

## Publications

# DOL Finalizes More Stringent Procedures for Requesting Prohibited Transaction Exemptions

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The Department of Labor's ("DOL") prohibited transaction exemption procedures provide an opportunity for plan sponsors, service providers, industry groups, or others to apply for permission to engage in a variety of transactions involving employee benefit plans covered by the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and IRAs. On January 24, 2024, the DOL published [final amendments](#) to its regulations governing these procedures (the "Final Amendments"). Among other things, the Final Amendments would increase the information applicants for an exemption would need to provide; impose more requirements on independent fiduciaries, appraisers, accountants and auditors representing plans or IRAs in connection with exemption transactions; and provide more discretion for the DOL to deny an application for an exemption. These changes will be effective for prohibited transaction exemption applications filed with the DOL on and after April 8, 2024.

## I. Introduction

ERISA and the Internal Revenue Code of 1986, as amended (the "Code"), prohibit a wide array of transactions involving employee benefit plans and IRAs. By their terms, the ERISA and Code prohibited transaction rules restrict transactions that are necessary or advantageous for the operation of plans and IRAs. To temper the broad sweep of the prohibited transaction rules, Congress established a prohibited transaction exemption framework. In this regard, ERISA and the Code contain a number of statutory prohibited transaction exemptions, such as those that allow the payment of reasonable compensation to service providers. Additionally, Congress provided DOL with the authority to grant prohibited transaction exemptions on a class or individual basis provided three conditions are met. Specifically, DOL must determine that the exemption is administratively feasible, in the interests of

participants and beneficiaries, and protective of the rights of participants and beneficiaries.

The DOL can issue prohibited transaction exemptions on its own or upon request. The Final Amendments will update the DOL's long-standing regulations setting forth the procedures for its consideration of an exemption request. Plan sponsors and financial institutions have applied for, and been granted, hundreds of prohibited transaction exemptions under these procedures over the years. However, the number of exemptions the DOL has granted has significantly declined over the years. For example, in the five-year period from 1997 to 2001, DOL issued an average of approximately 90 exemptions per year. While the DOL granted 21 exemptions in 2023, it only granted four exemptions in 2022 and three in 2021. The exemption application process has also taken longer and become considerably costlier for applicants.

At the same time, the DOL has recently included or expanded disqualification provisions in other prohibited transaction class exemptions, including PTE 84-14 (the class exemption for Qualified Professional Asset Managers, or "QPAMs") and PTE 2020-02 (an exemption for investment advice to plans and IRAs). These disqualification provisions raise the significance of the Final Amendments. If a financial institution runs afoul of these disqualification provisions, it would no longer be eligible to rely on the class exemption and may need to apply for an individual exemption that would allow it to continue providing services to ERISA plans and IRAs. The Final Amendments will govern the process for seeking that individual exemption.

## II. Summary of the Final Amendments

We provide an overview of the Final Amendments and how they would change the exemption procedures regulation below.

### A. Pre-Submission Conferences

The Final Amendments provide that pre-submission conferences, and any documents submitted to the DOL in connection with a pre-submission conference, will become part of the public record of an exemption if a formal application is submitted. Applicants will be required to identify in their formal application the date of any pre-submission conferences they held and with whom at the DOL they spoke. On the other hand, if a prospective applicant who held a pre-submission conference decides not to file a formal application, no public record will be created. Additionally, the Final Amendments remove the prohibition on seeking a pre-submission conference on a no-names basis.

### B. Independent Fiduciary and Appraiser Requirements

Exemptions often include conditions that require an independent fiduciary with no conflict of interest in the transaction to represent the interests of the plan and, if relevant, an independent appraiser to help establish that the plan will pay no more or receive no less than the fair market value of an asset in a transaction. The Final Amendments include a number of provisions applicable to independent fiduciaries and appraisers, as well as accountants and auditors.

#### 1. Definition of "Independent"

The Final Amendments change the definition of when a fiduciary or appraiser will be considered "independent" to a definition that is closer to the current regulations, although still stricter than in the proposed regulations. The regulations currently include a percentage of revenue test, providing that a fiduciary or appraiser is deemed independent if less than two-percent of its revenue is derived from parties involved in the transaction but state the fiduciary or appraiser may nonetheless be independent if the revenue is less than five-percent. Under the Final Amendments, a fiduciary or appraiser can be considered independent if less than five-percent of its revenue is derived from parties in interest engaged in the exemption transaction, although the DOL will exert more "stringent scrutiny" than if the percentage is less than two-percent.

Additionally, the Final Amendments provide that in making a determination as to whether the fiduciary or appraiser can be considered independent, the DOL will consider the extent to which the counterparty to the plan in the exemption transaction influenced the selection of the fiduciary or appraiser.

Finally, the Final Amendments omit language from the proposed amendments stating that an entity will not be considered independent if it has an interest in the subject transaction or future transactions of the same nature or type. The DOL acknowledged in the preamble that this language could be read as precluding an independent fiduciary from developing expertise in representing plans in connection with particular types of transactions.

## 2. Fiduciary Liability Insurance

The proposed amendments would have required an independent fiduciary 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 Final Amendments remove the requirement for an independent fiduciary to maintain specific levels of fiduciary liability insurance. However, the formal application to the DOL will need to provide information regarding any fiduciary liability policy maintained by the independent fiduciary and a representation that the independent fiduciary's insurance coverage was prudently considered by the plan fiduciary retained by the independent fiduciary.

## 3. Contractual Indemnification and Exculpation Provisions

The Final Amendments include certain standards for a plan's contract with an independent fiduciary, appraiser, auditor, or accountant. The contract can not include indemnification for breach of contract or violations of applicable law or a waiver of the plan's claims under applicable law, including ERISA. However, the Final Amendments include a narrow exception allowing reimbursement of the independent fiduciary, appraiser, auditor, and accountant's legal expenses for claims of breach of contract or violation of law if:

- The plan determines that the provision is prudent following a good faith determination that the independent fiduciary, appraiser, auditor, or accountant likely did not breach its contract or violate applicable law; and
- The contract requires the independent fiduciary, appraiser, auditor, or accountant to repay all of the reimbursements, in a timely fashion, in the event it enters into a settlement agreement regarding any asserted failure to adhere to its contractual obligations or to state or Federal laws or has been found liable for breach of contract or violation of any Federal or state laws applicable to its work.

The plan will apparently be required to determine if a reimbursement is prudent even if a party other than the plan (such as a plan sponsor) is responsible under the contract to reimburse the independent fiduciary, appraiser, auditor, or accountant.

## 4. Relationship Between Independent Fiduciaries and Independent Appraisers

The Final Amendments require that each application for an exemption requiring the retention of an independent appraiser include a representation that an independent fiduciary prudently selected the appraiser after diligent review of the appraiser's technical training and proficiency with respect to the type of valuation at issue, the appraiser's independence from the plan's counterparties in the exemption transaction, and the absence of any material conflicts of interest with respect to the exemption transaction.

## 5. Additional Required Information

The Final Amendments require the provision of more information regarding independent fiduciaries, accountants, auditors, and appraisers in the formal application for the exemption, including:

- A description of any past engagements between the plan or party in interest engaging in the exemption transaction and the independent appraiser, auditor, account, or independent fiduciary;
- Where an independent fiduciary is required, a representation that an appropriate plan fiduciary prudently retained the independent fiduciary without material conflicts of interest after a diligent review of the independent fiduciary's technical training and proficiency with respect to ERISA and the Code and the specific details of the exemption transaction, as well as the independent fiduciary's fiduciary liability insurance; and
- Any criminal convictions of an independent fiduciary within the past 13 years for a series of enumerated crimes (whether in foreign or domestic courts) must be reported in the exemption application. However, convictions of an independent fiduciary's affiliates are not required to be reported. Additionally, as described below, certain investigations of an independent fiduciary are not required to be reported.

## 6. Conferences that Exclude the Applicant

The Final Amendments allow the DOL to hold a private conference with any party, including the independent fiduciary or the independent appraiser, without the applicant or its representatives present. In the preamble to the Final Amendments, the DOL described its view that such parties "may be less restrained when discussing issues solely" with the DOL and that such parties may provide "additional insight" than would be provided if the applicant is present to limit the topics under discussion.

## C. Parties Under Investigation

The Final Amendments require the formal application to report whether, within the past five years, any plan affected by the exemption transaction, the independent fiduciary, and, if the application is for an individual exemption, the applicant, or any party in interest (or

its affiliates) involved in the exemption transaction, has been under investigation or examination by, or has been engaged in litigation or a continuing controversy with a regulatory body regarding:

- Compliance with provisions of ERISA or the Federal Employees' Retirement System Act of 1986;
- Its representation of or position or employment with any employee benefit plan, including investigations or controversies involving ERISA, the Code, or any other Federal or state law;
- Conduct of the business of a broker, dealer, investment adviser, bank, insurance company, or fiduciary;
- Income tax evasion; or
- Any felony or conspiracy involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities.

Additionally, after the application is filed, the applicant would have to update the DOL to disclose any such actions or investigations that have begun during the pendency of the DOL's consideration of the exemption request. However, in the preamble to the Final Amendments, the DOL stated that SEC examinations would not need to be disclosed after the formal application is filed.

## D. Impartial Conduct Standards

The Final Amendments require that every exemption application report whether the transaction will meet the "impartial conduct standards" of PTE 2020-02 or explain why the impartial conduct standards are inapplicable to the transaction. The impartial conduct standards are:

- The transaction is in the "best interest" of the plan and its participants and beneficiaries, meaning the fiduciary causing the plan to enter into the transaction determines, with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would, in the conduct of an enterprise of a like character and with like aims, enter into the exemption transaction based on the circumstances and needs of the plan and that such fiduciary shall not place the financial or other interests of itself, a party to the exemption transaction, or any affiliate ahead of the interests of the plan or subordinate the plan's interests to any party or affiliate;
- All compensation received, directly or indirectly, by a party involved in the exemption transaction does not exceed reasonable compensation; and
- All of the statements to DOL, the plan, or, if applicable, the independent fiduciary or appraiser about the exemption transaction and other relevant matters are not, at the time the statements are made, materially misleading.

**GROOM INSIGHT:** While the DOL stated in the preamble that the impartial conduct standards are not applicable to every exemption and their omission is not "automatically" disqualifying, it claimed that the impartial conduct standards "can lend important support" to a finding that the exemption is in the interest of a plan and its participants and beneficiaries. This could be read as a presumption that the impartial conduct standards should apply, which is a significant expansion of DOL policy, especially to the extent that the best interest standard, which is modeled off of ERISA fiduciary duties of prudence and loyalty, is extended to exemptions involving IRAs.

## E. Additional Information to be Reported by Applicants

The DOL's exemption procedures regulations, in their current form, require that applicants provide a significant amount of information in the formal application. However, in addition to the increased reporting, the Final Amendments require, with respect to independent fiduciaries, accountants, auditors, and appraisers, more information to be supplied by applicants, including:

- A description of any material benefit that may be received by a party in interest (or its affiliates) as a result of the exemption transaction (including the avoidance of any materially adverse outcome by a party in interest (or its affiliates) as a result of engaging in the exemption transaction. The DOL stated this information would help it assess the "scope and severity" of potential conflicts of interest associated with the exemption transaction.

- The costs and benefits of the exemption transaction to the affected plan(s), participants, and beneficiaries, including quantification of those costs and benefits to the extent possible. The DOL noted that a “full actuarial or technical economic accounting” would not be required, however.
- A description of the alternatives to the exemption transaction that did not involve a prohibited transaction that were considered or evaluated by the applicant before submitting its exemption application and the reason(s) why those alternatives were not pursued. In the preamble to the Final Amendments, the DOL stated it is seeking an explanation of the process by which the applicant arrived at its decision to propose an exemption application as opposed to an exhaustive review of each imaginable option. Further, the DOL stated that the application should explain why refraining from engaging in the exemption transaction would not be the most protective approach.
- 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:
  - Any prior transaction between (i) the plan or plan sponsor and (ii) any party in interest involved in the exemption transaction. The DOL explained in the preamble to the proposed amendments that the requirement to report prior transactions is intended to allow DOL to determine whether the transaction that the exemption is requested for fits into a larger pattern or practice.
  - Certain foreign (in addition to United States) criminal convictions of the applicant or any party in interest involved in the exemption application over the past 13 years.
  - The person or entity who will bear the costs of any commissions, fees, or costs associated with the exemption transaction and any related transaction. The DOL removed a requirement in the proposed amendments that costs not be imposed on the plan unless a compelling reason for the plan’s incurrence of the costs existed.

The exemption procedure regulations currently require that an officer associated with the applicant certify that the information is true under penalty of perjury. The Final Amendments remove the requirement that the certification be made under penalty of perjury.

## F. Retroactive Exemptions

At times, it may be necessary for a plan to engage in a transaction requiring an exemption before it is possible to obtain an exemption from the DOL. The Final Amendments will add a requirement for an applicant to describe in the formal application for a retroactive exemption whether the exemption transaction could have been performed without engaging in a prohibited exemption transaction and whether the goals of the transaction could have been achieved through an alternative transaction that served the aims of the plan equally well. The applicant will need to demonstrate that the plan and its participants were not harmed by the exemption transaction. As with the current regulations, the DOL will consider the presence of an independent fiduciary as an indicator that the applicant acted in good faith. The Final Amendments also clarify that the DOL may, in its sole discretion, consider an appointment and retrospective review of a transaction by an independent fiduciary, after the completion of the exemption transaction, due to exigent circumstances.

## G. Ongoing Reporting to DOL and Revocations After Grant of Exemption

The current exemption procedures regulations require an applicant to update the DOL if any material fact or representation contained in the application or in any documents or testimony provided in support of the application becomes inaccurate while the application is pending. The Final Amendments extend the responsibility to update the DOL at any time after the grant of the final exemption. Additionally, the applicant would have to notify the DOL if an independent fiduciary required by the exemption resigns, is terminated, or is convicted of a crime. The Final Amendments grant the DOL with authority to revoke an exemption if a material change in facts, circumstances, or representations occur or if an independent fiduciary resigns, is terminated, or is convicted of a crime. However, the DOL would first have to notify the applicant and publish notice of the proposed revocation in the Federal Register.

## H. Other Changes

The Final Amendments also:

- Codify the DOL’s view that an applicant is not entitled to an exemption solely because DOL has granted the same or a substantially similar exemption in the past. The Final Amendments do, however, provide that previously-issued exemptions may inform the DOL’s determination of whether to propose future exemptions.
- Streamline the DOL’s ability to deny an exemption if the formal application is incomplete or if the applicant has failed to submit information requested by the DOL.

## III. Observations

By increasing the information applicants will have to provide to the DOL and imposing more requirements on independent fiduciaries and appraisers, the Final Amendments will undoubtedly make it more difficult to apply for and receive a prohibited transaction exemption. The DOL claims that the additional information required to be provided at the outset in the formal application will streamline its review and allow it to process applications on a more efficient basis. In this regard, the DOL admitted that its exemption request processing time has become longer than necessary in recent years. However, it remains to be seen whether the Final Amendments will allow the DOL to grant exemptions more quickly, whether there will be fewer applications in total, and/or whether the DOL will use its authority to deny exemption requests on a more expeditious basis.