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DOL Updates and Expands Prohibited Transaction Exemption Procedure Regulation

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TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension
Tax RE: DOL Updates and Expands Prohibited Transaction Exemption Procedure Regulation

The US Department of Labor (DOL) recently updated the procedures (Procedures) governing the process for the filing and processing of administrative prohibited transaction exemptions (PTEs), pursuant to authority under ERISA § 408(a).[1] DOL has long had formal procedures that provide structure around the PTE application process, with the first procedures being issued in 1975. The most recent procedures (prior to this update) were issued in 2011.[2] The Procedures address applications for both class exemptions, which apply to a category of transactions meeting defined criteria; and individual exemptions, which apply to a specific transaction involving specific identified parties.

DOL describes the Procedures as intended "to promote a prompt, efficient, open, and transparent exemption application process."[3] A common DOL refrain is its goal of creating a process whereby impacted participants and beneficiaries can better review and understand the exemption process and DOL's decision-making, as well as to make the process more accessible to prospective applicants. DOL emphasizes in the preamble of the Procedures ("Preamble") that the Procedures do not increase the burden on parties applying for a PTE, as they formalize practices and information requests that have become common in DOL's consideration of PTE applications.[4] Accordingly, the Procedures adopt significantly more specificity than prior procedures as to what is required in a PTE application. DOL views the Procedures as fostering efficiencies by requiring that information be provided to DOL up-front, as opposed to DOL's prior practice of requesting additional information in follow-up requests after a PTE application is submitted, which makes the PTE process more drawn-out and longer than necessary.[5] DOL acknowledges that achieving this result necessarily required that the Procedures be more prescriptive in nature than previous iterations.

This memorandum highlights significant changes made to the Procedures. We also highlight

those items where ICI had requested DOL change positions it took in the Proposal.

Pre-Submission Meetings and Discussions

A common element of the PTE application process involves informal meetings with DOL staff prior to a party filing an application. These meetings, which may or may not be anonymous, allow prospective applicants to ascertain whether DOL views a proposed transaction as requiring a PTE. They also help a prospective applicant understand not only DOL's potential concerns but also the requirements that may be imposed as part of granting a PTE.

The Procedures newly require that pre-submission meetings be included in the public administrative record of a PTE process once a PTE application is filed. DOL will memorialize any such meeting. When a party later files a PTE application, it must include information to enable DOL to associate all such meetings with the application. DOL's memorialization (along with materials provided to DOL) will then be included in the administrative record, which is available for public inspection. Applicants will not be permitted to review DOL's memorialization for accuracy prior to its inclusion in the administrative record, though parties can separately submit clarifications—including if they view DOL's record as inaccurate or incomplete. DOL will not include materials provided to DOL that are not material to the subject transaction. DOL also noted that it may decline to engage in extended pre-submission discussions without a formal PTE application having been submitted, due to concerns that parties may seek to circumvent an open PTE application process by "informally" seeking an exemption.[6]

DOL had initially proposed that the administrative record for a PTE application would be created, and open for inspection, as of the first pre-submission meeting with DOL, that anonymous discussions no longer would be permitted, and that the administrative record would begin when a party first 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."[7] ICI's Comment Letter expressed concern that this approach would "significantly limit or eliminate altogether" these valuable informal discussions with DOL exemption staff—both anonymous and identified pre-submission discussions. DOL's revised approach in the Procedures addressed ICI's concerns.

Independence of Qualified Independent Appraisers (QIAs) and Independent Fiduciaries (IFs)

A significant aspect of PTE procedures is the manner in which they define the independence of QIAs and IFs. The Procedures, while noting that independence is "based on all relevant facts and circumstances," retain their prior consideration of the QIA/IF's revenues from any party in interest engaging in the transaction. Where the revenue received or projected to be received by the QIA/IF in the current tax year from the parties in interest (and their affiliates), as a percentage of the QIA's/IF's revenues from all sources in the prior tax year, is not more than 2 percent; DOL "generally will not conclude that [a QIA's/IF's] independence is compromised solely based on the revenues it receives from the parties in interest (and their affiliates) that engaged in the exemption transaction."[8] Percentages greater than 2 percent but less than 5 percent "merit more stringent scrutiny," but a QIA/IF may be considered independent based on other facts and circumstances.[9]

The Proposed Procedures took a much narrower approach. DOL had proposed to consider revenues from any party involved in the transaction as opposed to just parties in interest; and would have foreclosed the possibility that a QIA/IF could be considered independent if

the revenue percentage was more than 2 percent unless DOL in its sole discretion determined otherwise. DOL also would have required that the QIA be independent of all parties including the IF, and also would have considered the QIA's "related business interests." As to the IF, DOL would have also considered whether the IF had any interest in "future transactions of the same nature and type."

ICI's Comment Letter indicated our concern that the lower thresholds in the Proposed Procedures would create an unnecessary barrier to entry for otherwise qualified service providers, and that it would reduce competition by narrowing the field of smaller firms. Smaller firms would be more constrained than larger firms in the amount of work they could do for any one client, and also would have their fees effectively capped at a lower amount than larger entities. We also highlighted our concern that requiring the QIA to be independent of all parties including the IF would unnecessarily limit the parties willing to participate in exemption transactions, and raise the costs associated with such transactions. Lastly, ICI noted that flagging an interest in future transactions as a negative factor in evaluating IF independence is an amorphous standard—especially when an IF would always have a business interest in facilitating a transaction to promote its services in the hopes of gaining future business. DOL's changes from the Proposed Procedures generally address ICI's concerns.

We note a potential collateral impact of the revised independence and conflict of interest standards for QIAs and IFs. These enhanced standards may see adoption by the industry outside of the PTE context, as was the case for the standards in the 2011 Procedures. While DOL in the Procedures clarifies that their application is limited to the PTE context, this clarification discounts the realities of the marketplace where parties often look to what standards exist as best practices when retaining appraisers and independent fiduciaries, as well as in some cases other plan service providers.

Independent Fiduciary Insurance Information

The Procedures newly require an IF to include in its statement a description of any fiduciary liability insurance coverage maintained by the IF including: (1) the amount of coverage available to indemnify the plan for damages resulting from a breach by the IF of either ERISA, the Code, or any other Federal or state law or the terms of its contract; and (2) whether the insurance policy contains an exclusion for actions brought by the Secretary or any other Federal, State, or regulatory body, the plan, or plan participants or beneficiaries.. DOL noted that this information is important to enable DOL to ensure that the IF has sufficient resources to compensate plans for any losses resulting from an IF's breach of its duties. DOL emphasized that PTE applicants should be in a position to "carefully consider and disclose" the IF's "ability to remedy any injuries caused by its fiduciary violations and make the plan whole for any losses caused by [its] failure to discharge its role properly."[10] DOL also noted that an IF should undertake a similar analysis as to any third party service providers such as QIAs.

DOL in the Proposed Procedures would have gone a step further by requiring that IFs maintain sufficient fiduciary liability insurance coverage to indemnify a plan for damages resulting from the IF's breach of ERISA, the Code, or any other federal or state law; or of the terms of its engagement by the plan, rather than requiring merely a description of any liability coverage. ICI's Comment Letter expressed concern that such a requirement would make fiduciary liability insurance unavailable or prohibitively expensive for all but exceptionally large transactions. Other commenters had expressed concerns that this requirement could cause may IFs to exit the employee benefit plan marketplace. DOL's

changes to this requirement address ICI's concerns.

PTE Application Contents

The Procedures significantly expand the information required to be included in a PTE application as compared to the 2011 Procedures. The Procedures newly require inclusion of the following items, among others, in PTE applications. (We do not list here items carried over from the 2011 Procedures.)

- For all PTE applications:
  - Contact information for the applicants, affected plans, and parties in interest to the proposed transaction;
  - A description of any material benefit a party in interest (including affiliates) may receive as a result of the transaction by virtue of engaging in the transaction;
  - A description and quantification (to the extent possible) of the costs and benefits of the transaction to the affected plans, participants, and beneficiaries;
  - A description of the alternatives to the transaction that did not involve a prohibited transaction, and why such 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;
  - Disclosure of whether the exemption transaction is or has been the subject of an investigation or enforcement action by any regulatory authority (expanding on the prior requirement that only addressed actions by DOL or IRS);
  - Clarification that the administrative feasibility of an exemption under ERISA sec 408(a) refers to feasibility for DOL;
  - A statement that the transaction will adhere to impartial conduct standards, or if not why such standards are not applicable to the transaction;
  - Information sufficient to allow DOL to identify any pre-submission oral or written communication with DOL regarding the transaction, including anonymous discussions;
  - For statements and documents from a QIA, auditor or accountant:
    - A copy of their retention letter, which may not contain (1) any provision that provides for the direct or indirect indemnification of such party by the plan or another party for any failure to adhere to its contractual obligations (including adhering to applicable federal or state laws); provided that reimbursement of legal expenses as incurred is permitted but only to the extent that (i) the plan has determined that reimbursement is prudent following a good faith determination that the party likely did not fail to adhere to its obligations, and (ii) the party agrees to timely repay all reimbursed amounts if is either found liable for such breach or enters into a settlement regarding an assertion of its failure to adhere to such obligations; or (2) a waiver of any rights, claims or remedies of the plan or its participants and beneficiaries under ERISA or any state or federal law against the IF with regard to the transaction; and
    - A description of any past engagements with the plan or any party in interest that may influence the appraiser, auditor, or accountant;
  - Where a QIA is required, a representation that they were prudently selected after a diligent review of their training and proficiency, their independence from the counterparties in the transaction and the absence of any material conflicts of interest with respect to the transaction;
  - Where an IF is required:
    - A representation that they are without material conflicts of interest and

were prudently selected after a diligent review of their training and proficiency, and a representation as to the sufficiency of their fiduciary liability insurance (see discussion above);
        - A copy of their retention letter, which may not contain either (1) any provision that provides for the direct or indirect indemnification of such party by the plan or another party for any failure to adhere to its contractual obligations (including adhering to applicable federal or state laws); provided that reimbursement of legal expenses as incurred is permitted but only to the extent that (i) the plan has determined that reimbursement is prudent following a good faith determination that the party likely did not fail to adhere to its obligations, and (ii) the party agrees to timely repay all reimbursed amounts if is either found liable for such breach or enters into a settlement regarding an assertion of its failure to adhere to such obligations; or (2) a waiver of any rights, claims or remedies of the plan under ERISA or any state or federal law against the IF with regard to the transaction;
        - A description of the IF's fiduciary liability insurance, including the amounts of such coverage and whether it includes any exclusions for actions brought by DOL, any federal state or other regulatory body, or plan participants and beneficiaries;
        - The IF's current revenues derived from a party in interest involved in the transaction or their affiliates, in dollars and as a percentage of the IF's total revenues for both the current and prior tax year;
        - Information regarding the IF as to any investigations, examinations, or litigation in the previous five years with DOL, IRS, the Justice Department, PBGC, FRTIB, or any other federal or state agency, including a description thereof, involving (i) compliance with ERISA or FERSA, (ii) any representation of or position or employment with any employee benefit plan, (iii) conduct of the business of a broker, dealer, investment adviser, bank, insurance company, or fiduciary, (iv) income tax evasion, or (v) any of a variety of felonies (analogous information previously was required only in connection with individual PTEs); and
        - Confirmation that the IF has not, within the last 13 years, been convicted or released from imprisonment as a result of any of a number of felonies, including the above and any crime identified under ERISA§ 411, whether the conviction is domestic or foreign; and if there was such a conviction or release a description thereof (analogous information previously was required only in connection with individual PTEs);
- For individual PTE applications:
    - Any prior transactions between the plan or plan sponsor and any party in interest (including affiliates) involved in the transaction;
    - Whether any plan or trust affected by the requested exemption is currently under investigation for violation of the exclusive benefits rule of Code § 401(a), Code § 4975(c)(1), ERISA §§ 406 or 407(a), or 5 U.S.C. § 8477(c)(3), along with a description of the circumstances surrounding any such investigations (the 2011 Procedures only address finding of such violations); and
    - Whether the applicant has, within the last 13 years, been convicted or released from imprisonment as a result of any of a number of felonies, including any crime identified under ERISA § 411, whether the conviction is domestic or foreign; and if there was such a conviction or release a description thereof (the inclusion of foreign convictions is new);

While expanding the information required to be included in a PTE application, DOL nonetheless adopted modest improvements from the Proposal such as:

- Narrowing numerous disclosures that had originally referenced any party involved in the transaction to refer only to parties in interest or their affiliates;
- Dialing back the effective presumption that the transaction must adhere to impartial conduct standards;
- Adding the ability to expand indemnification of QIAs, auditors, accountants, and IFs to provide for reimbursement of legal fees, provided that they are refunded if a party is found to have breached applicable standards, or to have settled allegations of such breaches; and
- Removing the requirement that a QIA act solely on behalf of the plan (which would have meant that the QIA was not independent).

ICI's Comment Letter expressed concern that the above additional information requirements DOL proposed for PTE applications would create a barrier to entry to the PTE process for all but the largest PTE applicants, and that as such they would eliminate many transactions that would otherwise be commercially beneficial. DOL in the Procedures explained its decision to largely retain the proposed information requirements, stating that they generally reference information DOL views as essential components of a PTE application, and that DOL already requests as part of the PTE process. Requiring this information up-front will, in DOL's view, streamline the exemption application process and reduce costs for applicants.[11]

ICI also noted its concern that the Proposed Procedures placed the burden on a PTE applicant to explain why the newly required impartial conduct standards "should not be applicable" to a transaction (the text of the Proposed Procedures). DOL in the preamble to the Proposed Procedures had interpreted this requirement broadly, describing the impartial conduct standards as a "baseline condition" to approve a PTE application while also recognizing that that they may not be "appropriate or necessary" in all PTE transactions.[12] The Procedures amend the proposed text, instead requiring that an applicant explain why the impartial conduct standards are not applicable if they are not included in a PTE application. DOL clarified this less prescriptive position in the Preamble, stating that "while the failure to propose adoption of such standards is not automatically disqualifying, the adoption of such standards as part of a proposed exemption can lend important support to a finding by the Department that the exemption transaction is in the interest of and protective of the plan and its participants and beneficiaries."[13]

ICI further noted in the Comment Letter that the strong encouragement to incorporate impartial conduct standards would effectively extend ERISA's fiduciary standard of care to IRAs (if an IRA is the subject of a PTE application) in a manner inconsistent with the reasoning of the Fifth Circuit's decision vacating DOL's 2016 fiduciary regulations.[14] DOL disagreed with these concerns, further clarifying that the Procedures "do not mandate the adoption of impartial conduct standards in every case, independently impose an enforceable obligation to comply with those standards, or purport to pre-decide" where such standards should be imposed.[15]

PTE Process

The Procedures make a number of minor changes to the process by which DOL considers PTE applications. We highlight some of these.

- A PTE application no longer will need to include a separately submitted paper copy

when submitted electronically.
- The duty to amend a PTE application has been expanded to include reporting not only a new investigation or enforcement action by DOL, IRS, the Justice Department, PBGC, FRTIB but also an investigation by any other federal or state governmental entity. The types of investigations and enforcement actions that trigger a duty to report are those involving (i) compliance with ERISA or FERSA (as previously required), (ii) any representation of or position or employment with any employee benefit plan, (iii) conduct of the business of a broker, dealer, investment adviser, bank, insurance company, or fiduciary, (iv) income tax evasion, or (v) any of a variety of felonies or conspiracies.
- DOL will no longer issue a denial letter without first providing a tentative denial and an opportunity for a party to request a conference with DOL.
- DOL may at any time hold a conference with any party, including the QIA or the IF, without the presence of the applicant. DOL described this addition as clarifying its existing authority.

Retroactive Exemptions and Other Limits on PTE Applications

In some cases, a party may need to complete a transaction before it can obtain a PTE. In determining whether to grant a Retroactive Exemption in such a situation, DOL will apply a high level of scrutiny to an application using longstanding standards previously set forth by DOL.[16] In this vein, DOL's policy (confirmed in the Procedures) is that it generally will not support a request for a Retroactive Exemption where participants and beneficiaries have been negatively impacted by the transaction. One consideration is whether participants and beneficiaries have been made whole for any harm. The Procedures also clarify that while retaining an IF before the transaction argues that an applicant acted in good faith, DOL may consider the post-transaction appointment of an IF due to exigent circumstances. Lastly, the Procedures confirm DOL's view that a determination of whether a transaction subject to a request for a Retroactive Exemption resulted in a loss to the plan is made based on the facts existing at the time of the PTE application. Accordingly, if later facts show that the transaction resulted in a loss for the plan, this information is not relevant to DOL's evaluation of the PTE application.[17]

DOL also clarified what PTE applications it ordinarily will not consider. The Procedures modified the practice under the 2011 Procedures whereby DOL would review a PTE application containing information designated as confidential to determine whether such information was material to DOL's exemption determination, and if it so determined DOL would then require that the confidentiality designation be withdrawn before proceeding. The Procedures provide that DOL will not consider any PTE application that contains information designated as confidential, and also state that by submitting a PTE application the applicant consents to public disclosure of the entire administrative record as discussed above.

Regulatory Impact Analysis (RIA)

ICI's Comment Letter criticized DOL for determining that the Proposal was not "significant," and therefore did not require an RIA. Our Comment Letter also criticized the lack of data or examples of wrongdoing or abuse to support the significant changes in the Proposal (many of which, as discussed above, where included in the Procedures). In the Preamble, DOL changed course (with no apparent analysis of the reasons for reversing its position), and as such included an RIA. After evaluating the benefits and costs of the Procedures, DOL determined that "[o]n balance, the final amendment will be cost neutral as a result of the efficiency gains that will be generated; however, the Department does not have sufficient

data to quantify [these gains]."[18] The Department in quantifying the costs of the Procedures determined a per PTE application incremental cost (including for outside advisors) of $1,511.57, and a total annual incremental industry cost of $29,194 (assuming 21 PTE applications per year).[19]

Notably, the RIA suggests that policy considerations, as opposed to benefits to plans and plan participants, were a primary driver in finalizing the Procedures. DOL notes two primary policy drivers—a need to amend the Procedures such that DOL receives sufficient information up front (as opposed to through subsequent back-and-forth communications) to make its findings, and a desire to clarify when the administrative record opens and the items that are included in the record.

Effective Date

The Procedures are effective April 8, 2024. As a practical matter, however, parties considering applying for a PTE may wish to act in accordance with the Procedures earlier in light of DOL's repeated statements in the Procedures that many of the changes reflect the formalization of DOL's practices.

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Notes

[1] Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications, 89 Fed. Reg. 4662 (DOL Jan. 24, 2024), available at https://www.govinfo.gov/content/pkg/FR-2024-01-24/pdf/2024-00586.pdf ("Procedures"). See also Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications, 87 Fed. Reg. 14722 (DOL March 15, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-03-15/pdf/2022-04963.pdf ("Proposed Procedures"). For a description of the Proposed Procedures, see ICI Memorandum No. 34068, dated March 9, 2022, available at https://www.ici.org/memo34068.

[2] Prohibited Transaction Exemption Procedures; Employee Benefit Plans, 76 Fed. Reg. 66637 (DOL Oct. 27, 2011), available at https://www.govinfo.gov/content/pkg/FR-2011-10-27/pdf/2011-27312.pdf ("2011 Procedures").

[3] 89 Fed. Reg. at 4664.

[4] Id. at 4664.

[5] DOL in the Preamble noted that it shared commenters' concerns that the PTE application process has become more lengthy than necessary. Id.

[6] 89 Fed. Reg. at 4669.

[7] Letter from David Abbey and Shannon Salinas, ICI, to Office of Exemption Deters., EBSA, dated May 31, 2022, available at https://www.ici.org/system/files/2022-05/34166a.pdf ("Comment Letter"). See ICI Memorandum No. 34166, dated June 1, 2022, available at https://www.ici.org/memo34166.

[8] New 29 C.F.R. sec 2570.31(i)-(j), 89 Fed. Reg. at 4692-93 (emphasis added).

[9] Both of these thresholds are somewhat stricter than in the 2011 Procedures. While the 2011 Procedures also considered 2 percent and 5 percent thresholds, where the revenue percentage was no more than 2 percent they created a presumption of independence absent facts and circumstances demonstrating otherwise. For a revenue percentage of more than 2 percent but no more than 5 percent, a presumption of independence did not apply but a party "nonetheless may be considered independent based on other facts and circumstances."

[10] 89 Fed. Reg. at 4677.

[11] 89 Fed. Reg. at 4671-72.

[12] 87 Fed. Reg. at 14728.

[13] 89 Fed. Reg. at 4673

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

[15] 89 Fed. Reg. at 4673.

[16] Id. at 4665.

[17] Id. at 4680.

[18] Id. at 4686.

[19] Id.
