.

C. Future Transactions

The Proposed Rule provides that the Department would consider whether the independent fiduciary will have an interest in "future transactions of the same nature or type" when determining whether the fiduciary is independent. 87 Fed. Reg. at 14740. In the preamble, the Department states that a "fiduciary may not be independent if it has a business interest in promoting the exemption transaction." 87 Fed. Reg. at 14726.

Potentially disqualifying an independent fiduciary who intends, as part of its business, to work on more than one engagement is counterproductive and is so vague and subjective as to constitute a restraint of trade that has no support in ERISA. It is also completely inconsistent with the notion that independent fiduciaries need to develop sufficiently robust practices so as to meet the percentage-of-revenues test discussed above. Finally, the Department, perhaps unintentionally, is in effect advocating that independent fiduciaries be inexperienced in the transactions or issues raised in a proposed exemption. This is wholly inconsistent with ERISA's fiduciary standards, as articulated by the Department and the courts over the last few decades. The Department should not penalize fiduciaries of any type for seeking to gain experience in a particular area that future potential clients might seek to utilize. Surely the Department would not advocate, for example, that investment managers be prohibited from marketing their expertise on plan asset management issues to future clients. The Department should be pursuing policies that encourage fiduciaries to gain skills and expertise, as well as a wide range of client relationships, not punishing them for it.

D. Contractual Liability Limitations

The Proposed Rule would prohibit the independent fiduciary's contract or engagement letter from containing terms providing for indemnification for breach of contract or violations of applicable law, or a waiver of the plan's claims under applicable law, including ERISA. 87 Fed. Reg. at 14742,

14743. The Group believes this position is inconsistent with ERISA and with the weight of the Department's historic positions.

As the Department is aware, section 410 of ERISA already prohibits indemnification and limitation of liability provisions that relieve a fiduciary from liability under part 4 of Title I of ERISA. *See* DOL Adv. Op. 2003-08 (June 26, 2003). The new contractual requirements unreasonably deny the availability of traditional indemnification protections that are permissible under ERISA section 410. This in direct contradiction to established practices and the Department's own position that certain "limitations of liability and indemnification provisions, applying to negligence and unintentional malpractice, may be consistent with sections 404(a)(1) and 408(b)(2) of ERISA when considered in connection with the reasonableness of the arrangement as a whole and the potential risks to participants and beneficiaries." DOL Adv. Op. 2002-08 (Aug. 20, 2002).

The Department fails to provide a justification for its changed position or an analysis of the impacts this change will have on applicants or how the use of indemnification and limitation of liability provisions on such commercially reasonable terms should be viewed as per se impermissible. In fact, such provisions are an important tool for cost and risk control, and many experienced firms are likely to cease accepting fiduciary engagements if this provision in the Proposed Rule is not removed.

E. Fiduciary Liability Insurance

The Proposed Rule would require an independent fiduciary to maintain fiduciary liability insurance in an amount sufficient to indemnify the plan for damages resulting from a breach by the independent fiduciary of either (a) ERISA, the Code, or any other Federal or state law; or (b) its agreement with the plan. The Department seeks to impose this requirement despite having conducted no analysis of the additional costs, nor of the limitations of the fiduciary insurance market, and is at best imprecise in trying to identify what is an "amount sufficient" for these purposes – is it tied to the value of the transaction, the parties, or other metrics that need to be identified? The Department has also failed to demonstrate why an independent fiduciary with respect to an individual prohibited transaction exemption should be subject to a requirement not imposed on any other fiduciary, or whether other alternatives (such as minimum capitalization requirements as articulated in other exemptions (e.g., PTCE 84-14 for QPAMs) might also be appropriate

F. Increased Reporting

The Proposed Rule would require that applicants provide additional information in an application about independent fiduciaries, including a statement describing the process leading to the selection of the fiduciary or appraiser, the due diligence performed, the potential independent candidates reviewed, and the references contacted. 87 Fed. Reg. at 14743. The Department states that it intends the requirement to provide "insight into the prudence of the hiring process." 87 Fed. Reg. at 14729.

The Group is concerned that the Proposed Rule does not include adequate safeguards to protect the public disclosure of an independent fiduciary's confidential business information, or that of its clients or parties that, for example, might be used for references. Parties may hire an independent fiduciary before deciding whether it is necessary or helpful to apply for a prohibited transaction exemption. Group members are often asked to sign non-disclosure agreements in connection with such engagements or potential engagements. The Group does not believe it is appropriate for the

Department to require that either the independent fiduciary or the party seeking the exemption disclose the due diligence process for an independent fiduciary engagement. The Department should either clarify that applicants are not required to provide the Department with confidential information or create a process for safeguarding sensitive information.

III. Recommendations

Our focus here is limited to the provisions of the Proposed Rule that directly impact our Group members and their prospective clients. However, we note that there are numerous other provisions that the Group considers to be flawed or ill-conceived that we anticipate will be addressed by others.

In light of the foregoing, we urge the Department to either withdraw the Proposed Rule or, at the very least, propose a new rule after taking into consideration the comments and concerns provided by stakeholders. We further urge the Department to hold hearings on the Proposed Rule.

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We appreciate the Department's consideration of the above comments. We would be please to discuss these issues further.

Sincerely,

Jennifer E. Eller
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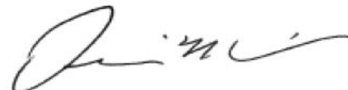

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