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DOL Streamlines PTE Application Rule With New Requirements

Analysis

Prohibited transaction exemption application procedural amendments may clarify many points but clearly add new informational requirements to ensure integrity of the applicant and interested parties as well as independence of fiduciaries, note Michael Schloss and Stephen Wilkes of The Wagner Law Group.

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New amended procedures for prohibited transaction exemption applications hopefully will encourage more employee benefit plans to apply and ultimately see their application approved.

The Department of Labor's Employee Benefits Security Administration (EBSA) says its revisions will create more clarity, certainty, and transparency around the process of applying for, reviewing, and granting administrative PTEs pursuant to Section 408(a) of the Employee Retirement Income Security Act of 1974 (ERISA). While EBSA's goals are laudable, the efficacy of these revisions is not yet clear.

Finalizing a 2022 proposed rule with subsequent consideration to public comments, these long-awaited new procedures, published on January 24, 2024 (concurrent with an EBSA announcement), are effective for PTE applications filed on or after April 8, 2024.

In 2023, EBSA granted only 21 new individual exemptions; in 2022 only four; and in 2021 only three, one of them for which The Wagner Law Group prepared an independent fiduciary report as part of the application filing (see proposed exemption, granted exemption). Twenty-five years ago, EBSA was granting close to 100 exemptions per year.

Prohibited Transaction Exemptions

Both ERISA and the Internal Revenue Code ("Code") provide various statutory exemptions from the broad prohibited transaction rules found in ERISA §§406 and 407. In addition to these statutory exemptions, ERISA §408(a) authorizes the Secretary of Labor to grant administrative exemptions from the restrictions contained in Sections 406 and 407(a) in instances where the Secretary makes a finding on the record that the exemption 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 plan. Importantly, Congress recognized the need for an administrative exemption process to address the many transactions that would be in the best interest of plans, participants, and beneficiaries, but not addressed in the statutory exemptions enacted in ERISA itself.

Therefore, ERISA §408(a) authorizes the Secretary to grant either individual or class exemptions. Class exemptions provide general relief from the restrictions of ERISA, the Code, and (pursuant to 5 U.S.C. §8477(c)(3)) the Federal Employees Retirement System Act of 1986 ("FERSA") to those parties in interest who engage in the categories of transactions described in the exemption and who also satisfy the conditions stipulated by the exemption. Persons who are in conformity with all the requirements of a class exemption do not ordinarily decide to seek an individual exemption for the same transaction from the Department.

Individual exemptions, by contrast, involve case-by-case determinations as to whether the specific facts represented by an applicant concerning an exemption transaction, as well as the conditions applicable to such a transaction, support a finding by the Department that the requirements for relief from the prohibited transaction provisions of ERISA, the Code, and FERSA have been satisfied in a particular instance. The updated procedural regulations apply both to applications for class exemptions as well as applications for individual exemptions.

The New Procedures

According to EBSA, the new procedures will promote the DOL's prompt and efficient consideration of applications by, among other things:

- Clarifying the types of information and documentation required for a complete application.
- Revising the definitions of a qualified independent fiduciary and qualified independent appraiser in order to ensure their independence.
- Clarifying the content of specific reports and documents applicants must submit in order to ensure that the Department receives sufficient information to make the requisite findings under ERISA §408(a) to issue an exemption.
- Updating various timing requirements to ensure clarity in the application review process.
- Specifying items that are included in the administrative record for an application and when the administrative record is available for public inspection.
- Expanding opportunities for applicants to submit information to the Department electronically."

While a full review of the proposal is beyond the scope of this article, a few new features are worth noting.

New 'Pre-Submission' Requirements

The new procedures include rules designed to defeat attempts to "pre-game" exemption applications through informal discussions with DOL personnel. In particular, the updated procedures feature a new definition of a "pre-submission applicant" to include all parties who contact the Department (presumably either EBSA or Office of the Solicitor personnel), whether orally or in writing, with reference to a "particular fact pattern" before they actually file an application.

The new procedures also provide that those seeking pre-submission guidance identify the transaction for which exemptive relief is sought as well as the applicable prohibited transaction provisions. Those asking for such pre-submission guidance can, however, keep the identity of their client anonymous at the pre-submission stage.

The Administrative Record

When a pre-submission contact is made and/or pre-submission background information is provided, unless EBSA determines that the pre-submission communication or background information is not "material," it will become part of the administrative record available for public inspection. The Department rejected a request that applicants be allowed to review, comment on or correct the administrative record before it becomes public.

Originally, EBSA proposed that all pre-submission documents and communications with the Department would immediately become part of the administrative record that would be open to the public. However, commenters argued that making all pre-submission contact immediately public would have a chilling effect on informal and anonymous communications between the Department and the regulated community. The final procedures provide that the administrative record, including pre-submission documents and communications, becomes public only on the date an applicant submits an exemption application with EBSA's Office of Exemption Determinations.

Impact of Current or Past Investigations or Legal Actions

Currently, EBSA's procedures bar exemption applications relating to matters that are the subject of an EBSA investigation or lawsuit by DOL or the IRS. The final rule does not include EBSA's proposal to additionally bar applications by parties who are under investigation pursuant to any other federal or state law. Even so, the new procedures require an applicant to disclose investigations or court enforcement actions for consideration by EBSA.

The final rule also states that, by submitting an exemption application, an applicant consents to public disclosure of the entire administrative record (*i.e.*, do not submit confidential information to EBSA as part of your application). Applications that purport to include confidential information will not be processed under the new rule.

New Information Required

In addition to information and representations previously required under the prior rules, exemption applications will now need to include: (a) addresses, phone numbers, and e-mail addresses for applicants, representatives, and parties in interest; (b) the reasons for engaging in the transaction; (c) identification of any material benefit that a party in interest may receive from the transaction; (d) costs and benefits of the transaction to plans (quantified to the extent possible) (EBSA notes that it already routinely requests these types of information); (e) alternatives to the exemption transaction not involving prohibited transactions that were considered and why they were rejected; (f) a description of each conflict of interest or potential instance of self-dealing that would be permitted by the exemption; (g) a statement that the transaction is in the best interest of the plan and that all compensation received by a party in interest will not exceed reasonable compensation; and (h) a statement setting forth the date(s) and with whom at the Department the applicant communicated before submitting the application. Regarding (g), an inability to make a best interest statement might not be fatal to an application. In such cases, applicants will have to explain why these standards should not be applicable to the exemption transaction.

New Requirements for Independent Fiduciaries and Appraisers

The rule includes updated definitions of a "qualified independent fiduciary." Pursuant to the rule, the Department will make a determination of independence based on all of the relevant facts and circumstances such as the extent to which the plan's counterparty in the exemption transaction participated or influenced the selection of the fiduciary. Similarly, the Department will make a determination of a "qualified independent appraiser's" independence based on all relevant facts and circumstances such as the extent to which the plan's counterparty in the exemption transaction participated in or influenced the selection of the appraiser as well as the amount of revenue the appraiser derives from parties in interest.

With regard to revenues, the rule provides that the Department generally will not conclude that a fiduciary's or appraiser's independence is compromised solely based on the revenues it receives from parties in interest (and their affiliates) if such receipts are not projected to constitute more than 5% of its revenues within the current federal income tax year.

EBSA dropped a proposed requirement that statements by independent entities be signed under penalty of perjury. The final proposal requires that a certification be based on a fiduciary's, appraiser's, auditor's, or accountant's knowledge and belief that the representations are true and correct.

EBSA has constricted permissible indemnification provisions solely to limited contractual reimbursement of legal expenses provisions that may be offered to independent fiduciaries, appraisers, accountants or auditors. EBSA will now require a description of any insurance coverage applicable to selected independent fiduciaries be included in an application (but dropped its proposal that independent fiduciaries must have insurance in all instances). The application must also contain a representation that the independent fiduciary's insurance coverage was prudently considered by the plan fiduciary.

Finally, EBSA updated specified disclosures by a proposed independent fiduciary of prior investigation or litigation or controversies involving (a) compliance with ERISA; (b) its presentation of or position or employment with any employee benefit plan involving ERISA or any other federal or state law; (c) conduct as a broker, dealer, investment adviser, bank, insurance company or fiduciary; (d) income tax evasion; or (e) specified crimes. The rules also require an affirmative statement that the proposed independent fiduciary has not been convicted (or released from imprisonment) of certain specified crimes in the past 13 years or convicted (or released from imprisonment) by a foreign court for substantially equivalent crimes.

Compliance With 'Impartial Conduct Standards' Favored but Not Required

EBSA's initial proposal required the "impartial conduct standards" as formalized in Prohibited Transaction Exemption 2020-02, to be applicable to all exemptions. Commenters objected, however, noting that impartial conduct standards may not be applicable to all transactions. As a result, EBSA made the impartial conduct standards condition optional (although it noted that "the adoption of such standards as part of a proposed exemption can lend important support to a finding … that the exemption transaction is in the interest of and protective of the plan…."). Where applicants do not assert that the exemption adopts EBSA's impartial conduct standards, the final rule requires applicants to explain why the impartial conduct standards should not be applicable to their exemption transactions. The overall context of this language suggests that the Department is, in fact, requiring that the impartial conduct standards apply unless the applicant makes a convincing argument to overcome this presumption.

Conclusion

There is, of course, much more to digest in the 13 pages of condensed regulatory text defining EBSA's new procedures. EBSA asserts that, by including more detailed requirements in its rules relating to the initial submission of an application, it will streamline and expedite the application process which would otherwise, through a more drawn-out give-and-take process, ultimately require submission of the same information. In particular, EBSA states, "by adding more specificity, the Department will make the exemption application process less burdensome and costly and more streamlined and efficient."

Time will tell whether the new rules are effective in achieving EBSA's stated goal. However, rather than encourage additional parties to take advantage of the relief available under ERISA §408(a), our experience dictates that the new rules will make participating in the exemption process more complicated for plans that are unfamiliar with the nuances and underlying policy objectives of the Department while trying to engage in otherwise worthwhile transactions.

We will be following up with more detailed insights and observations on how to successfully navigate the Department's new prohibited transaction exemption process.

Author Information

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We'd love to hear your smart, original take: Write for us .