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Filed Electronically

May 31, 2022

Office of Exemption Determinations
Employee Benefits Security Administration
Room N–5655
US Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Proposed Procedures for Prohibited Transaction Exemption Applications (RIN 1210-AC05)

Dear Acting Assistant Secretary Ali Khawar:

The Investment Company Institute (ICI)[1] writes to express significant concerns with the Department of Labor's (the "Department") proposed procedures for the filing and processing of individual and class prohibited transaction exemption (PTE) applications (the "Proposal").[2]

ICI strongly supports efforts to promote retirement security for US workers. As a trade association representing regulated investment funds, ICI is especially attuned to the needs of retirement savers because regulated funds play a significant role in US retirement saving through defined contribution (DC) plans and individual retirement accounts (IRAs). At year-end 2021, more than 60 percent of private-sector 401(k) plan assets were invested in regulated funds.

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $31.3 trillion in the United States, serving more than 100 million investors, and an additional $10.0 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and conducts its international work through ICI Global.

[2] On March 15, 2022, the Department published proposed amendments to its regulations specifying the procedures for applying for class and individual exemptions and the processing of such applications. 87 Fed. Reg. 14722 (March 15, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-03-15/pdf/2022-04963.pdf. Comments to the Department were originally due by April 14, 2022, but the time has been extended to May 29, 2022. 87 Fed. Reg. 21600 (April 12, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-04-12/pdf/2022-07785.pdf.

The Employee Retirement Income Security Act of 1974, as amended (ERISA), was enacted in part to protect the retirement savings of participants in their employers' retirement plans from losses due to transactions with persons with specified relationships to the plan. These protections against potential conflicts of interest included far reaching prohibited transaction rules, which generally prevent the parties who are responsible for operating employer-sponsored retirement plans from engaging in almost any transaction with a broad array of "parties in interest" (as defined in ERISA) and "disqualified persons" under the Internal Revenue Code of 1986 (the "Code").[3] Understanding that such an extremely far reaching set of prohibitions would harm plans by preventing them from accessing many beneficial services, investments, and transactions that are necessary for, or beneficial to, their creation and operation, ERISA also includes three kinds of possible exemptions from the prohibited transaction prohibitions: statutory exemptions, class exemptions and individual exemptions.[4]

The Department has long had regulations setting forth the procedures for applying for class and individual PTEs and—prior to the last two decades—has granted many such exemptions since ERISA's enactment.[5] Now, however, the Department is proposing changes to its procedures that would significantly modify the exemption application process and formally codify new additional burdens on applicants and independent fiduciaries covered by the exemption.

As discussed in greater detail below, we are concerned that the collective impact of these changes at a minimum will be to make it more difficult and expensive to apply for a PTE and put the success of an application in significant doubt—discouraging stakeholders from seeking exemptions at all. If finalized as proposed, the changes will restrict the ability of the regulated community to obtain exemptions for transactions that facilitate efficient plan administration, and provide for favorable investments, to the detriment of retirement plans and their participants. Further, the proposed changes effectively will discourage the regulated community from proactive, informal communication with the Department and reduce the Department's understanding of current issues and concerns and, conversely, the public's understanding of the Department's views.

EXECUTIVE SUMMARY

Our comments and recommendations include the following:

- The proposed changes regarding pre-submission discussions with the Department will significantly limit the mutually beneficial dialogue that has developed between the

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[3] ERISA § 406 (29 U.S.C. § 1106) and 26 U.S.C. § 4975(c).

[4] ERISA § 408(a) (29 U.S.C. § 1108(a)) and 26 U.S.C. § 4975(d).

[5] See EBSA Index of Individual Exemptions https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/exemptions/granted. See also Wade, William P., & Loebl, Richard I. 1994. "Individual Prohibited Transaction Exemptions: The 'Common Law.'" *Real Property, Probate and Trust Journal*, Vol. 29, No. 2 (Summer 1994), pp. 185–261. Available at http://www.jstor.org/stable/20782047.

Department and the regulated community about potential transactions that may be considered to implicate ERISA's prohibited transaction rules.

- The proposed changes to the requirements for independent fiduciaries and appraisers—including new revenue thresholds for determining "independence," a requirement to be independent of any qualified independent fiduciary and not merely the applicant, and a requirement that the independent fiduciary maintain fiduciary liability insurance in an amount that is sufficient to indemnify the plan for damages resulting from a breach by the independent fiduciary—would unnecessarily reduce competition, increase costs, and create uncertainty.

- The costs associated with the proposed changes' new information requirements will create barriers of entry to the exemption process except for the largest applicants, resulting in the elimination of transactions that would otherwise be commercially beneficial, and consequently will reduce plan investment returns.

- The provision that the Department generally would not consider the exemption application for any transaction that involves a party in interest who is the subject of an investigation by any regulatory entity under any federal or state laws—including investigations and actions under statutes or regulations that are unrelated to ERISA or a party's ability to manage or administer an employee benefit plan—would unnecessarily narrow the universe of parties that are eligible to participate in an exemption transaction and the types of transactions that will be eligible.

- The proposed changes would limit the universe of exemption transactions that will be considered and granted, but the Department fails to consider the impact on retirement plans and their participants in accessing beneficial services, investments, and transactions that are necessary for, or beneficial to, their creation and operation.

Collectively, these changes will make it more difficult and expensive to apply for a PTE and put in doubt the success of an application—discouraging parties from even applying; the changes will restrict the ability of the regulated community to obtain exemptions for transactions that facilitate efficient plan administration, and provide for favorable investments, to the detriment of retirement plans and their participants.

BACKGROUND

ERISA's prohibited transaction rules generally prevent the parties who are responsible for creating and operating employer-sponsored retirement plans from engaging in almost any transaction with parties in interest,[6] which includes just about any person or entity that has any connection to the plan. In other words, Congress created a regime under which almost any transaction with a plan and related party would be prohibited. But because such a regime necessarily would prevent plans from accessing many beneficial services, investments, and

[6] ERISA § 3(14) (29 U.S.C. § 1002(14)) and 26 U.S.C. § 4975(e)(2).

transactions that are necessary for, or beneficial to, the creation and operation of retirement plans, it included a series of statutory PTEs. Additionally, because Congress knew it would not be able to foresee every instance where an exemption would be appropriate so that plans could continue to access investments, products and services, Congress gave the Department the authority to grant administrative exemptions when it determines that such relief is: (1) administratively feasible; (2) in the interests of the plan and its participants and beneficiaries; and (3) protective of the rights of participants and beneficiaries of such plans.[7]

For many years following the passage of ERISA, the Department had been willing to exercise this statutory authority to grant, annually, dozens of individual and class PTEs that had been requested by retirement plan sponsors, service providers, and trade associations.[8] As Congress intended when it established the prohibited transaction regime along with the exemption process, these exemptions benefited plans by providing much needed flexibility to the otherwise rigid prohibited transaction rules imposed by ERISA.

In recent years, however, the Department has become increasingly reluctant to grant administrative exemptions. In 2021, for example, the Department only granted *three* individual exemptions, and in 2020, the Department only granted *one* individual exemption. The Department has only granted *three* class exemptions in the past 15 years (and those three were all in connection with the Department's changes to the definition of the term "fiduciary").[9] This virtual shut-down of the exemption process has discouraged parties from requesting individual relief and prevented plans and service providers from developing new and innovative offerings for retirement savers. The proposed changes do not appear likely to improve these trends, or ultimately to enable plans and participants to benefit from prudently issued exemptions. In fact, they may force applicants to choose less beneficial transactions or avoid the transactions altogether, a lost opportunity for the plan and its participants.

CONCERNS WITH PROPOSED AMENDMENTS

We discuss our specific concerns with the proposed changes below.

1. The proposed changes' pre-submission public-disclosure obligations will limit mutually beneficial discussions with the regulated community.

ICI is concerned that the proposed changes would significantly limit or eliminate altogether the informal discussions that the Department will have with the regulated community about potential transactions that may be considered to implicate ERISA's prohibited transaction rules. These

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7 ERISA § 408(a) (29 U.S.C. § 1108(a)).

8 For example, PTE 77-3, which permits the purchase and sale of open-end mutual fund shares by a plan which only covers employees of a mutual fund, its investment adviser or principal underwriter, or an affiliate, was issued to the ICI. Prohibited Transaction Class Exemption 77-3, 42 Fed. Reg. 18734 (April 8, 1977). Individual exemptions issued after the issuance of PTE 77-3 provided needed modifications to certain of the PTE's conditions to allow for its use. See, e.g., PTE 2002-17, published at 67 Fed. Reg. 13366 (March 22, 2002).

9 See footnote 5, supra.

concerns are primarily based on three changes included in the Proposal that: (1) would require that all communications with the Department regarding a requested exemption be part of the administrative record that the public can obtain on request; (2) would bar the Department from communicating with pre-submission applicants on an anonymous basis; and (3) would broadly define the term "pre-submission applicant" to mean a "party that contacts the Department, either orally or in writing, to inquire whether a party with a particular fact pattern would need to submit an exemption application and, if so, what conditions and relief would be applicable."[10] Taken together, these changes mean that a prospective applicant or its representative contacting the Department's exemption staff about the application of ERISA's prohibited transaction rules and the potential need for administrative relief will be required to identify themselves, and the Department will create a record of their inquiry that is open to public inspection.

We are concerned that these changes would significantly deter the customary practice of seeking a meeting with the Department's exemption staff to discuss what the staff's attitude would be toward a requested exemption before a would-be applicant incurs the time and expense of preparing a formal application. They may also prevent plan sponsors and service providers from consulting the Department to request informal views that they do not need to request an exemption because, for example, under their facts no prohibited transaction would occur or because another exemption is available.

This new public disclosure obligation seems particularly anomalous given that preliminary conversations about whether an exemption is feasible in light of the circumstances surrounding a particular transaction can be beneficial to both the Department and the regulated community. ERISA's prohibited transaction rules and their accompanying exemptions are complex, and in many instances, there is little guidance from the Department on when and how specific conditions of the exemptions apply. By eliminating these anonymous discussions and clarifying that the Department will make a record that is open to the public whenever a party inquires "whether a party with a particular fact pattern would need to submit an exemption application, and, if so, what conditions and relief would be applicable," we are concerned that the proposed changes will significantly limit the beneficial dialogue that has informally developed between the Department and such practitioners. ICI believes that these unfortunate consequences could be avoided if the Department's application procedures continue to permit ERISA practitioners to have pre-submission conversations with the Department without identifying their clients by name.

2. The proposed changes for confirming the "independence" of independent fiduciaries and appraisers would reduce competition, increase costs and create uncertainty.

Exemptions often impose requirements that an independent fiduciary be appointed to represent the interests of the plan and, if relevant, an independent appraiser to establish that the plan will pay no more for or receive no less than the fair market value of an asset in a transaction. The proposed changes would impose significant changes to the requirements for independent

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[10] Section 2570.31(k) of Proposal.

fiduciaries and appraisers and the circumstances under which such persons will be considered independent of the parties involved in an exemption transaction,[11] including new revenue thresholds for determining "independence," as well as new independence and insurance requirements—which collectively will serve to reduce competition, increase costs and create uncertainty.

2.1 Independence threshold.

For example, under the Proposal, the Department would presume that a fiduciary does *not* qualify as "independent" if its revenues from the parties involved in the exemption transaction exceed 2 percent of its revenues, "unless, in its sole discretion, the Department determines otherwise."[12]

We are concerned that this new 2 percent ceiling on the revenues of qualified independent fiduciaries and appraisers will create an unnecessary barrier to entry for fiduciaries and service providers who would otherwise be able to serve as a qualified independent fiduciary under the standards that are present in the Department's existing procedures.

The new revenue standard for independence will be harder for exemption applicants to meet and could reduce competition, by narrowing down the field of smaller firms. It could impact smaller entities by limiting the amount of work they do for any one client and allow a larger entity to negotiate a larger fee by virtue of its overall revenue characteristics. This means *less competition, fewer choices, and increased cost* for plan sponsors and others in need of these independent fiduciary providers. The Department does not provide any evidence that the current standards are insufficient.

2.2 Independence from all parties.

ICI is also concerned that the proposed changes would require qualified independent appraisers to be independent of any qualified independent fiduciary, and not merely the applicant. Like the discussion above, we are concerned that these new conditions will unnecessarily limit choices for plans and participants by limiting the parties who will be willing to participate in an exemption transaction and increasing the costs associated with exemption transactions. These limitations would also apparently elevate independence over competence, experience, and expertise. This change could, for example, prevent qualified independent fiduciaries from selecting appraisers with whom they have developed longstanding and trusted relationships.

The proposed changes also provide that an entity may not be considered independent if it has an interest in the subject transaction *or future transactions of the same nature or type*. In the preamble to the Proposal, the Department stated that it is concerned that certain independent

[11] Section 2570.31(j) of Proposal.

[12] This change would significantly alter the Department's existing rules that currently: (1) indicate that a fiduciary may be considered as "independent" if its revenues from any party in interest involved in the exemption transaction are not more than 5 percent of its total revenues; and (2) provide an independence safe harbor if a fiduciary receives fewer than 2 percent of its revenues from any party in interest. See, e.g., DOL Adv. Op. 2001-09 (Dec. 14, 2001).

fiduciaries may have a "business interest" in facilitating an exemption transaction, such as to promote its independent fiduciary services to other clients, or to promote a relationship with a third party, such as an investment advisor or bank. The uncertainly inherent in this standard will likely reduce the number of entities willing to serve as independent fiduciaries, reduce competition and increase fees, all without any apparent benefit to plans.

2.3 Liability insurance requirement.

An independent fiduciary would be required under the proposed changes to maintain fiduciary liability insurance in an amount that is sufficient to indemnify the plan for damages resulting from a breach by the independent fiduciary of either (a) ERISA, the Code, or any other federal or state law, or (b) its agreement with the plan. The insurance may not contain an exclusion for actions brought by the Department or any other federal or state regulator, the plan, or plan participants or beneficiaries.

For exceptionally large transactions, this may make fiduciary insurance unavailable or at least prohibitively expensive. As the Department notes, many and perhaps most independent fiduciaries have an interest in future business and can more accurately assess risk as they have more complete information. This interest appears to negate the only positive benefit from insurance since any claim resulting in a payout would materially damage the ability of an independent fiduciary to obtain future business.

3. The proposed changes' information requirements will significantly increase the costs of seeking an individual exemption.

ICI is also concerned that the proposed changes' new information requirements will create barriers of entry to the exemption process except for the largest applicants. In this respect, the proposed changes would require even more information from the applicant than the voluminous amount already required, including:

- A description of material benefits non-plan parties would receive as a result of the transactions the exemption would permit.
- The costs and benefits (quantified if possible) of the transaction to plans, participants, and beneficiaries.
- A detailed description of potential alternatives to engaging in the prohibited transaction (if an exemption is granted), and why those alternatives were not pursued.
- A description of each conflict of interest or potential instance of self-dealing that would be permitted if the exemption is granted.
- With respect to applications for individual exemptions, the applicant would need to report:
    - foreign (in addition to domestic) criminal convictions and

- any prior transaction between (i) the plan or plan sponsor and (ii) a party involved in the transaction.[13]

Much of this information appears similar to the type of regulatory impact analysis required of federal agencies in promulgating new regulations and for which many applicants would not have the resources to perform. The costs associated with this requirement would eliminate—except for exceptionally large plans—transactions that would otherwise be commercially beneficial.

4. The proposed changes would unnecessarily narrow the universe of eligible parties and transactions.

Under the Proposal, the Department generally would not consider the exemption application for any transaction that involves a party in interest who is the subject of an investigation by any regulatory entity under any federal or state laws.[14] We are concerned that this broadly drafted exclusion would unnecessarily and without benefit narrow the universe of parties that are eligible to participate in an exemption transaction and the types of transactions that will be eligible.

Among other persons and entities, a "party in interest" includes any fiduciary, service provider, employer, or employee organization involved in the exemption transaction, as well as the employees, officers, and directors of some of those entities. The limitation described in the preceding paragraph would unreasonably expand the existing bar for parties in interest who are being investigated or charged for ERISA violations to cover *any investigation or action by any state or federal regulator*. This condition is far too broad and will unnecessarily limit the universe of parties that will be eligible to participate in an exemption transaction. Large institutions are often and routinely under examination by a state or federal regulator (e.g., occupational, tax, or environmental regulators) as part of normal business operating requirements.

While we could understand concerns with parties in interest who are being investigated or charged ***for ERISA violations***, we do not believe that investigations and actions under statutes or regulations that are unrelated to ERISA or a party's ability to manage or administer an employee benefit plan should impact an application's review. ICI does not believe, for example, that every routine investigation resulting from a customer complaint should prevent the Department from considering an exemption application involving those parties. Similarly, we do not believe that the investigation of a service provider's employee by *any* state or federal regulator should generally prevent the consideration of an exemption application.

Furthermore, we believe that the added information requirements regarding investigations and criminal actions involving the applicant and any qualified independent fiduciary are unnecessary to the extent that they are unrelated to ERISA or other statutes or regulations that are indicative

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[13] The Department explained in the preamble to the Proposal that the requirement to report prior transactions is intended to allow the Department to determine whether the proposed transaction fits into a larger pattern or practice. 87 Fed. Reg. 14722, at 14731.

[14] Section 2570.33(a)(2) of Proposal.

of a party's ability to manage or administer an employee benefit plan. These new disclosures are not necessary to ensure that an exemption transaction meets the statutory requirements of being administratively feasible, in the interests of plans and participants, and protective of their rights.

5. The proposed changes fail to consider the impact on retirement plans and their participants in accessing beneficial services, investments, and transactions that are necessary for, or beneficial to, their creation and operation.

Finally, while the preamble to the Proposal includes a lengthy discussion of the newly proposed conditions and how they will operate to limit the universe of exemption transactions that will be considered and granted,[15] the preamble does not provide any data or examples of wrongdoing or abuse to support enormous changes to the application procedures and fails to include any regulatory impact analysis designed to assess the impact of the proposed changes on retirement plans and their participants in accessing beneficial services, investments, and transactions that are necessary for, or beneficial to, their creation and operation.[16] This is genuinely concerning because, in the absence of such evidence, the Department's proposed application procedures will arbitrarily create significant roadblocks for retirement plans and participants who would otherwise be able to benefit from an exemption transaction.

We assume that the Department concluded that such an analysis was not required in light of its finding that the proposed rulemaking was not considered "significant." This conclusion is surprising and troubling (and in our view incorrect) given that, as discussed above, these changes will substantively impact the design and operation of, and costs associated with, exemption transactions. Perhaps even more compelling is that the Proposal provides that the Department will presume that the impartial conduct standards of the Department's fiduciary advice class exemption (PTE 2020-02) will be applied to each new exemption. An exemption applicant who could not (or did not wish to) meet these impartial conduct standards would bear the burden of establishing why the standards should not apply to its requested exemption. This would be a significant expansion of the Department's policy regarding impartiality. Since these rules also apply to exemptions for IRA transactions, they would essentially create a fiduciary standard for exemptions covering IRAs that are otherwise not subject to ERISA's fiduciary standard of care. We believe that this is inconsistent with the reasoning of the Fifth Circuit's decision to vacate the Department's fiduciary regulations.[17]

ICI urges the Department to reconsider its conclusion that the proposed rulemaking is not "significant," and analyze how each of these new conditions is likely to increase the costs

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[15] In addition to the amendments discussed above, several additional preamble statements and proposed changes seem intended solely to discourage the public from submitting exemption applications. For example, the Department expressly states that the existence of an exemption is not determinative of whether a future exemption will be granted with the same or similar facts and that exemptions will only be granted when administratively feasible "*for the Department*" (emphasis added). Sections 2570.30(g), and 2570.48(a)(1) of the Proposal.

[16] 87 Fed. Reg. 14722 (March 15, 2022). See also Executive Order 12866, 58 Fed. Reg. 51735 (October 4, 1993).

[17] See *Chamber of Commerce of the United States v. Acosta*, 885 F.3d 360, 384 (5th Cir. 2018).

associated with exemption transactions, thereby reducing the overall benefits of the exemption and the likelihood of the Department granting an exemption.

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ICI and its members appreciate the opportunity to help inform the Department as it considers changes to the exemption procedures to ensure that the amendments are consistent with congressional intent and the interest of retirement plans and their participants in accessing beneficial services, investments, and transactions that are necessary for, or beneficial to, their creation and operation. We are committed to working with the Department on this matter. If you have any questions, or if we can be of assistance in any way, please contact David Abbey (202-326-5920 or david.abbey@ici.org) or Shannon Salinas (202-326-5809 or shannon.salinas@ici.org).

Sincerely,

/s/ David Abbey

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Deputy General Counsel
Retirement Policy

/s/ Shannon Salinas

Shannon Salinas
Associate General Counsel
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