May 31, 2022

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N–5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

ATTN: RIN 1210-ACO5 Proposed Rule, "Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications"

The AICPA appreciates the opportunity to comment on the U.S. Department of Labor's (DOL) proposed rule on Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications (the "Proposal") (RIN 1210-ACO5) that was published in the March 15, 2022 edition of the *Federal Register*.

Executive Summary

We applaud the DOL's efforts to protect the interests of plan participants and of the beneficiaries of employee benefit plans. While the proposed regulation's objective is to further define the requirements for applicants, including ESOP plan sponsors, to obtain a Prohibited Transaction Exemption letter from the DOL, the impact of the proposed regulation will extend beyond that objective with negative consequences that may not be in the best interest of the plan and its participants and beneficiaries. The end result will be higher costs to the plan and the elimination of the choice of qualified service providers.

We are concerned that the proposed expanded definitions, particularly with respect to the expanded definition and calculation-based determination of independence, and the proposed replacement of indemnification clauses in engagement letters with a requirement of fiduciary insurance, would impact the behavior of plan sponsors, appraisers, and fiduciary services in a manner such that plan participants would not be best served, and the industry as a whole would also be left worse off than before. The following comments apply specifically to these and other proposed changes:

1. Independence With Respect to "Qualified Independent Appraiser"

   The Proposal revises the definition of a Qualified Independent Appraiser (QIA) to "…any individual or entity with appropriate training, experience, and facilities to provide a qualified appraisal report on behalf of the plan regarding the particular asset or property appraised in the report that is independent of and unrelated to any party involved in the exemption transaction…" Further, the Proposal contains a new definition of how independence of the appraiser is to be determined:

   > "An appraiser will not be treated as independent if the revenues it receives, or is projected to receive, within the current Federal income tax year from parties involved in the exemption transaction are more than two percent of such appraiser's annual revenues from all sources based upon either its prior Federal income tax year or the appraiser's projected revenues for the current Federal income tax year, unless the Department determines otherwise in its sole discretion"

Other sections of the Proposal state that the "…Department determines the independence of the appraiser based on all relevant facts and circumstances" and also that the appraiser must now be "… independent of any potential qualified independent fiduciary in addition to other parties involved in the exemption transaction." Further, the Proposal states that it has included this expanded definition now requiring independence from fiduciaries to "…ensure that the

appraiser will not be pressured to deliver a valuation reflecting undue influence from the fiduciary."

We believe the proposed revisions to determining the appraisers' independence is based on an arbitrary percentage of total prior year or forecasted revenues and provides significantly less insight into an appraiser's independence than the current regulations that state '[a]bsent facts and circumstances demonstrating a lack of independence' the DOL will operate on the presumption the QIA is independent. Further, the proposed revised definition introduces an unnecessary and unknowable variable into the PTE exemption process.

With respect to the two percent revenue threshold, we observe that the existing regulations in 29 CFR 2570.31 (i), include a percentage of revenue test: an appraiser is deemed independent if less than two percent of its revenue is derived from parties involved in the transaction. However, based on the facts and circumstances, the appraiser may still be considered independent if the revenue is less than five percent. The Proposal has now removed this long-standing calculated range for independence determination, and has instead put forth as the independence standard at the low end of the range to create a single-point two percent threshold, which will also require the inclusion of revenues from both the prior tax year and the projected full current year. Further, in replacement of the range of up to five percent over which facts and circumstances can be applied in the determination of appraiser independence, the DOL now states that it will "in its sole discretion" determine otherwise, should there be an appeal to the single two percent threshold.

This proposed application of a two percent of total revenues 'bright-line' test instead of the current requirements in 29 CFR 2570.31 (i), will severely limit, if not entirely eliminate, an appraiser's ability to provide his or her services on behalf of the plan even if the appraiser would be considered independent under the current regulation. Without evidentiary support demonstrating how this change will help ensure appraisers are independent and, in turn, protect

plan beneficiaries, we believe this change will unnecessarily restrict the number of qualified appraisers.

The Proposal states the DOL "determines the independence of the appraiser based on all relevant facts and circumstances." The Proposal also emphasizes that the revisions will help the DOL to "more accurately identify potential conflicts of interest that could affect an appraiser's independence"; however, we are very concerned that the use of a two percent revenue metric is not consistent with either of those objectives. As written, the Proposal establishes a threshold that will result in binary outcomes as to whether an appraiser is independent regardless of additional relevant facts and circumstances, and result in the DOL assessing independence, in its sole discretion, with less relevant information and a less reliable process for identifying conflicts of interest.

We do not believe an arbitrary revenue threshold is a suitable metric by which to evaluate independence. The DOL should explain why and how the two percent threshold was arrived at, and how that defined level of total revenue determines a state of independence for the appraiser. Without this transparency, any 'bright-line' threshold based solely on a metric (revenue) that, on its own, cannot establish any indication of independence, is an uninformative and restrictive threshold.[1]

In the absence of any clear and supportable rationale for this change, we request that the DOL maintain the current regulations to allow for a more comprehensive assessment of independence using both quantitative and qualitative information in assessing an appraiser's independence. As described, the current use of a range of revenues, along with a presumption of independence unless facts and circumstances indicate otherwise, permits the DOL to

[1] For comparison, the AICPA's Code of Professional Conduct has a comprehensive Conceptual Framework for Independence to help assess independence and ethical issues because it is impossible to enumerate all relationships or circumstances in which the appearance of independence might be questioned.

evaluate an appraiser's independence that may exist outside of its ability to foresee, articulate, or define.

Forecasted revenues are management estimates that are based on professional judgment and invariably will differ from actual revenues. Therefore, by further including forecasted revenues into the calculation to assess independence, not only will the DOL be using less information than what is currently required but the information will be inherently less reliable. This will create innumerable situations where an appraiser's independence, and in turn its ability to engage a client, will hinge on how well an estimate aligns with actual results over the course of a year.

However, if the DOL nonetheless proceeds to adopt a two percent threshold as a determinative test for independence, we request the DOL to eliminate forecasted revenues as part of the calculation. The AICPA believes that the Proposal's new revenue requirements introduce arbitrary and unpredictable inputs into the DOL's assessment processes that impede the DOL's stated objectives to 'more accurately identify potential conflicts of interest that could affect an appraiser's independence' and should be removed and replaced with the current requirements in the final regulation.

2. Independence With Respect to "Qualified Independent Fiduciary"

The Proposal revises the definition of a Qualified Independent Fiduciary (QIF) to "…any individual or entity with appropriate training, experience, and facilities to act on behalf of the plan regarding the exemption transaction in accordance with the fiduciary duties and responsibilities prescribed by ERISA that is independent of and unrelated to: Any party involved in the exemption transaction,… and any other party involved in the development of the exemption request" with the last phrase, *"…any other party involved in the development of*

the exemption request" seemingly an expansion of the current definition's "…any individual or entity that is independent of and unrelated to any party engaging in the exemption transaction or its affiliates…"

We are particularly concerned by the DOL's attempts to redefine the definition of "fiduciary", and the responsibilities such a definition currently places on responsible parties and the benefits accruing to beneficiaries. The Proposal also states the DOL will determine independence based upon whether the fiduciary has "an interest in the subject transaction or future transactions of the same nature or type [emphasis added]".

With respect to the updated definition of fiduciary independence, we recommend the elimination of the requirement of the two percent revenue threshold for reasons that are consistent with our previously described concerns regarding the DOL's proposed revisions of the definition of independence with respect to QIA.

Moreover, it is clear that the proposed inclusion of "an interest in the subject transaction or future transactions of the same nature or type" with respect to fiduciaries fails to fully consider the broader impact to stakeholders and related businesses. Given the nature and dynamics of the industry, the complexities of ERISA and ESOPs have been a long-standing natural barrier to many would-be entrants. For those already in the industry, there is a high bar of expertise which has shaped the competitive landscape and has tended to filter out all except a small subset of highly-skilled practitioners including but not limited to specialist counsel, appraisers, and fiduciary service providers.

The ESOP industry is relatively small: there are approximately 6,500 ESOP plans in existence, according to the National Center for Employee Ownership (www.esop.org), the vast majority of which were created to facilitate equity transfer of departing founders, and less than ten percent of which are from public companies. In the view of the AICPA therefore, the strategic

and economic dynamics of the sector indicate that business relationships exist between plan sponsors and fiduciary and other service providers, and repeat engagements are not only possible, but likely. However, this alone – also a widely observed and, in many cases, inescapable way of doing business across numerous other industries – cannot be automatically construed as a disqualifier of independence.

The AICPA supports any efforts by the DOL to strengthen the independence requirements with guidance and requirements that align with other professional organizations to assess perceived or actual independence (e.g., through relationships, employment) of any covered person, and; minimize requirements that could have an adverse effect on plans, participants and beneficiaries.

However, we believe this expanded definition is unnecessary and should be removed. This aspect of the Proposal would unnecessarily expand the circumstances under which the DOL can i) question or investigate any fiduciary with extensive expertise in ERISA transactions for lack of independence, and ii) invalidate transactions without sufficient due process. This in turn could further discourage fiduciaries from engaging in this type of service especially because there is already a limited subset of fiduciaries that practice in negotiating ESOP transactions, potentially increasing the likelihood to new entrants being selected for this level of scrutiny in transaction review.

3. Qualified Appraisal Report

The Proposal states that a Qualified Appraisal Report (QAR) is prepared by a QIA "…solely on behalf of the plan, which insures that the qualified independent appraiser only takes into account the interest of the plan and its participants and beneficiaries when it produces the

report." This revision to the definition of a QAR is, according to the DOL, intended to further bolster the independence of the appraiser.

However, we are concerned that this revision may be interpreted as a near-fiduciary duty to provide a QAR that is prepared to the exclusive interests of the plan and its participants and overriding the importance of broadly accepted standards of objectivity required of ESOP valuation practitioners and other appraisers. Furthermore, should this section of the Proposal be accepted as written, the definition of a QAR could be extended to the determination of value for the purposes of a stock sale to an ESOP, which would in turn inherently contradict the Congressional definition of a QAR, which emphasizes the requirement of objectivity and being free of any inherent biases in the performance of valuation processes.

We suggest that the Proposal's language describing the responsibilities of the QIA as it relates to the preparation of the QAR should be revised so as not to imply or infer a level of responsibility to the plan and its participants that supersedes an appraiser's professional responsibility.

4. Authority of DOL "In Its Sole Discretion"

Throughout the Proposal and specifically within each section in which a framework for the determination of independence is provided, the DOL states that it will be the final determinant of independence "in its sole discretion". The AICPA believes that this makes the regulation vague and will result in significant uncertainty within the profession and inconsistency in how the DOL interprets and applies the regulation.

DOL should be promulgating guidance that improves transparency and establishes clear expectations, not the opposite. We believe that by including the catch-all phrase "in its sole

discretion", the DOL directly weakens its own intention of seeking to improve transparency with the Proposal. Use of such a phrase completely omits any clarity in guidance on how the DOL will make final determinations, what, if any, further documentation, activity, or other forms of supporting evidence will be required of appraisers and fiduciaries beyond that required for the two percent revenue calculation, the protocols which they would need to be follow, or the timeline over which a decision of independence could be expected subsequent to a revenue threshold test.

Furthermore, while the focus of the Proposal is, ostensibly, to enhance and strengthen only the changes to the Exemption Procedure Regulation, we are concerned that the repeated inclusion of "in its sole discretion" suggests the DOL appears to be reaching to change a number of long-standing definitions and standards which could be expanded into other areas of ERISA.

The AICPA requests the DOL to continue its efforts to support and implement transparent and consistent guidance so that fiduciaries, appraisers, and plan sponsors can reliably offer their services in a manner that is in the best interest of the plan beneficiaries.

The AICPA recommends the DOL consider the commissioning of a focused review panel, potentially comprised of senior industry service provider practitioners, plan representatives and participants, alongside DOL regulators. Such a panel – similar examples of which exist in various industries - could then adjudicate fairly on matters which are escalated via a predetermined and standardized framework.

5. Expansion of Definition of Parties Involved in the Exemption Transaction

The current definitions included within "parties in interest" are contained in 5 U.S.C. 8477(a)(4), and include fiduciaries, counsel, service providers, and any relatives and majority financial interests thereof, in addition to participants and others with a direct financial interest. The Proposal revises this definition to "parties involved in the exemption transaction" that includes all of the preceding, in addition to "…any party (or its affiliate) that is engaged in the exemption transaction; and …any party (or its affiliates) that provides services with respect to the exemption transaction to either the plan or a party described…" by the current existing definition or within party or affiliate that is engaged in exemption transaction.

Accordingly, it appears the proposed definition may therefore now include auditors, record keepers, repurchase obligation calculators, participant statement preparers, employee census data providers, Form 5500 preparers, among many others.

The AICPA believes the Proposal's revised definition "parties involved in the exemption transaction" from the former "parties in interest" will unnecessarily subject a much wider spectrum of professionals to DOL oversight. In addition, the limited transparency coupled with the increase in regulatory oversight requirements could potentially also create delays in addressing compliance with the new rules. As written in the Proposal, these revisions will provide the DOL with unnecessarily broad oversight and authority over professionals who are already subject to regulatory oversight and professional standards (see also the section of this Letter, "Redundancy in Disclosure Administration"). The AICPA therefore requests that the DOL should not adopt this expanded definition.

6. Replacement of Indemnification Clauses with Fiduciary Insurance

With respect to the long-standing established business practice for service providers to include indemnification clause in their client engagement letters, the DOL's position in the Proposal is that any and all indemnification clauses in engagement letters between ESOPs and relevant service providers should not be included, and inclusion of these clauses will now render such engagement letters null and void. The DOL instead intends to mandate that appraisers, fiduciaries, and others who would otherwise routinely employ indemnification clauses in contracts and engagement letters, instead resort to carrying fiduciary insurance "…in an amount sufficient to indemnify the plan for damages resulting from a breach by the independent fiduciary of either (1) ERISA, the Code, or any other Federal or state law or (2) its contract or engagement letter under proposed paragraph (f)(3)."

The AICPA is concerned about the Proposal's indemnification clause restrictions and believes they will have a significant deleterious impact on all professionals who provide services to ESOPs and potentially beyond. Further, even if indemnification clauses are summarily replaced with insurance of this type (and at appropriate coverage levels), the Proposal states that the insurance "…may not contain an exclusion for actions brought by the Secretary or any other Federal, state, or regulatory body; the plan; or plan participants or beneficiaries." The DOL indicates this language applies only to the Proposal, yet it clearly appears that this reasoning may be extended to virtually all ERISA-related services. The DOL has not provided any supportable reason that would necessitate such a serious change and the Association believes that direct effects to appraisers and fiduciaries, and broader associated consequences throughout the industry could potentially be extremely negative to all stakeholders, including plan sponsors and participants.

As the costs of doing business increase, a potential result – actually, a common effect in many scenarios and across any number of industries – could be the proportional increase in cost-

reduction strategies pursued by appraisers and other service providers, or to the extent such costs could be passed on, an increase in costs to clients. This in turn could lead to the unintended but not unusual consequence of an erosion of the quality of services provided, as some of these cost reduction strategies eventually turn into shortcuts. These two effects are yet further direct examples of how the Proposal would not be in the best interest of plan participants.

In addition to this, we also believe that another immediate and direct effect of this aspect of the Proposal would be to drive appraisers and fiduciaries away from the sector given the increased cost burden of the new insurance requirement, and the increased exposure to litigation risks. In the first case, insurance premiums would steeply increase, both from new industrywide demand, and also the risk exposure from wide-ranging prohibition of exclusions for the potential actions previously described. In the second case, appraisers and service providers would either conclude the heightened litigation risks significantly outweigh the expected benefits of staying in the industry.

Based on the significant harm this type of restrictive provision could have on all professionals who work on ERISA related engagements, the AICPA requests the DOL to remove the proposed prohibition of indemnification clauses and the added requirement of liability insurance from the final regulation.

7. Redundancy in Disclosure Administration

Finally, the Proposal extends additional disclosures to appraisers, accountants, and auditors. According to the DOL, the justification for this is to help insure the DOL will be able to rely on financial documents submitted by third parties. Under severe penalties of perjury, the third party must attest that all representations are true and correct.

The DOL provides no justification for this redundancy. Intentional or otherwise, one potential explanation for this is to further raise the bar for service providers with the imposition of additional layers of administrative hurdles. This requirement seems redundant as professionals such as accountants, auditors and appraisers are already held to widely accepted professional standards.

For instance, members of the AICPA are subject to a rigorous Code of Professional Conduct that requires them to maintain their objectivity and integrity in addition to their competence. Failure to maintain objectivity and integrity or perform the engagement with due care and in line with professional standards results in violations of this code, for which a robust disciplinary mechanism exists. Further, valuation practitioners in this sector of industry routinely state they closely adhere to process agreements which have evolved directly from widely quoted precedents set by DOL settlements with ESOP trustees (for example, those involving First Bankers Trust, 2017; GreatBanc Trust Company, 2014). These agreements continue to provide effective guidance on the expectations of the DOL regarding the valuation appraiser's roles and responsibilities as a financial advisor to the trustee of an ESOP.

Given the added requirements in the Proposal, the additional unnecessary layer of required regulatory administration for providing services may become too costly for many and drive them from the business, or it will cause prices to ratchet up, further contributing to the sector-level strategic and economic shifts leading to deleterious unintended consequences described in previous sections of this Letter.

Yet another potential consequence is an increase in targeted, opportunistic and payout-driven litigation aimed at what would otherwise be smoothly running and fully compliant employee benefit plans. Therefore, in light of these several and potentially excessive negative consequences, the AICPA believes it is clearly incumbent on the DOL to either provide clearer

substantiation for including this change within the Proposal, or not include them within the final regulation.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please feel free to contact Ian MacKay, Director – AICPA Federal Regulatory Affairs, at Ian.MacKay@AICPA-CIMA.com, or (202) 434-9253, Mark O. Smith, Director – AICPA Valuation Services at Mark.Smith@AICPA-CIMA.com, or (919) 402-2140, or Bethany M. Hearn at bethany.hearn@CLAconnect.com, or (217) 373-3109, Chair of the AICPA Forensic and Valuation Services Executive Committee.

Sincerely,

Bethany M. Hearn, CPA, ABV, CFF
Chair, AICPA Forensic and Valuation Services Executive Committee