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Assistant Secretary Ali Khawar
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption) (Application No. D-12022) (EBSA-2022-0008)

Dear Assistant Secretary Khawar:

The American Bankers Association[1] (ABA) appreciates the opportunity to provide comments to the Department of Labor (Department) on proposed amendments (Proposal) to prohibited transaction class exemption (PTE) 84-14,[2] commonly referred to as the QPAM exemption (QPAM Exemption or Exemption).[3] Under the QPAM Exemption, an investment fund holding assets of retirement plans and individual retirement accounts (IRAs) (collectively, Plans) that is managed by a qualified professional asset manager (the QPAM) generally may engage in transactions with one or more parties in interest or disqualified persons to a Plan, subject to protective conditions and safeguards.[4] Institutional investment managers of retirement assets, which include ABA member banks, serve as QPAMs and therefore rely on the Exemption for relief from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA) and the Internal Revenue Code of 1986, as amended (Code).

Since its issuance nearly four decades ago, the retirement services industry has widely and responsibly relied on the QPAM Exemption to enhance investment performance for retirement assets by (i) providing Plans with the full range of investment management strategies and investment options, and (ii) authorizing QPAMs to engage sub-advisors and other investment management experts to assist the QPAM in effective, efficient, and prudent investment decision-making and risk management. The Exemption, in fact, has become a core market practice of the

[1] The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $19.6 trillion in deposits, and extend $11.8 trillion in loans. Learn more at www.aba.com.
[2] *See* Department of Labor, *Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption)* , 87 *Fed. Reg.* 45,204 (2022) (Proposal).
[3] *See* PTE 84-14, 49 *Fed. Reg.* 9494 (1984). The Department has amended PTE 84-14 on several occasions, most recently in the 2010 amendments to the class exemption. *See* 75 *Fed. Reg.* 38,837 (2010).
[4] *See* Proposal, 87 *Fed. Reg.* at 45,204.

retirement services industry across the spectrum of financial lines of business and products. Moreover, the QPAM Exemption's guardrails ensure proper use of the Exemption, and provide the Department with full authority to supervise its implementation and to sanction improper conduct, including – where necessary – QPAM ineligibility (*i.e.*, disqualification from QPAM status). The QPAM Exemption, in other words, has functioned well and exactly as intended.

Curiously, by issuing the Proposal, the Department has elected to undertake a sweeping overhaul of the QPAM Exemption. We believe this Department action will drastically impact continued reliance on the QPAM Exemption and its critical role as a retirement industry standard. Specifically, the Proposal would (i) considerably expand Department direction, discretion, and oversight, (ii) unilaterally alter existing investment management agreements, (iii) significantly broaden the circumstances under which an asset manager would be disqualified from serving as a QPAM, and (iv) greatly restrict the authority of a QPAM to direct investments and its ability to maximize investment performance for Plan assets. We believe these proposed additions and revisions are entirely unnecessary and unwarranted and may result in an unclear, imbalanced, costly, and unworkable Exemption, while creating significantly heightened compliance and reputation risks. Ironically, rather than benefitting Plans, a finalized Proposal could inflict immediate and lasting harm on Plan participants and beneficiaries and on IRA owners through (i) diminished and compromised returns on retirement assets, (ii) fewer available investment options and strategies, (iii) reduced choice in asset managers, and (v) increased Plan expenses.

We recommend, therefore, that the Department withdraw the Proposal and, prior to any re-proposal, conduct a comprehensive study and assessment of the QPAM Exemption, including: (i) an assessment of the QPAM Exemption's established position in the retirement marketplace for day-to-day investment management activity, (ii) roundtable discussions with QPAMs, client plans that retain QPAMs, and industry stakeholders, and (iii) formal consultations with the federal financial agencies, including the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), and the Office of the Comptroller of the Currency (OCC), as well as with the Department of Justice (DOJ), to determine whether significant revision to the QPAM Exemption is necessary or appropriate and consistent with the rules and regulations of these peer agencies. This should be followed by additional public hearings on the QPAM Exemption and a publicly released written report on the results of the study and assessment.

If the Department proceeds with the Proposal, then we recommend that the Department adopt all of the recommendations described herein.[5] We believe these recommendations, if implemented, not only would provide tangible benefits to Plans but also would work to avoid the compliance uncertainty, liability, and reputational exposure, and the excessive administrative and regulatory costs to QPAMs and Plans, while at the same time preserving QPAMs' authority to (i) pursue prudent investment strategies and investments and (ii) obtain investment management assistance and resources, in order to responsibly discharge their fiduciary obligations under ERISA. We hereby request a public hearing and an opportunity to testify at such hearing concerning the regulatory process leading to the Proposal.[6] We further request a meeting with Department staff to discuss and dialogue on the concerns expressed herein as part of our efforts to work with the

[5] *See* Section III(A) through III(I), *infra*.
[6] The evidence to be presented at such hearing is identified and described in Section II herein.

Department to address its concerns related to the QPAM Exemption in a manner that is targeted, tailored, and purposeful.[7]

I. The Proposal.

The Department originally granted the QPAM Exemption to provide broad exemptive relief from the prohibitions of ERISA sections 406(a)(1)(A) through (D) and corresponding Code section 4975(c)(1)(A) through (D).[8] Specifically, the Exemption is made available for transactions in which a retirement plan engages with a party in interest "if the commitments and investments of Plan assets and the negotiations leading thereto are the sole responsibility of an independent investment manager" (*i.e.*, the QPAM).[9] The QPAM's independence and discretionary control over investment management decisions protect Plans from the risk that one or more parties in interest will improperly influence the decision-making process. Thus, in the words of the Department, "[t]he QPAM acts as a fundamental protection against the possibility that parties in interest could otherwise favor their own competing financial interests at the expense of Plans, their participants and beneficiaries, and IRA owners."[10]

The Department states that the Proposal was prompted by substantial changes and developments that have occurred in the financial services industry since the QPAM Exemption was issued, namely (i) industry consolidation, (ii) financial institutions' increasingly global reach in affiliations and in investment strategies involving retirement assets, and (iii) the Department's accumulated experience in dealing with corporate criminal convictions that give rise to QPAM ineligibility. In its subsequently released Initial Regulatory Flexibility Analysis, the Department states further that the Proposal is necessary "to ensure the QPAM Exemption remains in the interest of and protective of the rights of Plans, their participants and beneficiaries, and individual retirement account (IRA) owners."[11] The Department, however, does not point to, identify, or explain any problems, gaps, or issues with the implementation or functioning of the QPAM Exemption itself. It is thus unclear why the reasons cited by the Department would necessitate substantive, in certain cases far-reaching, changes to the QPAM Exemption.

Indeed, the Proposal contains three striking additions that would fundamentally alter the operation and functionality of the QPAM Exemption. Specifically, the Proposal would:

(1) require Department-drafted language to be inserted into investment agreements between QPAMs and their Plan clients;

(2) expand the basis for QPAM ineligibility by significantly broadening the circumstances to include not only "substantively equivalent" foreign crimes, but also any instance of "prohibited misconduct" of the QPAM or any affiliate; and

[7] Given ongoing concerns about transmission of COVID-19 and its variants, we would be willing and available to engage in such discussion through video and/or audio conference calls with Department staff.
[8] Proposal, 87 *Fed. Reg.* at 45,205.
[9] *Id.*
[10] *Id.*
[11] Department of Labor, *Initial Regulatory Flexibility Analysis for Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption)*, 87 *Fed. Reg.* 56,912 (2022) (Regulatory Analysis).

(3) require the QPAM to become solely responsible for all aspects of investment fund transactions, including initiation, terms, commitments, investments, and associated negotiations.[12]

The Proposal further would (i) provide a one-year winding down period of circumscribed activity for ineligible QPAMs in connection with terminating their relationship with client Plans, (ii) adjust the asset management and equity thresholds in the QPAM definition, (iii) include a new recordkeeping requirement, and (iv) require QPAMs to provide a one-time notice to the Department of their reliance on the QPAM Exemption.[13] The proposed revisions collectively would result in a significant restructuring and reworking of the QPAM Exemption.[14]

II. General Concerns.

The Department's goal of revising an established and longstanding class exemption calls for discreet and measured rulemaking, since "[g]overnment actions can be unintentionally harmful, and even useful regulations can impede market efficiency."[15] Given the scope and magnitude of the Department's proposed amendments to the QPAM Exemption, it would have been prudent, beneficial, and constructive if Department staff, prior to the Proposal's issuance, had reached out and consulted with QPAMs and their client Plans and service providers.[16] Indeed, prior to drafting the Proposal, we believe that the Department's *obligation* was to seek input from these and other stakeholders likely to be impacted from the revisions and additions to the QPAM Exemption. As stated in Executive Order 13563:

> "*Before* issuing a notice of proposed rulemaking, each agency, where feasible and appropriate, *shall* seek the views of those who are likely to be affected, including those . . . who are potentially subject to such rulemaking."[17]

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[12] Proposal, 87 *Fed. Reg.* at 45,204-05.

[13] *Id.*

[14] The Proposal also appears to conflict with the Department's earlier views on class exemptions expressed in its 1982 QPAM proposal. *See* 47 *Fed. Reg.* 56,945, 56,947 (1982) ("Where a potentially prohibited party in interest transaction is identified and is not covered by an existing class exemption, the asset manager may have to choose between applying for an individual administrative exemption or foregoing the investment opportunity entirely. The Department believes that further actions would be appropriate in order to eliminate the need for individual exemptions wherever feasible, and that substantial deregulation in this area can be accomplished by administrative means without sacrificing the interests of plan participants and beneficiaries."). *See also id.* at 56,946 ("[T]he Department believes that, as a general matter, transactions entered into on behalf of plans with parties in interest are most likely to conform to ERISA's general fiduciary standards where the decision to enter into the transaction is made by an independent fiduciary.").

[15] OMB Circular A-4 (Sept. 17, 2003).

[16] For instance, the Proposal would have greatly benefitted from a collaborative process between the Department and representatives from banks and other asset managers that are QPAMs to discuss the operation and functioning of the QPAM Exemption and to identify any issues of concern or any compliance or administrative challenges, which the Department then could have factored into the Proposal. The Department further could have benefitted from consultations with staffs at the SEC, CFTC, OCC, and DOJ on how the Proposal might interact with rules and requirements of the other agencies that could impact implementation of a revised QPAM Exemption.

[17] Executive Order 13563: Improving Regulation and Regulatory Review § 2(c) (Jan. 18, 2011). [Emphasis added.] *See also* OMB Circular A-4, *supra*: "As you [the Department] design, execute, and write your regulatory analysis, *you should seek out the opinions of those who will be affected by the regulation* . . . Consultation can be useful in ensuring that your analysis addresses all of the relevant issues and that you have access to all pertinent data. *Early*

We are not aware of any Department efforts, prior to the Proposal's issuance, to study, survey, analyze, or evaluate banks or other asset managers serving as QPAMs to understand how current activities would be directly or indirectly impacted by the Proposal. The Department likewise has not uncovered any evidence of systemic misconduct, violations, or abuse, to support its conclusion that the QPAM Exemption is flawed and in need of revision.

Instead, the Department has relied on its general sense of macro-trends in global asset management and on its experience with the individual exemption process. This appears to be a largely extraneous policy rationale, particularly given the absence of any discernible problems or deficiencies with the QPAM Exemption. The Proposal plainly would have benefitted from the reaction and input of the retirement services industry prior to its release. At a minimum, the omission of advance input from impacted banks and other marketplace participants and stakeholders provides a compelling reason to withdraw the Proposal.[18]

While we believe that the Proposal among other things would (i) disrupt the smooth and efficient functioning of the QPAM Exemption in the retirement marketplace, (ii) raise considerable compliance uncertainty, regulatory burden, and implementation costs with respect to QPAMs, their client Plans, and other impacted parties, and (iii) possibly expose a QPAM to violating its ERISA fiduciary duty to diversify investments and to manage plan expenses prudently by avoiding unnecessary costs,[19] we are particularly concerned about the following unintended consequences of the Proposal specifically on Plans and on participants, beneficiaries, and IRA owners:

- ***Potentially diminished and compromised investment returns on retirement assets.*** The Proposal has the potential to greatly restrict a QPAM's ability to seek investment management assistance from sub-advisors and fund investment experts since the Proposal could reasonably be interpreted to mean that a QPAM's "sole responsibility" includes responsibility for each and every aspect of an investment fund transaction. This interpretation could greatly restrict the QPAM's ability to find and invest in optimal performing investments, leading to reduced investment performance return for Plan assets. Other investment returns may be compromised because the QPAM Exemption may be unavailable for transactions involving fixed income securities and a number of derivatives products, given the role of counterparties – who may be parties in interest with respect to a client plan – in those transactions.[20]

- ***Fewer available investment strategies.*** Again due to the proposed requirement that QPAMs exercise sole responsibility in investment transactions, there could be fewer available investment strategies for client Plans, as QPAMs may not be able to leverage

consultation can be especially helpful. You should not limit consultation to the final stages of your analytical efforts." [Emphasis added.]

[18] We would be glad to work with the Department as it evaluates how to improve the Proposal, consistent with the federal government's priority that the rulemaking respond to compelling need and offer "the least burdensome tools for achieving regulatory ends." Executive Order 13563, *supra*, §1(a).

[19] *See* n.20, *infra.*

[20] These negative consequences further expose the QPAM to liability under ERISA for breach of fiduciary duty to the client Plan due to a failure to diversify investments and defray Plan expenses. *See* 29 U.S.C. § 1104(a)(1)(C) (investment diversification), § 1104(a)(1)(A)(ii) (defraying reasonable expenses of the plan).

the expertise or advice of sub-advisors specializing in certain investment sectors (*e.g.*, global commodities, ESG).

- ***Reduced choice in asset managers.*** The significantly lowered thresholds for QPAM ineligibility and the accompanying reputation and liability risks may lead to fewer available QPAMs due to (i) QPAMs that become ineligible as a result of the criminal conviction or prohibited misconduct of the QPAM or an affiliate (particularly in a foreign jurisdiction),[21] (ii) investment managers that no longer can serve as QPAMs as a result of the raised minimum asset threshold requirements, and (iii) QPAMs that voluntarily give up their QPAM status as a result of the increased reputation and liability risks arising from the Proposal.

- ***Increased costs to Plans.*** The significant costs to comply with the QPAM Exemption's amended requirements will likely mean increased expenses for Plans, including greater costs as a result of a QPAM losing the efficiencies of securing the advice and expertise of sub-advisors and other parties that assist the QPAM in investment decision-making and risk management.

III. ABA Recommendations for Proposal.

Without limiting the foregoing, we also wish to comment on specific portions of the Proposal that are of particular concern to our members and which the Department should consider fully in its evaluation of the Proposal.

A. Administrative Action on Proposal.

The Department should not take any regulatory action on the QPAM Exemption since none is necessary. The Exemption already (I) provides adequate relief for QPAMs relying on the Exemption and (II) effectively equips the Department with the supervisory tools necessary to enforce its requirements.

We believe that the Department does not need to take any regulatory or other agency action on the QPAM Exemption since the Exemption has been working as intended and provides the Department with the supervisory tools necessary to enforce its provisions. Consequently, we believe that the Department should withdraw the Proposal in its entirety. If the Department believes that amendments to the QPAM Exemption are warranted, then it should withdraw the Proposal and undertake, in the manner described above, a comprehensive agency study and assessment of the QPAM Exemption. After this study is concluded, the Department would be equipped to determine whether or not to amend the QPAM Exemption.

If after the completed study is released, the Department reasonably concludes that amendments to the QPAM Exemption are warranted, then the Department should first (i) issue an Advance Notice of Proposed Rulemaking (ANPR) to provide full opportunity for public comment and subsequent public hearings that would assess the need for the proposed amendments to the

[21] Based on the Department's estimate, this factor alone could result in disqualification of nearly a quarter of all QPAMs over the next 10 years.

QPAM Exemption, and (ii) after completion of the ANPR process, ensure that any subsequent proposed rulemaking provides specifically tailored and workable improvements to the QPAM Exemption.

B. Department-Mandated Indemnification Language in Investment Management Agreements.

Do not require Department-mandated indemnification and related language to be inserted into investment management contracts. Such a requirement among other things would require existing agreements to be re-opened, re-negotiated, reconciled with conflicting contractual provisions, and possibly re-priced to reflect the new requirement, resulting in costs to QPAMs and to their client Plans far in excess of the Department's estimate.

As part of the Department's implementation of a new section entitled "Integrity," the Proposal would require every QPAM to amend their written investment management agreements with client Plans to provide that if the QPAM becomes ineligible to rely on the Exemption, then the QPAM:

(i) agrees not to restrict the client Plan's ability to terminate or withdraw from its arrangement with the QPAM;

(ii) with certain exceptions, will not impose any fees, penalties, or charges on the client Plan in connection with the process of terminating or withdrawing from a QPAM-managed investment fund;

(iii) agrees to indemnify, hold harmless, and promptly restore actual losses and costs to the client Plan (including losses and costs arising from unwinding transactions and from transitioning Plan assets to an alternative QPAM or other asset manager) for any damages directly resulting from a violation of applicable laws arising out of the conduct that caused ineligibility; and

(iv) will not employ or knowingly engage any person who participated in the conduct that is the subject of the QPAM's ineligibility.[22]

The Department provides no legal, regulatory, or public policy rationale for imposing this enormously burdensome and costly requirement. Moreover, there is no evidence that the Department has reviewed and analyzed these investment management agreements; if it had, the agency would have discovered that there are often liability and indemnification provisions already in place that are intended to protect plans in the event of a non-exempt prohibited transaction or breach of fiduciary duty. Instead, the Department apparently believes that in implementing this requirement, QPAMs will merely need to send an "update" to client Plans and "would be able to prepare a single standard form with identical language and then send it to each client Plan."[23] The Department further estimates that "it will take one hour of in-house legal

[22] Proposal § I(g)(2), 87 *Fed. Reg.* at 45,227.
[23] *Id.*, 87 *Fed. Reg.* at 45,218.

professional time to update and supplement their existent standard management agreements, and two minutes of clerical time to prepare and mail a one-page addition to the agreement to each client Plan," for a total industry cost of $135,540.[24]

These estimates starkly reveal the Department's well-intentioned but deeply flawed understanding of how contractual arrangements operate between QPAMs and their client Plans. As commonly found in negotiated commercial arrangements, investment management agreements between QPAMs and Plan clients routinely include language that expressly set forth the terms, conditions, and procedures for amending these agreements. These contracts often do not authorize or provide for unilateral insertions. Rather, in order to implement the Department's proposed directive, the QPAM and its client Plans may be required to re-open, review, and if necessary, renegotiate the terms and conditions of the agreement and possibly re-price the arrangement. Since these contracts routinely include liability and indemnification provisions, these terms will need to be reviewed, reconciled, and rewritten to accommodate the Department's mandatory language. Moreover, the QPAM likely will need to contact and work with each client Plan *separately* to comply with the Proposal's contractual language requirement.[25] This requirement will result in a dollar amount for industry compliance that is exponentially in excess of the Department's estimate – by one conservative estimate, nearly $1 billion.[26]

We recommend, therefore, that the Department delete from the Proposal the language requiring QPAMs to include the indemnification and other provisions described in Section I(g)(2). As noted above, investment management agreements between QPAMs and their client Plans already provide mutually agreed-upon sufficiently protective liability and indemnification clauses in their contracts that would apply to and address the possibility of the QPAM's ineligibility to rely on the QPAM Exemption. Alternatively, *provided that there are no other available exemptions on which the QPAM may rely*, the Department could mandate that the contract requirements be triggered only upon the *final* determination of a violation of the Exemption's Section 1(g) (Integrity), at which point the QPAM would be required to notify client Plans and provide them

[24] *Id.* The Department bases this industry dollar amount on its estimate that, on average, a single QPAM services 32 client Plans. *See* Regulatory Analysis, 87 *Fed. Reg.* at 56,915. We believe this figure greatly underestimates the average number of client Plans serviced by each QPAM. *See* n. 26, *infra.*

[25] This is further assuming that a plan would negotiate in good faith and not seek to amend or otherwise alter the terms of the agreement that are not part of the indemnification requirement. There is also no guarantee that a QPAM would be able to amend every contract in a timely manner as negotiations with certain plans may take significantly longer than the timeframe contemplated by the Department.

[26] One QPAM, an ABA member, has indicated that it has over 4500 contracts with Plan clients, each of which would need to be re-opened and separately reviewed and re-negotiated. (Some ABA members, in their capacity as a QPAM, have significantly more written agreements with Plans.) Allowing a minimum of 10 hours for the QPAM to complete the new contractual arrangement to reflect the insertion of the Department's indemnification language, and using the Department's adopted hourly rate of $140.96, it would cost this one QPAM just over $6.3 million to comply with this amended section of the Exemption. Adding Plan clients' time with the QPAM and their respective costs, the total amount would double to over $12.6 million. Even if the remaining QPAMs (616 by the Department's count) each have only one-quarter the number of Plan clients, the industry cost would balloon to over $975 million. These amounts, moreover, do not account for contracts with IRA owners.

with amendatory language to existing contracts covering the requisite additional protections, effective as of the date of the violation's final determination.[27]

C. QPAM Ineligibility Requirements.

1. Focus QPAM ineligibility on criminal conduct that involves the investment management of retirement assets and that involves only (I) the QPAM and (II) an affiliate that the QPAM controls or over which the QPAM exercises a controlling influence.

The existing QPAM Exemption provides for QPAM ineligibility for a criminal conviction involving not only the QPAM, but also any affiliate, regardless of that affiliate's relationship with the QPAM or its activity. This can lead to the anomalous result of QPAM ineligibility resulting from the criminal conduct of a foreign affiliate that has no contact or relationship with the QPAM and which may be engaged in activities that are wholly unrelated to the investment management of pension assets (*e.g.*, foreign real estate brokerage, human resources support). Furthermore, these may be activities in which the QPAM has not participated and about which it has no knowledge. We believe that including every QPAM affiliate's actions as a possible basis for QPAM ineligibility, regardless of its activity or level of contact with the QPAM, is regulatory overreach and unnecessarily exposes every QPAM to an additional layer of compliance risk. Rather, the determination for QPAM ineligibility should be concentrated exclusively on the activities of the QPAM itself and on any entity that controls or is controlled by the QPAM.[28]

We recommend, therefore, that the QPAM Exemption be amended to focus QPAM ineligibility on criminal conduct that involves the investment management of retirement assets and which exclusively involves (i) the QPAM (ii) any affiliate that the QPAM controls or over which the QPAM exercises a controlling influence, as the "control" terms are defined in the Exemption.[29]

2. Amend the "substantially equivalent" standard for foreign criminal convictions to apply only where the factual record of such conviction, when applied to United States federal criminal law, would highly likely lead to a criminal conviction in the United States.

The QPAM Exemption currently requires a QPAM to become ineligible for criminal convictions. The Proposal would make clear that this section would apply also for foreign criminal convictions (*i.e.*, a criminal conviction by a foreign court of competent jurisdiction) for crimes that are "substantially equivalent to" one of the U.S. federal or state crimes identified in the Exemption.[30] We agree with the Department's conclusion that investment transactions that

[27] This would limit use of the contractual language to those instances in which they would actually be applied; namely, to the situation involving the ineligibility of an asset manager to continue relying on the Exemption.
[28] *Cf.* OCC, Fiduciary Activities of National Banks, 12 C.F.R. § 9.17(b) (Surrender or Revocation of Fiduciary Powers) (OCC authorized to revoke the fiduciary powers of a national bank only where the bank *itself* has engaged in unlawful or unsound exercise of such powers).
[29] *See* Proposal § VI(e), 87 *Fed. Reg.* at 45,230 (defining the term "controls" and its derivative terms).
[30] *See id.* § VI(r)(2). The list of crimes are identified in section (r)(1) and generally include felonies of financial and financial-related criminal activity (*e.g.*, embezzlement, forgery, counterfeiting, and misappropriation of funds or securities, including conspiracy or attempt to commit such crimes).

include Plan assets are increasingly likely to involve entities that may reside or operate in jurisdictions outside the U.S. and that the Exemption therefore must appropriately be tailored to address criminal activity, whether occurring in the U.S. or in a foreign jurisdiction.

We believe, however, that the Department's proposed "substantial equivalent" standard fails to account for basic due process protections. It is not credible to assume that the judicial systems of certain countries, such as China, uniformly will interpret and apply the subject crimes listed in the Exemption in the same impartial manner and with "substantially equivalent" criminal procedures and due process safeguards as U.S. federal and state courts.[31] Moreover, since the foreign courts of certain countries directly or indirectly may be subject to the control or influence of that country's governing body, it is possible that a QPAM or its affiliate may be subjected to illicit or inappropriate coercion from the foreign government (*e.g.*, pressure to lend to or invest in foreign government-owned funds or enterprises) in exchange for the government withholding criminal prosecution against the QPAM (or more likely, an affiliate doing business in the foreign country) in order for the QPAM to maintain its QPAM status.[32]

We recommend, therefore, that the foreign crime "substantially equivalent" standard be amended so that the QPAM Exemption's penalties for a foreign criminal conviction apply *only* when the factual record of such conviction, when applied to United States federal criminal law, would highly likely lead also to a criminal conviction in the U.S., as determined under appropriate regulatory authority by the Department's Office of the Solicitor.[33]

3. <u>Amend the proposed "Prohibited Misconduct" standard to (I) eliminate references to non-prosecution and deferred prosecution agreements since this may violate due process protections and (II) apply only to QPAMs that knowingly and repeatedly engage in such misconduct that is directly attributable to an absence or failure of internal controls</u>.

As part of a significant expansion of the QPAM disqualification provisions, the Department has proposed that a QPAM become ineligible in the event the QPAM or an affiliate engage in "Prohibited Misconduct." Despite the sweeping application of this proposed term, the Department concedes that it is uncertain regarding the number of QPAMs that would become ineligible under the proposed expansion of the ineligibility provision.[34] The Department nevertheless broadly defines "Prohibited Misconduct" to include "any conduct that forms the basis for a non-prosecution or deferred prosecution agreement [or their substantial equivalent] that if successfully prosecuted, would have constituted a crime described in [the QPAM

[31] *See, e.g.*, "China strips license of lawyer for Hong Kong activist," The Asahi Shimban (Jan. 18, 2021), *available at* www.asahi.com/ajw/articles/14116054 (China requires lawyers "to swear an oath of loyalty to the ruling Communist Party.").
[32] *See id.* ("Lawyers [in China] have been stripped of their licenses for representing defendants in politically sensitive cases. Some have been imprisoned.").
[33] The language further should state that the Office of the Solicitor's decision would be subject to judicial review by a U.S. federal court to ensure that the Department's interest in the case does not impact the impartial application of the factual record to U.S. law.
[34] *See* Regulatory Analysis, 87 *Fed. Reg.* at 56,915. ("The Department is uncertain, however, regarding the number of QPAMs that would become ineligible under the proposed expansion of the ineligibility provision related to participating in Prohibited Misconduct.")

Exemption]."[35] The Department states that this added language ensures that QPAMs do not evade the Exemption's conditions related to integrity by entering into a non-prosecution or deferred prosecution agreements in order to "side-step the consequences that otherwise would result from a Criminal Conviction."[36]

The Department's view, however, mischaracterizes the nature and use of non-prosecution and deferred prosecution agreements, as well as their objectives (such as avoiding the collateral consequences of penalizing innocent parties). Specifically, non-prosecution and deferred prosecution agreements, by themselves, provide no conclusive evidence of misconduct and no admission of criminal conduct or other wrongdoing. Thus, it would be pure speculation to determine whether the conduct cited in such agreements, "if successfully prosecuted, would have constituted a crime" or would lead otherwise to a criminal conviction.[37]

"Prohibited Misconduct" under the Proposal further would include intentionally or systematically violating the QPAM Exemption's conditions and providing the Department with materially misleading information in connection with the Exemption's conditions. While we agree with the Department that such misconduct should be discouraged, we believe the proposed sanction (*i.e.*, QPAM ineligibility) is draconian and disproportionate to the described conduct. This is especially true where the conduct stems from a QPAM affiliate that: (i) has no contact or relationship with the QPAM, (ii) does not engage in any way in the investment management of Plan assets, and (iii) employs a person who intentionally and independently engages in such conduct, in violation of the affiliate's code of conduct. The QPAM, in other words, should not be held captive to the unauthorized actions of a rogue employee of an affiliate, who otherwise would singlehandedly be empowered through independent, unauthorized action to disqualify the investment manager from its QPAM status.[38] Rather, these instances of Prohibited Misconduct should apply only where such conduct was made possible or enabled by an absence or failure of internal controls.

We recommend, therefore, that the "Prohibited Misconduct" standard and provisions be deleted entirely from the Proposal. Alternatively, the Proposal should be amended to delete the proposed sections concerning the non-prosecution and deferred prosecution agreements and, with respect to the remaining proposed sections, apply only where (i) a QPAM <u>knowingly</u> and <u>repeatedly</u> engages in such misconduct, <u>and</u> (ii) the Department affirmatively concludes, after formal investigation and hearing, that such instance(s) of conduct resulted from an absence or failure of the QPAM's internal controls.

D. <u>Warning and Opportunity for Department Hearing on Prohibited Misconduct</u>.

<u>Amend and expand the procedures for issuing a warning of Ineligibility Notice and request for Department hearing.</u>

[35] Proposal § VI(s), 87 *Fed. Reg.* at 45,232.
[36] *Id.* at 45,209.
[37] Such speculation would especially be the case for *foreign* non-prosecution and deferred prosecution agreements.
[38] For example, the rogue employee could intentionally and falsely provide the Department with materially misleading information in connection with the Exemption's conditions in order to have the QPAM disqualified.

The Proposal provides that the Department, prior to issuing a written Ineligibility Notice for Prohibited Misconduct, would issue a written warning to the QPAM identifying the conduct and providing 20 days to respond, followed by a Department-sponsored hearing within 30 days of the QPAM's response.[39] This timetable does not provide adequate time either for the QPAM to assess, analyze, and evaluate the Department's issuance or to allow proper preparation for the hearing. In order to ensure due process protections, the Department should amend the Proposal as follows with respect to these procedures:

(i) Provide the QPAM with at least 60 days to read and digest the written Ineligibility Notice and with the opportunity to request from the Department any clarifications or explanations of the alleged Prohibited Misconduct. The QPAM will need this additional time to confer internally with the appropriate parties and, if necessary, with any domestic and foreign affiliate(s) that may be involved in the alleged conduct.

(ii) After the Department has provided the QPAM with any clarifications and explanations of the alleged Prohibited Misconduct, allow the QPAM an additional 30 days to consider the allegations and decide whether to request a hearing with the Department.

(iii) If the QPAM requests a hearing, schedule it no sooner than 90 days after the date that the Department notifies the QPAM of the hearing, in order to allow the QPAM enough time to prepare for the proceedings. In addition, allow the QPAM a one-time option to extend the hearing date for up to 60 days if the QPAM reasonably concludes that additional time is required and notifies the Department of the reasons for the extension of time for the hearing.

E. Wind-Down Requirements.

1. Amend the proposed QPAM ineligibility "wind down" requirements as follows: (I) do not commence the wind-down period until after a request for an individual exemption has been formally denied; and (II) allow for new transactions to continue for the entirety of the wind-down period.

The Proposal includes a required one-year winding-down period that begins on the Ineligibility Date (*i.e.*, either on the criminal conviction date or the date of the Ineligibility Notice).[40] As a matter of procedural fairness and in order to minimize any disruption to the QPAM-client Plan relationship, we recommend that the Department refrain from commencing the one-year wind down period until after a final determination by the Department – *i.e.*, after a hearing if one is required or after the QPAM's request for an individual exemption (if such request has been made to the Department) has been denied in writing.

The Proposal further provides that during the wind-down period, the QPAM may not engage in new transactions in reliance on the QPAM Exemption for existing client Plans. We believe that

[39] Proposal § I(i), 87 *Fed. Reg.* at 45,228.
[40] *Id.* § I(h), 87 *Fed. Reg.* at 45,228.

this prohibition would trigger at least two unintended adverse consequences: (i) the QPAM may be forced to violate its ERISA-imposed fiduciary duty to the client Plans to prudently invest the Plans' assets since it would no longer be authorized to buy or sell investments on behalf of the Plans in reliance on the Exemption,[41] and (ii) the client Plans, as a fiduciary obligation to their plan participants and beneficiaries, may be forced to immediately terminate the relationship with the QPAM, since the QPAM's inability to perform any new transactions in reliance on the Exemption may negatively impact the investment performance of the funds in which the assets of the client Plans are invested. With this result, the wind-down period is rendered useless. We recommend, therefore, that the Department continue to permit the QPAM to rely on the Exemption in order to avoid violating its fiduciary duties to client Plans, and to ensure that client Plans will continue to receive optimal and timely investment opportunities.

2. In order to minimize the adverse impact of the wind-down period on non-ERISA investors in an investment fund, expressly provide that the QPAM ineligibility requirements do not preclude or supersede a QPAM's authority or obligation to exercise equitable treatment toward all investors in a pooled fund.

The Proposal provides that, as part of the wind-down period and the QPAM's indemnification to client Plans arising out of the QPAM's ineligibility, that the QPAM promptly restore to client Plans the losses and costs arising from unwinding transactions with third parties and from transitioning Plan assets to an alternative discretionary asset manager. The Proposal, however, does not account for the termination or withdrawal of client Plans from investment funds that may have a mix of assets from client Plans and non-ERISA investors (*e.g.,* pooled funds such as bank collective investment funds). It is unclear from the Proposal what the QPAM's obligations are with respect to non-ERISA investors, or how these investors would be treated. We recommend, therefore, that the Department amend the Proposal to expressly provide that the QPAM ineligibility requirements do not preclude or supersede a QPAM's authority or obligation to exercise equitable treatment of all investors (ERISA and non-ERISA investors) in a pooled fund, including the imposition of reasonable restrictions on the ability to withdraw from the fund, if appropriately disclosed in advance.[42]

F. QPAM's Sole Responsibility for Investment Fund Transactions.

1. Eliminate the proposed language requiring the QPAM to be solely responsible for all aspects of investment fund transactions since this requirement would significantly impair the QPAM's ability to (I) participate in the fixed-income and derivatives markets, and (II) retain sub-advisers and

[41] During the wind-down period, the QPAM could invest client Plans' assets without reliance on the Exception, but this would involve a costly exercise of sifting through possible parties in interest for each prospective investment transaction plus a significant amount of time required for the QPAM to conduct its own research and analysis of investments involved in the transaction, which would significantly reduce the available selection of investments and the timeliness of securities transactions while raising costs for client Plans.

[42] This recommended provision likewise should apply to the wind-down requirements. For example, in the case of an illiquid fund investment, if an investment manager becomes disqualified as a QPAM, that manager nevertheless should be authorized to continue engaging in transactions in reliance on the QPAM Exemption, and investors must remain invested per the terms of the fund, for the life of the illiquid fund.

other expert parties, thereby compromising the QPAM's ability to diversify Plan investments and contain Plan costs.

The Department has proposed to amend the QPAM Exemption to provide that investment transactions are the "sole responsibility" of the QPAM and that no relief would be available "for any transaction that has been planned, negotiated, or initiated by a party in interest, in whole or in part, and presented to the QPAM for approval because the QPAM would not have sole responsibility with respect to the transaction."[43] The Department further states that a party in interest "should not be involved in any aspect of a transaction, aside from certain ministerial duties and oversight associated with plan transactions, such as providing general investment guidelines to the QPAM."[44] This amendment is intended apparently to address the Department's concerns that a QPAM may be tempted to simply rubberstamp investment transactions recommended by parties in interest, or otherwise improperly act as a "mere independent approver" of investment transactions while exercising no discretion over the commitments and investments of Plan assets.

While we understand and appreciate the Department's well-intentioned efforts to ensure that QPAMs retain full decision-making responsibility for investment fund transactions, these proposed amendments do not accurately portray the QPAM Exemption's functioning in the marketplace and appear to mischaracterize the actual application of a QPAM's discretionary authority. Although QPAMs possess and exercise discretion over transactions, they are also mindful of their fiduciary duties under ERISA to diversify Plan assets and to defray unnecessary costs.[45] Both of these ERISA duties, however, would be compromised under the Department's proposed language.

For example, if the Department's proposed amended language were in effect, then a QPAM, in place of relying on sub-advisors to make recommendations for certain investments in which they specialize or possess expertise, would be compelled to do its own research for such investments (raising Plan costs), or forego altogether making any investments in that sector (compromising its ability to prudently diversify investments). Moreover, the proposed language would prohibit altogether a QPAM's ability to invest in fixed income securities, which would require the QPAM or party in interest to "initiate" an action in order to provide a bid in the fixed income markets.[46] A similar scenario exists for engaging in numerous derivatives transactions.[47] Rather than preserving a QPAM's discretionary investment authority, the Department's proposed language would upend and curtail QPAM investment activity and inadvertently expose a number of QPAMs to possible violation of their ERISA-imposed fiduciary duties.

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[43] Proposal, 87 *Fed. Reg.* at 45,213.
[44] *Id.*
[45] *See* n.20, *supra.*
[46] The fixed income market is largely over-the-counter. Buyers and sellers in fixed income securities often transact in a bilateral nature, with one side asking for bids/offers. Clearly, one side "initiates" a trade by its ask. Thus, any time a dealer (the potential party in interest) communicates that it wants to trade fixed income products, it is presumably "initiating" a trade under the Department's proposed amendment.
[47] Investment fund transactions in derivatives or other investment products that are developed and pitched to the QPAM by a financial institution acting as a service provider to the QPAM – a common scenario in the derivatives market – would not be permitted under the Proposal, since such transactions would be initiated by a party in interest (here, the financial institution service provider).

We recommend, therefore, that the Department delete the proposed amendments to Section I(c), or alternatively, clarify that a QPAM may retain sub-advisors, consultants, and other experts to assist the QPAM in discharging its investment duties and responsibilities to its client Plans, provided that the QPAM retains the exclusive (*i.e.*, sole) discretionary authority on investment transactions.

2. Clarify that the proposed amendatory language requiring that an investment fund be "established primarily for investment purposes" includes investment-related transactions by asset pools with mixed purposes (*e.g.*, payment of benefits and Plan expenses).

In addition to the above-described amendatory language, the Proposal further conditions reliance on the QPAM Exemption to an investment fund "that is established primarily for investment purposes."[48] Although the term "primarily" is not defined or described in the Proposal, the Department notes in the preamble that the Exemption would be unavailable if a plan sponsor were to hire a QPAM to engage a plan in transactions "that do not include an investment component."[49] In order to continue allowing QPAMs to conduct investment-related transactions in asset pools with mixed purposes (*i.e.*, investment and non-investment purposes, such as payment of benefits and plan expenses), we recommend that the Department clarify that a fund established primarily for investment purposes includes a fund that is established for mixed-use purposes and that contains an investment component.

G. Recordkeeping Requirement.

1. Simplify the proposed recordkeeping mandate by requiring only that QPAMs undertake prudent efforts to maintain accurate records reflecting their QPAM duties and responsibilities.

The Proposal would add a new recordkeeping requirement that would require a QPAM to maintain records for six years demonstrating compliance with the QPAM Exemption.[50] The proposed language implies that the QPAM establish and maintain complete and accurate records of each and every investment transaction.[51] This is an unnecessarily prescriptive and costly requirement, particularly given the volume, specificity, and variety of investment fund transactions that QPAMs are involved in, and the fact that many transactions may include combined or consolidated investment transactions from multiple accounts and from mixed pools of retirement and non-retirement assets. We recommend that the Department simplify the recordkeeping requirement by requiring only that QPAMs undertake prudent efforts to maintain accurate records consistent with their duties and responsibilities under ERISA. Adoption of this recommendation would still enable appropriate inspection and examination of QPAM records.

[48] Proposal § I(c), 87 *Fed. Reg.* at 45,232.
[49] *Id.* at 45,213 n.36.
[50] *See id.* § VI(t), 87 *Fed. Reg.* at 45,232.
[51] Specifically, the proposed language requires the QPAM to maintain the records "necessary to enable the persons [examining the records] to determine whether the conditions of this exemption have been met *with respect to a transaction* in a manner that is reasonably accessible for examination." *Id.* [Emphasis added.]

2. Delete the proposed requirement making available to retirement investors the QPAM's records that demonstrate compliance with the QPAM Exemption, since this requirement does not add materially to the protective provisions already in place and unnecessarily increases regulatory compliance costs.

The Proposal provides that certain parties be permitted to review the QPAM's records demonstrating compliance with the QPAM Exemption.[52] These include any participant or beneficiary of a Plan invested in an investment fund managed by the QPAM.[53] The Department provides no explanation for this authorization or its purpose.[54] In the absence of such explanation or public policy rationale, we do not believe it is necessary to make the QPAM's records available to these parties. Moreover, the National Bank visitorial powers provision and OCC regulations would prevent retirement investors from accessing the records of national banks and federal savings associations, leading to an unintended discriminatory effect between these banks and state-chartered banks, which may not have the same available safeguards on the release of the records of the QPAM bank. We recommend, therefore, that the Department delete the proposed language that would allow retirement investors direct access to QPAM Exemption-related records of certain banks.

H. QPAM Registration Requirement.

Absent a publicly explained and cogent policy rationale, the Department should delete the proposed requirement that QPAMs notify the Department of their reliance on the QPAM Exemption.

The Proposal would require any entity that relies on the QPAM Exemption (*i.e.*, every QPAM) to notify the Department by e-mail of its reliance on the Exemption.[55] The Department has not provided any policy rationale for requesting this information or explanation of its intended use, other than stating that it intends to post the list of QPAMs on its publicly available website.[56] Moreover, we are not aware of any other class exemption that requires entities to notify the Department of their reliance on the exemption. We are also concerned that this requirement may infer that a QPAM is not relying, or may not rely, on one or more other exemptions in discharging its investment management responsibilities.[57] In the absence of a clear and

[52] *See* Proposal § VI(t)(2), 87 *Fed. Reg.* at 45,232.
[53] *See id.* § VI(t)(2)(D).
[54] Retirement investors presumably already have access to their account information, including investment transactions and holdings. It is unclear why a retirement investor would want to review additional records of the QPAM except in anticipation of possible litigation against the QPAM or an affiliate.
[55] *See* Proposal § I (g)(1), 87 *Fed. Reg.* at 45,227. The reporting entity must again notify the Department if there is a change to its legal or operating name or if the entity no longer relies on the QPAM Exception. *See id.*
[56] *Id.* at 45,208. The Department, however, has requested comment on whether it should require additional identifying information. *See id.*
[57] The QPAM Exemption is a transactional exemption, not a functional exemption. Therefore, it is possible that an investment manager of retirement assets relying on the QPAM Exemption further may be relying, with respect to any given investment transaction, on another available exemption (class exemption or individual exemption) in lieu of the QPAM Exemption. A notification/registration requirement would not account for this distinction, and therefore, possibly mislead plan and plan participants and beneficiaries into concluding that an investment manager is relying solely on the QPAM Exemption.

reasonably articulated purpose and objective, we recommend that the Department delete this proposed notification/registration requirement.

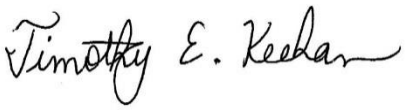
I. Compliance Date for Amended QPAM Exemption.

If the Department proceeds with the Proposal, it should set the compliance date for the amended QPAM Exemption at least 18 months after the effective date in order to allow QPAMs and other affected entities the time required to transition to the amended Exemption's requirements.

The Department has designated the Proposal to be effective 60 days after the publication date of the finalized amendments to the QPAM Exemption.[58] We believe that QPAMs, plan sponsors, investment managers, and other fiduciaries and market participants that may be impacted by the Proposal will require a significant transitional period to (i) re-open, review, renegotiate, and possibly re-price investment management agreements to account for the addition of the Department-mandated language (including reworked representations and covenants), and (ii) review, modify, and approve their policies, procedures, and practices to conform to the requirements of the amended QPAM Exemption. We recommend, therefore, that the Department set the compliance date for the amended QPAM Exemption on the date that is, at a minimum, 18 months after the effective date of the finalized Proposal.

Thank you for your consideration of our views and recommendations. If you have any questions or require any additional information, please do not hesitate to contact the undersigned at 202-663-5479 (tkeehan@aba.com).

Sincerely,



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[58] *See* Proposal, 87 *Fed. Reg.* at 45,204.