The SPARK Institute, Inc.
SHAPING AMERICA'S RETIREMENT

October 11, 2022

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

Re: Comments on Proposed Amendments to the QPAM Exemption and Request to Testify (EBSA-2022-0008)

Dear Sir or Madam:

The SPARK Institute, Inc. submits these comments in response to the Department of Labor's proposed amendments to Prohibited Transaction Exemption (PTE) 84-14, commonly known as the qualified professional asset manager or QPAM Exemption.

The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms, and benefits consultants. Collectively, our members serve approximately 100 million employer-sponsored plan participants.

SPARK's members routinely rely on the QPAM Exemption, or facilitate its use for plans selecting investments managed by entities that rely on the QPAM Exemption. SPARK's members also may be tasked with assisting plans in mitigating the significant consequences that would occur if an otherwise successful investment manager suddenly can no longer rely on the QPAM Exemption, which would be a much more common occurrence under the Department's proposal.

We understand that the motivating purposes behind this proposal are (a) to settle a question for which there has been some uncertainty, namely whether or not a criminal conviction under non-U.S. law would disqualify an entity and all of its affiliates from qualifying under the QPAM Exemption, and (b) to make available temporary relief and a process for individual exemptions to help address the issues that can arise when an investment manager suddenly becomes ineligible for the QPAM. However, the proposal goes well beyond addressing those issues, and many of the changes the Department is proposing are of serious concern to SPARK members, for reasons explained in our letter. Accordingly, our letter recommends a number of changes before the proposal is finalized.

Request to Testify

The SPARK Institute requests to testify on this proposal at the hearing to be held on November 17 and (if necessary) November 18, 2022. We expect that Michael Hadley, Partner, Davis & Harman LLP, will testify on behalf of the SPARK Institute. A separate letter will be filed with respect to this request.

Summary of Comments

In this comment letter, we make the following comments and suggestions:

- The SPARK Institute strongly recommends that the Department remove all of the proposed requirements to include certain contractual terms in investment management agreements. Even if the Department does not accept our recommendation to remove this new requirement, the Department should apply it only to contracts entered into or materially modified 18 months after the final amended exemption is released.

- The SPARK Institute recommends that the Written Ineligibility Notice process be removed from the final exemption. Alternatively, the procedure must provide a fair opportunity for review by an administrative law judge, court, or similar independent party.

- The SPARK Institute recommends that the Department delete the last sentence of proposed section I(c), relating to transactions that are "planned, negotiated, or initiated by a Party in Interest." In addition, we recommend that the Department either eliminate the "sole responsibility" language or clarify that this does not prevent the use by financial institutions that appoint and supervise sub-advisers.

- The SPARK Institute recommends that the Department eliminate the condition that, during the winding down period, the QPAM "may not engage in new transactions after the Ineligibility Date in reliance on this exemption for existing client Plans." Otherwise, the winding down period is not useful for advisers and would be very problematic for plans and their ability to transition advisers.

- The SPARK Institute recommends that the winding down period automatically be extended while an application for an individual exemption is pending.

- The SPARK Institute recommends that the Department reconsider whether it is appropriate to single out QPAMs for a notice to the Department.

- The SPARK Institute recommends that increases in the assets under management, equity, and net worth thresholds for inflation be effective no earlier than the first day of the next calendar year following the January 31 announcement from the Department.

- The SPARK Institute recommends that the access to records demonstrating compliance with the QPAM Exemption be limited to employees of the Department or the Internal Revenue Service or another state or federal regulator.

- The SPARK Institute recommends that the amendment to the QPAM Exemption be effective with respect to new transactions occurring no earlier than 18 months after publication of the final amendment in the Federal Register.

The Importance of QPAM

We expect that comments from many stakeholders will point out that the QPAM Exemption is unlike any other class exemption. Most class exemptions are identified and complied with when a fiduciary identifies a specific transaction that may require an exemption. But investment managers of plan assets make, every minute of the day, investment decisions that could inadvertently involve prohibited transactions. That is because ERISA's prohibited transaction rules are very broad, generally prohibiting any transaction of any kind involving a "party in interest" to the plan—a term that itself is very broad. When an investment manager is managing plan assets for many plans, it would be virtually impossible for the investment manager to know every party in interest to all of its plan clients and completely avoid ever entering into a transaction with one of these parties in interest.

Compliance with ERISA without using the QPAM Exemption has become even more difficult in recent years as financial institutions have consolidated or expanded their business lines. When ERISA was enacted, it would have been unusual for the trust company that serves as trustee of a plan to have an affiliate that is a securities underwriter or loan servicer of mortgages that are part of a mortgage-backed securities offering. The securities that are available in the marketplace have become more complex, with more financial institutions involved in their creation, underwriting, and management. Plans are using more and more service providers, including utilizing multiple brokers for trades. Plans increasingly are relying on index and similar investment strategies which involve purchasing and selling many securities at the same time. Denying plans access to these securities and strategies would significantly reduce their investment returns and limit their risk management strategies. In fact, if an investment manager of plan assets was forced to avoid every investment opportunity that might result in a prohibited transaction, it would be difficult to meet ERISA's standards of prudence and diversification.

Even more, compliance with the QPAM Exemption is perceived in the financial marketplace as being a virtual necessity when dealing with plan assets. Named fiduciaries that engage investment managers generally require in the investment management agreement that the investment manager qualifies as a QPAM. It is not considered acceptable to simply require the investment manager to avoid engaging in a nonexempt prohibited transaction. And many contracts, offering documents, prospectuses, and other agreements that facilitate financial transactions require the investment manager to represent that it qualifies as a QPAM if it is investing on behalf of ERISA plans. Counterparties to a variety of transactions regularly insist on QPAM status, especially if they serve as a broker.

Thus, all of our comments below are made with the idea that eligibility for the QPAM Exemption is a "must have" not a "nice to have." When the Department denies an investment manager, and any plan that has engaged the investment manager, the ability to rely on the QPAM Exemption, the Department is effectively shutting off the manager and the plan from large portions of the securities markets.

We are concerned the Department may not have been aware of the broad impact its proposal would have. For example, it is very concerning that the Department's regulatory flexibility analysis states that 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" and is "also uncertain about the extent to which the proposed changes in asset management and equity thresholds would give rise to new costs because some QPAMs that meet the current thresholds no longer would be able to rely on the exemption if they do not meet the proposed increased thresholds."

We are also concerned about the Department's estimates regarding the number of plans that a typical QPAM serves. The Department estimates that "on average, a single QPAM services 32 client Plans." We would be very surprised if there is a single SPARK member that provides services to so few plans, as a QPAM or otherwise. Most of the ERISA plan assets in the U.S. are managed by investment managers that have hundreds – and more likely thousands – of client plans whose assets they manage.

In addition to direct investment management agreements with plan fiduciaries, we would note that the QPAM Exemption is also commonly used with respect to collective investment trust managers (CITs) as the QPAM Exemption specifically contemplates its use with respect to pooled investment funds. One single SPARK member that provides trust services to CITs estimated it has 15,000 participation agreements that would need to be amended. CITs and other similar structures also commonly involve the use of one or more sub-advisers, all of whom enter into an investment management agreement with the trust company or another investment manager.

In short, we are concerned that the Department would undertake to adopt such sweeping and disruptive changes to such an important exemption in the absence of any discernible benefit to plans or participants and beneficiaries. We would note that, despite over forty years of exemption compliance enforcement, the Department provides little in the way of actual support (empirical data, enforcement/investigative results or even anecdotal evidence) demonstrating a need for the proposed changes, and readily notes that it lacks data.

New Requirements for Investment Management Agreements

The Department's proposal includes, for the first time, very specific terms that must be contained in every investment management agreement when the investment manager might, at some point, rely on the QPAM exemption, all of which must apply for at least 10 years after the entity no longer qualifies as QPAM. Specifically, the proposal would require in each investment management agreement:

- An explicit provision that in the event the QPAM, its affiliates, or five percent or more owners engage in conduct resulting in a Criminal Conviction or receipt of a written Ineligibility Notice, the QPAM would not restrict its client Plan's ability to terminate or withdraw from its arrangement with the QPAM.
- An explicit provision that the QPAM will not impose any fees, penalties, or charges on client plans in connection with the process of terminating or withdrawing from an investment fund managed by the QPAM except for reasonable fees, appropriately disclosed in advance, that are specifically designed to: (i) prevent generally recognized abusive investment practices or (ii) ensure equitable treatment of all investors in a pooled fund in the event such withdrawal or termination may have adverse consequences for all other investors, provided that such fees are applied consistently and in a like manner to all such investors;
- An explicit provision that would require the QPAM to indemnify, hold harmless, and promptly restore "actual losses" to each client Plan for any damages directly resulting from a violation of applicable laws, a breach of contract, or any claim arising out of the failure of such QPAM to remain eligible for relief under the QPAM Exemption as a result of conduct that leads to a Criminal Conviction or Ineligibility Notice. For this purpose, actual losses include losses and related costs arising from unwinding transactions with third parties and from transitioning plan assets to an alternative asset manager as well as costs associated with any exposure to excise taxes under Code section 4975 as a result of a QPAM's inability to rely upon the relief in the QPAM Exemption.
- An explicit statement that the QPAM will not employ or knowingly engage any individual that participated in the conduct that is the subject of a Criminal Conviction or Written Ineligibility Notice regardless of whether the individual is separately convicted in connection with the criminal conduct.

SPARK members have expressed significant concern about the extent to which this requirement to include specific contractual provisions represents an unwarranted and unsupported interference in the contractual process, effectively an effort to micromanages the negotiation process between plans and financial institutions.[1]

As an initial matter, we make the obvious point that every QPAM is, by definition, an ERISA fiduciary, and thus subject to all of ERISA's responsibilities and liabilities. There is no need to create new contractual rights of action here.

We also believe that the specific provisions the Department is proposing have already been carefully addressed by Congress in ERISA or in Department regulations implementing statutory provisions. For example, with respect to the first and second bullets above, Department

[1] *Chamber of Commerce v. U.S. Department of Labor*, 885 F.3rd 360, 384-385 (5th Cir. 2018) ("Only Congress may create privately enforceable rights, and agencies are empowered only to enforce the rights Congress creates.")

regulations already require that a service contract not contain any restrictions on termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous.[2] With respect to the second bullet above, section 408(b)(2) of ERISA requires that all fees be reasonable in light of the services provided, and the Department's implementing regulations require the disclosure of fees in advance in connection with the investment in a plan asset vehicle. Further, the duties of prudence and loyalty already require that a fiduciary managing a pooled investment vehicle treat investing plans fairly and equitably, including with respect to withdrawn plans.

With respect to the third bullet above, section 409 of ERISA already requires a plan fiduciary to make the plan whole for any losses associated with a breach of the duties imposed by ERISA, and section 410 prohibits any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under ERISA, which is void as against public policy. In addition, Code section 4975 already imposes the excise tax on the investment manager if, as the fiduciary, it is the one who "participated" in the prohibited transaction. With respect to the final bullet, ERISA section 411 already imposes rules regarding prohibiting persons convicted of crimes from serving as a fiduciary or in any capacity that involves decision making authority or custody or control of the moneys, funds, assets, or property of any employee benefit plan. These rules were carefully crafted by Congress, and already address when an individual should not be involved with ERISA plans.

To be very clear, the prior discussion should not be interpreted as a view that, since the law already provides adequate protection, the new proposed contractual provisions are "no big deal." To the contrary, they would be very disruptive and unwarranted. We are merely pointing out that *they are not needed* to protect plans.

A second significant concern is that these agreement provisions would introduce a variety of vague and unclear standards that, going forward, would be a condition of nearly every investment management agreement covering the investment of plan assets, putting managers and plan sponsors at odds over their interpretation. To take a few examples:

- What agreement provisions do or do not "prevent generally recognized abusive investment practices"? Can the Department point to a list of practices that are "generally recognized" to be abusive? What if a conservative investment manager is trying to prevent a practice it deems abusive but others may not?
- When is a fee "appropriately" disclosed in advance?

[2] DOL Reg. § 2550.408b-2(c)(3). In the preamble, the Department states that the new proposal will benefit plans by "ensuring they can terminate the arrangement or withdraw from a QPAM-managed Investment Fund without penalty, further ensuring that Plans are not exposed to unnecessary costs when relief under the exemption is lost through no fault of their own." The Department does not discuss how or why this protection is more protective than existing law.

- The Department is proposing to require a provision that an investment manager neither "employ" (which appears to have no knowledge requirement) or "knowingly engage" any individual that participated in the conduct that is the subject of a Criminal Conviction or Written Ineligibility Notice regardless of whether the individual is separately convicted in connection with the criminal conduct. Does this mean employ in *any capacity*?
- Since the Department's language does not require an actual conviction of a person, when has an employee "participated" in the conduct that is the subject of a Criminal Conviction or Written Ineligibility Notice? Does this include IT professionals, administrative assistants, or interns who were at the firm when the QPAM exemption was lost? Attorneys who represented the firm against the Department? Suppose the Department issues a Written Ineligibility Notice because a firm provided "materially misleading information"—how would a later firm know which person in the prior firm participated in providing information that was materially misleading?
- Will the Department publish a list of such persons when it issues a Written Ineligibility Notice? As an aside, under the Department's standard, this prohibition has no end date. Even ERISA section 412 limits the prohibition to 13 years.[3]

Third, the Department has provided insufficient justification to require inclusion of these new contractual provisions in every investment management agreement. In order for the Department to add a condition to the exemption, it must support a finding that the current QPAM Exemption fails to meet ERISA's standard that the current QPAM Exemption is "protective of the rights of participants and beneficiaries of such plan." In the preamble, the only justification that the Department provides is that QPAMs must "act with integrity" and the newly required agreement provisions would require QPAMs to include "certain standards of integrity." The Department cites no evidence, anecdotal or otherwise, that the absence of such provisions in investment management agreements has harmed plans, for example that existing ERISA rules have failed to prevent or restore losses to plans.[4] To the contrary, in SPARK's experience, these investment management agreements are generally carefully negotiated by an independent ERISA plan fiduciary, who must already act prudently. Our members' experience is that investment management agreements provide appropriate protections to the plan, its participants, and the plan sponsor, while incorporating commercially reasonable terms for investment managers.

SPARK members particularly noted concerns with the new requirement for indemnification that includes an extremely broad "actual losses" standard. This would impose potentially significant costs on an adviser that is no longer able to rely on the QPAM Exemption, and thus obligated to indemnify, as a result of conduct by any affiliate (including circumstances where the QPAM has no nexus to the conduct). The provision as drafted is not even tied to losses that result from a breach of contract or violation of applicable law that is actually a direct

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[3] While the language included in the proposal has a 10-year limit, there is no limit to how long ago an individual has "participated" in the conduct that would prohibit them from working at a new firm that is a QPAM.

[4] The Department also makes the statement, without any justification, that these proposed conditions "will increase the overall value and attractiveness to Plans of retaining an asset manager that meets the requirements of the QPAM Exemption." Since compliance with the QPAM Exemption is essentially mandatory in the marketplace, we do not believe this statement is correct.

result of the failure of the QPAM to remain eligible for relief under the QPAM Exemption. (To be clear, we are not suggesting this indemnification provision might be acceptable if it were modified.)

For all these reasons, the SPARK Institute strongly **recommends** that the Department remove all of the requirements to include these contractual terms in investment management agreements. We reiterate once again that, because compliance with the QPAM Exemption is essentially mandatory, inclusion of this provisions in investment management agreements involving ERISA plan assets would not be optional.

We would also make the point – which we return to later – that the Department has proposed to make the changes to the QPAM Exemption effective 60 days after publication of the final amended exemption in the Federal Register. This would mean nearly every investment management contract involving plan assets would need to be amended in that period. This is not humanly possible. Even digesting and preparing amendments will take many months, and reaching every client and getting them to respond will take many more months. Many (perhaps most) of these agreements cannot be amended without affirmative consent of both parties. Thus, even if the Department does not accept our recommendation to remove this new requirement for certain contractual provisions, the Department should apply it ***only to contracts entered into or materially modified after the effective date of final amended exemption***.

The Department estimates that QPAMs "will take one hour of in-house legal 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." Thus, the Department estimates that the total cost to comply with this requirement for every investment management agreement (and every subadvisor agreement) involving ERISA plan assets in the country will total $135,540. This estimate is off by a factor of 100, at least. Amending agreements of this nature is a labor-intensive process. Many investment managers will need to seek assistance of outside counsel,[5] and the firm will spend months reviewing records to ensure it has captured all of the agreements that need to be amended. Such a change is a massive undertaking to the investment adviser community. Because many, if not most, agreements require mutual consent, this could result in protracted costly negotiations for any plans that use outside counsel; the cost to plans in engaging outside counsel competent to understand the QPAM Exemption is not even considered by the Department.

In lieu of the approach that the Department has taken here, we recommend instead that the Department consider a different approach. If there are particular contractual provisions that the Department has evidence are actually appearing in investment management agreements and that are harming the plan and its participants, the Department should release a separate proposal which proposes to prohibit such provisions. A rule that prohibits the inclusion of abusive contractual provisions is much easier to administer and would address the issues the Department identifies. For example, the regulations under section 408(b)(2) have long prohibited clauses in

[5] It would be borderline malpractice for an attorney, in-house or otherwise, to spend only one hour on an amendment to an agreement of such critical importance.

service contracts that penalize a plan for termination on reasonably short notice, but wisely does not require specific detailed language in every contract.

We would also point out that many of these conditions can be addressed not by inserting them into *every* investment management agreement, but rather by making them conditions of the winding down period, discussed later. Thus, the Department could condition relief during the winding down period on the QPAM's agreement to amend its agreement to provide relief for actual losses incurred because of the QPAM's withdrawal from the agreement.

Written Ineligibility Notice Procedures

Under the proposal, the QPAM Exemption will contain a condition allowing the Department to prevent use of the exemption if the Department issues a "Written Ineligibility Notice" to the QPAM or any affiliate or five percent owner. The Department can issue a Written Ineligibility Notice whenever it feels a person has engaged in "Prohibited Conduct," which would be defined to mean:

(1) any conduct that forms the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a crime described in the QPAM exemption;
(2) any conduct that forms the basis for an agreement, however denominated by the laws of the relevant foreign government, that is substantially equivalent to a non-prosecution agreement or deferred prosecution agreement described in (1);
(3) engaging in a systematic pattern or practice of violating the conditions of this exemption in connection with otherwise non-exempt prohibited transactions;
(4) intentionally violating the conditions of this exemption in connection with otherwise non-exempt prohibited transactions; or
(5) providing materially misleading information to the Department in connection with the conditions of the exemption.

In other words, the Department has the power to decide, on its own, that someone has committed actions that would be crime under some law over which the Department has no authority or jurisdiction, including non-U.S. law. The Department also can decide, on its own, that someone has provided "materially misleading information" to the Department or engaged in a "systematic pattern or practice of violating the conditions" of the exemption.

This Written Ineligibility Notice process provides little by way of due process. The Department, or any of its regional offices, can issue such a notice at any time. This starts with what the Department calls a "written warning," but this is not a warning in the normal sense of the word. If the QPAM does not respond to the "warning" *in 20 days from the date of the letter*, the Written Ineligibility Notice is automatically issued. Even if the QPAM does respond, the QPAM still receives only one chance to be heard, which could be a single telephone call, and there is only one such opportunity guaranteed. There is no chance for a hearing before an impartial administrative judge, no right to a day in court, no chance for appeal, and formal procedures to present evidence. The issuance of a Written Ineligibility Notice is, essentially, a death sentence for an investment manager, who would be immediately prohibited from managing plan assets. (We say again—compliance with the QPAM Exemption is mandatory, not optional, for investment managers pursuant to the tens of thousands of investment management and other investment contracts, such as ISDAs, already in place.)

The Department already has the authority under section 409 and 502 of ERISA to bring an action to remove a fiduciary from acting as such, a power that the Department utilizes when necessary.[6] But this procedure is subject to the due process protections one would expect when such a serious action is to be taken. Due process is enshrined in many ERISA rules and federal laws. The Department cannot enforce a subpoena for documents without review by a federal judge, and even the issuance of a civil penalty provides a right to a hearing before an administrative law judge.[7] Both of these actions are far less devastating than preventing an investment manager from relying on the QPAM Exemption.

We also have significant concerns about the reference to non-prosecution or deferred prosecution agreements, including any agreement that is "substantially equivalent" to such an agreement under non-U.S. laws. The existence of a non-prosecution or deferred prosecution agreement does not prove that criminal conduct occurred. By definition, the party to such an agreement has not had a chance to defend itself in court. These agreements are used in a variety of circumstances, including when the government's case is very weak but the defending entity does not want to take any chance of losing in court. These agreements are certainly not the equivalent of a conviction (or guilty plea). By allowing such agreements to result in loss of QPAM status, especially when the Department makes this determination in its sole discretion (and without any opportunity for appeal), the proposal does not adequately protect the due process rights of investment managers. It also involves the Department making a finding of whether the conduct described in the non-prosecution or deferred prosecution agreement would constitute a crime, on which the Department has no expertise or authority. Finally, this interferes with the work of prosecutors. If entering into a non-prosecution or deferred prosecution agreement means that a firm's ERISA investment management business is effectively ended, the firm may not be able to agree, even when doing so is the best resolution for the government prosecutor involved.

In addition to the concerns about due process, we believe that the definitions of "Prohibited Conduct" lack objective standards by which parties can know whether or not they may be the subject of a Written Ineligibility Notice. As a result, the Written Eligibility Notice rules provide an improper amount of leverage to the Department. For example, suppose a regional office of the Department sends a request for information to an investment manager; the manager responds but the Department believes the response is incomplete. Normally, the Department would need to seek a subpoena in court, which would be subject to judicial review. But instead, the investigator could simply threaten to send a Written Ineligibility Notice on the

[6] The Department also routinely enters into settlement agreements where one of the conditions is that a person cannot serve as a fiduciary for any ERISA plan for a period of time.

[7] See, e.g., DOL Reg § 2570.168 (decision of administrative law judge for section 502(c)(8) civil penalty).

grounds that the investment manager provided materially misleading information, which circumvents review by a court. This is not a recipe for a fair and impartial investigation.

Finally, a class exemption should not have, as a condition, the ability of the Department to decide in its sole discretion that an entity cannot rely on the exemption. Rather, an exemption should include objective conditions which, if met, provides relief. The longstanding condition that the QPAM (and its affiliates) have not been convicted of certain crimes is an example of an objective standard—parties know when the condition is met and it does not rely on a subjective determination by the Department. The Written Ineligibility Notice provides an improper subjective standard, which is even more problematic given the application of this discretion to far flung affiliates, particularly non-US affiliates, which could put an adviser out of the ERISA business effectively.

The SPARK Institute **recommends** that the Written Ineligibility Notice be removed from the final exemption. If the Department decides to retain this process, the final exemption must provide an opportunity for review by an administrative law judge, court, or similar *independent* party.

QPAM Sole Discretion over Transaction

The QPAM Exemption currently contains a condition that the transaction at issue must be negotiated under the direction of the QPAM, the QPAM must make the decision to enter into the transaction, and the transaction cannot be part of an agreement, arrangement, or understanding designed to benefit a party in interest. The Department is proposing to significantly modify this condition to read:

> The terms of the transaction, commitments, and investment of fund assets, and any associated negotiations on behalf of the Investment Fund are the sole responsibility of the QPAM. . . . No relief is provided under this exemption for any transaction that has been planned, negotiated, or initiated by a Party in Interest, in whole or in part, and presented to a QPAM for approval because the QPAM would not have sole responsibility with respect to the transaction as required by this Section I(c);

The preamble explains that the purpose of this change is to "make clear that a QPAM must not permit other parties in interest to make decisions regarding Plan investments under the QPAM's control." The Department also asserts 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. The role of the QPAM under the terms of the exemption is not to act as a mere independent approver of transactions."

We share the goal of preventing the QPAM Exemption from being abused, i.e. a QPAM being used to "clean" a transaction where there is an underlying goal to avoid the restrictions of the prohibited transaction rules. We believe the current language in the QPAM Exemption adequately protects plans from such abuse. But if the Department is going to modify the language, we believe that the final sentence of the new language should be removed, as it would have significant negative unintended consequences.

In the securities marketplace, it is not the case that investment managers, completely out of thin air and through their own research, learn about investment opportunities. Investment managers routinely engage in discussions with counterparties about investment ideas. The securities market has a variety of intermediaries, including broker dealers and investment banks, whose purpose is to connect buyers and sellers who might not otherwise connect, and help initiate transactions. This is particularly true with fixed income products, including asset-backed securities and similar offerings, and other investments that are not traded on the large national exchanges where the counterparty is a party in interest negotiating the transaction in their principal capacity. All of this interaction among counterparties and intermediaries is part of the normal functioning of the securities markets. In the end, only the investment manager has the discretion to decide to enter into the transaction on behalf of the plan, and does so pursuant to its duties under ERISA.

The Department's language could be interpreted to prohibit ERISA plans from participating in almost any new issuance of an asset backed security or initial public offering. These new securities are routinely "planned, negotiated, or initiated" by a variety of entities who might happen to be parties in interest to one of the plans whose assets that the investment manager manages. We do not think the Department intended to shut off plans from major portions of the capital markets. The whole premise of the QPAM exemption is that a large professional investment manager or other financial institution can be expected to deal with a variety of counterparties and market participants without concern about conflicts.

We also believe that the existing language, in the current QPAM Exemption and retained in the proposal, which prevents its use for a transaction that is "part of an agreement, arrangement, or understanding designed to benefit a Party in Interest" is sufficient to address any abuse that the Department is concerned about.

In addition to our concerns about the final sentence of the above-quoted language, some SPARK members are concerned about the revision in the first sentence above, especially when a fund uses sub-advisers. The current QPAM Exemption requires that the terms of the transaction are "negotiated on behalf of the investment fund by, or under the authority and general direction of, the QPAM." This language better suits the actual way in which various fiduciaries allocate responsibility. For example, in a CIT, to comply with securities and banking laws, the sponsoring trust company generally retains ultimate investment authority, but typically appoints a sub-adviser who invests the CIT's assets on a day to day basis. The new language requires that the QPAM have the "sole authority" over the transaction.[8] Neither of these parties precisely

[8] The new language the Department is proposed is also confusing because it introduces a concept that does not really comport with ERISA. For example, ERISA does not contemplate that an investment manager has "sole responsibility." Even an investment manager appointed under ERISA section 3(38) is subject to the periodic

have the *sole* authority, although both are fiduciaries under ERISA and may need to rely on the QPAM Exemption. Again, we do not believe the Department intended to prohibit the use of the QPAM Exemption in these very common situations.

The SPARK Institute **recommends** that the Department delete the last sentence of proposed section I(c). In addition, we **recommend** that the Department either eliminate the "sole responsibility" language or clarify that this does not prevent the use by financial institutions that appoint and supervise sub-advisers.

Winding Down Process

The Department's proposal would create a one-year "winding down" process. The Department states that the winding down period is "designed to accommodate a Plan's ability to wind down its relationship with the QPAM." We agree with the concept behind this winding down period. If a QPAM suddenly becomes ineligible for the QPAM Exemption, because it, or more likely an affiliate, has a criminal conviction or receives a Written Ineligibility Notice, it is rarely in the best interest of the plan for the QPAM to withdraw immediately. We agree with the idea that the relief of the exemption should continue for a period while the QPAM seeks an individual exemption or extricates itself from its clients. In fact, a winding down process is critical because of the material risk to plans if the adviser is not able to orderly liquidate or transfer assets, as some positions cannot easily be transferred, such as derivatives. This risk is potentially exacerbated where market counterparties are aware of that an adviser may be unable to rely on QPAM now or in the future, and could trade ahead or squeeze such adviser on pricing. To be workable, however, we suggest a few changes to the winding down period.

First, the SPARK Institute **recommends** that the Department eliminate the condition that, during the winding down period, the QPAM "may not engage in new transactions after the Ineligibility Date in reliance on this exemption for existing client Plans." Unless this language is deleted, the winding down period is not of any use,[9] and in fact is *worse* than not having a winding down period. Effectively, the investment manager remains in charge of the client plan's assets but could not engage in any trades on behalf of the plan, whether or not those transactions would be prohibited transactions. The plan is thus stuck with an investment manager that cannot buy or sell any investments.

Second, the SPARK Institute **recommends** that that the winding down period automatically be extended while an application for an individual exemption is pending. In our experience, the Department often takes more than a year to process an individual exemption request, and if the Department ultimately grants an individual exemption (which it often does in

supervision of the appointing fiduciary, and ERISA section 405 requires that other fiduciaries not turn a blind eye to breaches by other fiduciaries.

[9] Even if the QPAM Exemption is no longer available, it would still provide protection for transactions that were entered into when it was available. Unless this new condition is eliminated, it is not clear that the winding down period provides any relief from the prohibited transaction rules.

cases where an affiliate was involved in a criminal conviction unrelated to the management of ERISA plan assets), it would be appropriate for protection of the QPAM exemption to be available while the application is pending. If the Department declines in writing to grant an individual exemption, then this automatic extension would end. We would point out that the winding down period does not prevent a plan fiduciary from terminating the QPAM and seeking a new investment manager after receiving notice that the QPAM is no longer eligible, whether or not there is a pending individual exemption request.

Singling out QPAMs for Notice Requirement

The Department's proposal would require every investment manager that intends to rely on the QPAM Exemption to identify itself to the Department, and identify the legal name of each business entity relying upon the exemption in the email to the Department, and any name the QPAM may be operating under. The notification must be updated if there is a change to the legal name or operating name(s) of the QPAM relying upon the exemption, or if the QPAM no longer is relying on the QPAM Exemption. We recommend that the Department consider whether this notice requirement is really necessary and whether the Department has the resources to properly maintain the public QPAM list.

The Department does not provide any justification for this requirement, other than a need to "ensure that the Department is aware of entities that rely on the QPAM Exemption for prohibited transaction relief." This seems strange. Although the Department has occasionally required reporting to the Department as a condition of individual exemptions, no other exemption that is this widely used requires a similar notice to the Department. It is not clear, nor does the Department explain, why it needs to know which entities are relying on the QPAM Exemption, and why this is necessary to meet the statutory requirements of section 408(a) of ERISA.

The Department states that it intends "to keep a current list of entities relying upon the QPAM Exemption on its publicly available website." This may or may not be useful information to the public, but public disclosure is not a requirement of section 408(a) of ERISA; the legal standard is only that the exemption must be in the interests of, and protective of the rights of, plans and their participants. In any event, this will require a commitment that the Department update the website immediately upon receiving a notice, as securities market participants may rely on the list. We would urge the Department to ensure that it has sufficient resources to dedicate to keeping the list up to date.

We also have concern with the requirement to *immediately* notify the Department of a change in the legal name or operating name(s) of the QPAM. We would suggest a period of at least 180 days. A change in legal name or operating name likely will be made for unrelated reasons and take some time to be identified by the person charged with a firm's QPAM compliance. There does not seem to be a need for the Department to know of a legal or operating name change immediately.

Finally, if the Department decides to retain the notification requirement, in response to the request for comment on whether additional information should be required, we recommend that the only information that is needed is the name of the business entity. The Department can always obtain additional information if necessary.

Inflation Increases in Net Worth, AUM and Equity Requirements

The Department has proposed to increase the equity, net worth and assets under management (AUM) requirements for QPAMs. In addition, the Department states that it plans to publish, by notice in the Federal Register, adjustments to these thresholds for inflation. The proposal states that this will occur "no later than January 31st of each year." We suggest the Department reconsider if such automatic increases represent good policy, as it introduces significant uncertainty to smaller investment managers, which will reduce competition. This is especially true given the Department's admission that it does not know how many QPAMs this will impact.

In addition, it is unclear when such an update to the requirements will become effective. It would not be workable to apply these new requirements immediately. As we have repeatedly stated, loss of QPAM status can be devastating to both the investment manager and its plan clients. Thus, the SPARK Institute **recommends** that a change in these thresholds because of inflation be effective no earlier than the first day of the next calendar year following the January 31 announcement.

Record Access

Under the proposal, a QPAM will be required to make all of its records demonstrating compliance available every business day, not just to an authorized employee of the Department or the Internal Revenue Service or another state or federal regulator, but also to any plan investing the investment fund and, even more concerning, any participant or beneficiary of a plan invested in an investment fund managed by the QPAM. The Department provides no evidence whatsoever that access to this information from all of these parties is in any way necessary to ensure that plans and participants are adequately protected. Nor has the Department provided evidence, even anecdotal, that plans or participants routinely request such information and have it denied.

Plan fiduciaries that engage investment managers are perfectly capable of including language in their investment management agreements that allows for the provision of information where needed to ensure compliance with the terms of the investment management agreement. Such provisions include reasonable protections for confidential information or information that might be used to front run investment decisions.

What such a change to the QPAM Exemption would do, however, is invite fishing expeditions from the plaintiffs' bar. And such fishing expeditions would go on without the supervision and protection of a court overseeing discovery. All a class action plaintiffs' firm would need to do is get a few participants to sign letters and they could demand QPAM compliance records from virtually every investment manager in the U.S.

Accordingly, the SPARK Institute **recommends** that the record access requirements be limited to employees of the Department or the Internal Revenue Service or another state or federal regulator.

Effective Date

The Department proposes to make the amendments to the QPAM Exemption effective 60 days after the final amendment is published in the Federal Register. This is not workable given the number of changes the Department is recommending and the pervasive use of the QPAM Exemption. The SPARK Institute **recommends** that the amendment be effective with respect to new transactions occurring no earlier than ***18 months*** after publication of the final amendment in the Federal Register.

As we noted earlier, it is not possible for every investment management agreement with every ERISA plan to be amended in 60 days. We have strongly recommended that the requirement to amend investment management agreements be removed. But even if that requirement is removed, the Department has proposed many other changes that will require significant implementation. For example, parties need to identify every affiliate that may be relying on the exemption, for purposes of the notification to the Department. Some financial institutions may have multiple affiliates. The Department also requires that QPAMs review and amend their record keeping systems to ensure that they can meet the new record retention requirement, as well as ensuring that records are available as required.

Further, the Department is proposing a significant increase in the AUM, net worth, and equity requirements of the QPAM Exemption. We would surmise that a number of investment advisers, banks, savings and loan associations, and insurance companies will no longer qualify. We think it appropriate to give such entities time to address the issue, through corporate transaction, transfer of clients, or the seeking of an individual exemption.

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The SPARK Institute appreciates the opportunity to provide these comments to the Department. We look forward to the hearing on November 17 to discuss our comments in more detail. If the Department has any questions or would like more information regarding our comments, please contact me or the SPARK Institute's outside counsel, Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com).

Sincerely,

Tim Rouse
Executive Director