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THE COALITION OF COLLECTIVE INVESTMENT TRUSTS

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Via Federal eRulemaking Portal:
www.regulations.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: Application No. D-12022
Docket ID Number: EBSA-2022-0008
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Re: Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption), Application No. D-12022

Dear Sir or Madam:

We appreciate the opportunity to respond to the request for comments issued by the U.S. Department of Labor (the "Department") regarding the proposed amendments to prohibited transaction class exemption 84-14, also known as the "QPAM Exemption" ("the Proposal"). The Coalition of Collective Investment Trusts (the "Coalition") is a group of fund sponsors and asset managers active in the collective investment trust industry. [1] With approximately $4.5 trillion in assets under management, bank-sponsored collective trust funds ("CITs") represent an important and rapidly growing sector of the retirement plan marketplace, as a cost-effective and flexible investment vehicle for plans and participants. Comprising approximately 50 member companies, the Coalition collectively represents a sizeable presence in the industry.

[1] The Coalition comprises a diverse group of fund sponsors, money managers and service providers. As a matter of course we note that comment letters submitted by the Coalition do not necessarily represent the views of any particular member. Additional information is accessible via: https://www.ctfcoalition.com.

The QPAM Exemption is among the most widely used exemptions, enabling plans and their participants to avail themselves of investment opportunities that otherwise might be precluded by the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). As noted in the preamble to the Proposal, for nearly 40 years, the QPAM Exemption has provided relief for a broad range of transactions with parties in interest. Investment managers and similar plan service providers, including providers and managers of CITs, have structured innumerable investment and service arrangements in reliance on the QPAM Exemption over the course of the nearly four decades since it was granted. While we appreciate the Department's stated purposes for the Proposal, we are concerned that the Proposal, as drafted, goes far beyond what is necessary to achieve these purposes and will have unintended consequences by dramatically limiting the investments available to plans and participants and reducing the choice plan sponsors have in selecting plan service providers. This is particularly true as applied to CITs and their providers, given the unique regulatory requirements applicable to CITs under the federal securities laws and Office of the Comptroller of the Currency ("OCC") Regulation 9 ("Reg. 9"), and the prevalence of common CIT investment structures involving multiple managers and layers of investment discretion.

For these reasons, we strongly encourage the Department to:

1. Withdraw the proposed amendments to section I(c) that would condition relief in connection with a given transaction on the QPAM having sole responsibility for the commitments and investments of plan assets and the negotiations leading thereto, and instead narrowly tailor any revisions to that section to specifically address the transactions the Department views as abusive.

2. Withdraw the proposed amendment to section I(g) of the QPAM Exemption that would mandate unprecedented and punitive contractual provisions associated with loss of eligibility to rely on the exemption or substantially modify the requirement.

3. Withdraw the requirement that each QPAM provide a one-time report to the Department of reliance on the Exemption, given the potential hazards and burdens of such reporting.

Background on CIT Regulation and Structures

CITs are a type of pooled investment vehicle specifically designed for eligible retirement plans. CITs are organized as trusts maintained by a bank or trust company. CITs

are designed to facilitate investment management and administration by combining assets from eligible retirement plan investors into a single investment portfolio (or "fund") with a specific investment strategy. By commingling or pooling assets, sponsors of CITs may take advantage of economies of scale to offer lower overall expenses, enhanced risk management, and more diverse and innovative investment opportunities for the participating investors than such investors could achieve by investing these assets in separate portfolios. Each CIT is managed and operated in accordance with the applicable trust's governing documents, which generally include a declaration of trust, which plans adopt through a participation agreement with the trustee to become one of the instruments governing the plan's investment in the fund, and the fund's description or statement of characteristics.

While CITs are very similar to mutual funds, they differ in that they are specifically designed for eligible retirement plans and are only available to individuals who participate in their employer's eligible retirement plan. CITs generally have relatively low operating costs because they operate under an exemption from registration as mutual funds set forth in section 3(c)(11) of the Investment Company Act of 1940 ("40 Act"). While mutual funds are regulated by the SEC, the OCC (or its State counterpart) is the primary regulator of CITs. Accordingly, to be eligible for this exemption, Section 3(c)(11) requires that a CIT must in the first place be "maintained by" a bank.

Neither the '40 Act nor its legislative history provide an explanation or guidelines regarding the "maintained by" requirement. A 1980 SEC Release provides the following discussion with respect to the maintained by a bank requirement:

> The word "maintained" has been interpreted by the staff to mean that the bank must exercise "substantial investment responsibility" over the trust funds administered by it. Thus a bank which functions in mere custodial or similar capacity will not satisfy the "maintained" requirement.[2]

At the same time, CIT trustees also serve as ERISA fiduciaries to the plan assets invested in CITs and thus manage each CIT under ERISA fiduciary standards to the extent ERISA assets are invested in the CIT. In accordance with those standards, it is a common practice for a CIT trustee to engage and delegate investment management functions to one or more investment advisers. In a series of SEC no-action letters the SEC staff sought to establish a framework in which a bank would be considered to exercise "substantial investment responsibility" with respect to the CIT in these circumstances.[3] In certain of these no-action letters involving third-party advisers, relief was conditioned on the bank retaining "full, final and complete authority for the approval of investments," such that the bank would approve or authorize all fund investments recommended by the adviser. In other no-action letters where the bank and investment adviser were affiliated, the staff

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[2] Employee Benefit Plans, Securities Act Release No. 6188 (Feb. 1, 1980), 45 Fed. Reg. 8960, 8972 (Feb 11, 1980).

[3] See, e.g., Employee Benefit Plans, Securities Act Release No.6188 (Feb. 1, 1980) ("Employee Benefit Plans Release"); General Motors Investment Management Corporation, SEC No-Action Letter (Feb. 2, 2000).

indicated that the "maintained by" requirement would be met if the bank exercised "immediately and essentially direct influence" over the affiliated adviser.[4] As such, to meet the 3(c)(11) "maintained by" requirement, CITs often are structured so that the trustee exercises substantial investment management responsibility and ultimate discretion while at the same time a third party adviser, or even multiple subadvisers, have or exercise discretionary authority with regard to investment transactions of the CIT.

Guidance issued by the OCC similarly establishes a construct under which the bank maintaining a CIT and an adviser or subadviser engaged to manage the assets of the CIT both have or exercise discretionary authority with regard to the CIT. Pursuant to OCC Reg. 9:

> a bank administering a [CIT] shall have exclusive management thereof, except as a prudent person might delegate responsibilities to others.[5]

As such, the OCC guidance recognized that a CIT may be prudently managed in a structure in which both the bank/trustee and a third-party adviser have or exercise discretionary management authority. Thus, given the SEC and OCC regulatory regime under which CITs operate, it is very common for CITs to be structured such that two or more fiduciaries have or exercise discretion with respect to any given investment transaction of the CIT, with the bank or trustee maintaining the CIT always required to do so.

Proposed Amendments to Section I(c) – Involvement in Investment Decisions by Parties in Interest

1. <u>The Proposed Amendments to Section (1)(c) are Incompatible with the Basic CIT Regulatory Structure</u>

The new language in the Proposal would limit the covered transactions to those for which the "commitments, investment of fund assets and negotiations on behalf of the Investment Fund are the sole responsibility of the QPAM" and further state that "no relief is provided under this exemption for any transaction that has been planned, negotiated or initiated by a Party in Interest, *in whole or in part*, and presented to the QPAM for approval because the QPAM would not have sole responsibility with respect to the transaction." (Emphasis added.) This revision would present a structural conundrum for CITs and their providers given the standards imposed by the federal securities laws and OCC regulations. Accordingly, we respectfully request that this requirement be withdrawn in its entirety, or at a minimum, revised to make clear that it only applies in narrow situations and not in the context of CIT arrangements.

Under section 3(c)(11) of the '40 Act and OCC Reg. 9, the bank/trustee must exercise "substantial investment responsibility" and have ultimate discretionary authority from a regulatory perspective, while at the same time, typically must engage investment advisers

[4] <u>See</u>, <u>e.g.</u>, The Citizens & Southern National Bank/Citizens and Southern Investment Advisors, Inc., SEC No-Action Letter (Feb. 10, 1986).
[5] 12 C.F.R. § 9.18(b)(2).

to perform vital investment management functions, giving rise to a need for dual or multiple levels of discretion. In this instance several different entities (the bank/trustee, investment adviser, one or more subadvisers, etc.) may be QPAMs and parties in interest and rely on the QPAM Exemption. By precluding any involvement of advisers or subadvisers in the planning or negotiation of a transaction where the trustee serves as a QPAM (or vice versa where the adviser or a subadviser is the QPAM seeking to rely upon the exemption) the Proposal may create a situation where essentially none could rely on the QPAM Exemption, which would result in transactions involving the most common CIT structures being ineligible for QPAM Exemption coverage.

We understand that the Department's view is that the current QPAM exemption might be subject to abuse by enabling parties in interest to search for a QPAM to "bless" an arrangement that is pre-designed to benefit a party in interest, or so-called "QPAM-for-a-day" transactions. The proposed language goes well beyond this concern and could be read to forbid any communications between a QPAM and other parties in interest. Particularly in the context of pooled investment funds, it is unclear why it should matter which party in interest proposes or initiates a transaction, as long as the approval and terms of the transaction are the ultimate responsibility of a QPAM. There is no evidence that the basic CIT structural arrangement is abusive or less protective of the interests of plans and participants investing in the CIT. To the contrary, CITs are efficient, flexible, cost-effective investment options that are increasingly included in plan line-ups because of these features.

Moreover, within the standard CIT trustee-subadviser structure, each entity performing discretionary investment management functions is a fiduciary, and performs its functions in accordance with ERISA's rigorous standards. It is unclear why it would be problematic for multiple fiduciaries to participate in the planning and coordination of a plan-related transaction, providing multiple layers of fiduciary protection for the transaction. Given that a CIT trustee, from a regulatory perspective, is always required to exercise substantial investment authority over the fund, imposing a requirement that a subadviser who seeks to rely on the QPAM Exemption have sole authority with regard to fund transactions undercuts the layer of fiduciary protection afforded by the trustee and makes it seemingly impossible to meet the securities law and OCC regulatory requirements applicable to CITs and the trustees that maintain them.

By constraining the availability of these vehicles and the providers that manage them, the Proposal would limit choice and disadvantage plans and participants.

2. <u>The Proposal would Limit the Availability of Common Tiered or Multi-Managed Investment Funds</u>

Another area where the proposed amendments to section I(c) of the QPAM Exemption may have a detrimental impact is with regard to multi-managed asset allocation funds, such as target date or target risk funds, and similar tiered or multi-managed investment vehicles, such as stable value funds. Although not specific to CITs, target date and target risk funds

typically are structured such that the top level fund invests in a mix of underlying equity and fixed income funds to achieve a portfolio consistent with the fund's objectives.

Target date, and to a lesser degree, target risk, funds are one of the most prolific investment vehicles used as default investment options in retirement plans. There is no evidence that this structure is ripe for abuse, particularly the perceived QPAM abuses that are of concern to the Department. To the contrary, the Department has explicitly validated these types of investment structures by approving their use as qualified default investment alternatives ("QDIAs").[6] The language in the Proposal requiring that "commitments, investment of fund assets and negotiations on behalf of the Investment Fund are the sole responsibility of the QPAM" and that "[a] party in interest should not be involved in any aspect of a transaction aside from certain ministerial duties and oversight" is incompatible with the concept of tiered or multi-managed investment funds where the top-level fund manager and underlying fund managers all are QPAMs and fiduciary parties in interest. Without the benefit of the QPAM exemption, each manager would have to keep a running track of every party in interest with every plan investing in the fund. The Proposal thus could seriously disrupt thousands of plans' investment menus, including their choice of QDIAs, as it would be virtually impossible for these funds to operate without the benefit of the QPAM exemption. As of 2021, assets invested in target date funds totaled $3.27 trillion, as plan sponsors and participants gravitate towards these options for their ease of use and substantial diversification.[7] Given this preference for target date funds and the significant market share they occupy, target date funds play a pivotal role in defined contribution plans and the Proposal has the prospect of causing chaos and dislocation in the retirement market, to the ultimate detriment of the plans and participants the Department seeks to protect.

Beyond circumstances in which a CIT may invest in one or more underlying CITs, it is not uncommon for different portfolios of individual CITs to be managed by one or more subadvisers. For example, in a manager-of-managers fund structure, a CIT sponsor may engage several subadvisers whose styles have low correlation in order to mute the impact of volatility and cyclical style disfavor on returns to investors. These types of structures require there to be planning and negotiation among the CIT provider and subadvisers regarding the overall fund strategy and objective and the role that each subadviser's portfolio plays in achieving this objective. In a multi-managed fund, each subadviser also must make decisions and exercise discretion regarding investment of the CIT's assets allocated to its portfolio, while at the same time, the CIT provider or manager must retain substantial investment responsibility for the CIT's management. The Proposal may create a situation where none of the entities in a multi-managed fund is able to rely on the QPAM Exemption. This may have the impact of decreasing the availability of beneficial investment options that are designed to be protective of plan investor returns, rather than achieving the Proposal's goal of ferreting out abuse.

[6] 29 C.F.R. § 2550.404a-5(e).
[7] "2022 Target-Date Strategy Landscape," Morningstar Research, March 23, 2022.

Notably, pooled stable value funds often are structured in a tiered or multi-manager format. In this format, the stable value fund's overall portfolio manager contracts with one or more wrap issuers to provide book value guarantees with respect to underlying portfolios managed by 3rd-party investment managers in order to support benefit responsive withdrawals by plan participants. This format requires planning and negotiation among the various entities, with the underlying investment managers exercising discretionary investment management authority over the portfolios they manage and the overall fund's investment manager having discretionary management authority over the entire fund and responsibility to coordinate with the wrap providers and underlying managers to ensure that the fund's objectives are achieved. Although no longer eligible to serve as QDIAs, stable value funds play an important role in a plan's investment line-up, providing participants access to a relatively low-risk vehicle that provides principal protection and liquidity with relatively higher crediting rates. The Proposal's inexplicably rigid requirement that the QPAM exercise "sole responsibility" over planning, negotiation and investments in connection with a transaction would undermine the variety and availability of stable value funds.[8] As in the case of target date funds, the Proposal could result in significant disruption in the stable value market, which ultimately would be harmful to plans and participants.[9]

3. Proposal Raises Uncertainty Regarding Cleared Swaps

A specific category of transactions that face uncertainty in the wake of the Proposal are "cleared swap" transactions conducted pursuant to provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[10] Dodd-Frank established clearing and trade execution requirements for standardized derivative products, such as swaps, in an effort to reduce risk, increase transparency, and promote market integrity within the overall financial system. Under the Dodd-Frank framework, all swaps required by the Commodity Futures Trading Commission to be centrally cleared must be submitted to a clearing counterparty ("CCP") for clearing.

Under the central clearing framework, a plan's fiduciary selects the clearing organization and a Clearing Member of the organization in connection with a particular swap transaction for purposes of clearing the swap. As a result of this central clearing process, once a swap is accepted for clearing by a CCP, the Clearing Member effectively steps into the shoes of the plan in the original swap and it is replaced with an equal and opposite swap between the CCP and Clearing Member. In connection with this central clearing process, the plan and Clearing Member engaged by the plan enter into an agreement that specifies, among other things, the rights of the Clearing Member upon

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[8] In this regard, we wish to express our support for the comment letter submitted by the Stable Value Investment Association ("SVIA"), which details the many benefits provided to plans and participants by stable value funds and burdens posed to this asset class by the Department's Proposal.

[9] With nearly $1 trillion in total assets, stable value funds represent a significant part of the retirement plan market. See "The Facts About Stable Value," SVIA, August 22, 2022.

[10] Public Law 111-203, 124 Stat. 1376 (2010).

default by the plan to engage in liquidation and close-out transactions with respect to a plan's account in order to manage and mitigate risks and damages caused by the default.

In Advisory Opinion ("AO") 2013-01A, the Department opined that a Clearing Member would be a party in interest pursuant to ERISA section 3(14)(B) in this context by virtue of providing services on behalf of a plan, and that the QPAM Exemption provided relief from relevant prohibited transactions under ERISA section 406(a) if the agreement between the QPAM acting on behalf of the plan and Clearing Member set forth all the material terms of the provision of services and guarantee by the Clearing Member. However, the Department's opinion was predicated, in part, on the existing language in section I(c) providing that the transaction be "negotiated on behalf of the investment fund by, or under the authority and general direction of, the QPAM," rather than the more stringent and inflexible "sole responsibility" language in the Proposal. As a result, it is unclear the extent to which AO 2013-01A may continue to be relied on in the case of these cleared swap liquidation and close-out transactions or other "subsidiary transactions" involving similarly structured principal derivatives or other transactions. As noted above, the purpose of the central clearing requirement and component liquidation and close-out provisions is to seek to reduce risk and promote market integrity within the overall financial system. In order to avoid the potential disruption to the financial system and existing and future counterparties to cleared swap and similar transactions that have been structured with the assumption of the availability of the QPAM Exemption to cover relevant aspects, the amendments to section I(c) should be withdrawn.

4. Proposal would Limit Beneficial Customization

In addition to their lower cost, among the more attractive features of CITs is the ability to customize investment solutions to meet the needs of individual plan demographics. The idea and desire to create custom investment options for a plan often may originate with the plan sponsor or a plan consultant, both of whom would be parties in interest and plan fiduciaries, and require coordinated planning and negotiation among these entities/individuals and a CIT provider or investment manager acting as a QPAM. The Proposal would appear to preclude this type of investment product design interaction among the various parties in interest and QPAM, potentially eliminating the ability to create beneficial custom solutions for individual plan line-ups. Thus, rather than prevent abuse, the Proposal would actually stifle innovation and may inhibit CIT providers' ability to best serve the plan and participant clients. Accordingly, we reiterate our request that the "sole responsibility" requirement be withdrawn, or revised to make clear that it applies only in narrow circumstances, and not in the context of CIT arrangements.

Proposed Amendments to section I(g) –Reporting to the Department, Written Management Agreement and Ineligibility

1. The Proposed Written Management Agreement Conditions Raise Problematic Privity Issues

The Proposal would require substantial information regarding terms that apply in the event of an entity's ineligibility to rely on the QPAM Exemption in a written management agreement with the client plan investing in the fund. In the case of a CIT, the fund's participation agreement serves as the functional equivalent of a written management agreement and is entered between the CIT provider and client plan investor. As noted above, pursuant to section 3(c)(11) of the '40 Act, a CIT must be maintained by a bank and this entity acts as the CIT provider. As also noted, in a CIT structure, the fund provider or trustee often is a third party unaffiliated with the adviser or subadvisers managing the fund's assets. In this instance, there is no separate agreement between a benefit plan investor and the underlying advisers or subadvisers managing the fund's assets.

Requiring a third party adviser or subadviser to a CIT that relies on the QPAM Exemption to enter into a separate management agreement with a plan investing in the CIT results in erosion of the "bank maintained" concept and could raise regulatory issues under the securities laws and OCC guidance. It is unclear why it would be necessary for a third party adviser or subadviser to a CIT to enter into a separate written agreement with a retirement plan investing in the CIT when privity of contract appropriately rests between the plan and fund provider. It also is unlikely that plan investors make decisions to adopt a CIT into plan investment lineups based on terms applicable to underlying third party advisers or subadvisers, and in any event, the wind-down and indemnification provision requirements would be inapposite in this context (i.e., an underlying third party adviser's or subadviser's ineligibility to rely on the QPAM Exemption should not force the CIT itself to terminate or trigger an obligation to reimburse a plan for the "actual costs" of withdrawal from the CIT). We encourage the Department to reevaluate the Proposal's written management agreement amendments in this context and withdraw the requirement in total (or at a minimum, clarify that it does not apply in the case of third party CIT advisers and subadvisers.) If the Department determines it necessary to maintain the requirement in the final QPAM Exemption amendments, we request that this only apply to CIT advisers and subadvisers to the extent that this requirement is consistent with the 3(c)(11) "bank maintained" requirement and similar obligations in connection with OCC Regulation 9. In either event, given the significant costs and time-consuming burdens imposed by the proposed amendments, at a minimum, entities relying on the exemption should be given

a period not less than 18 months following publication of final amendments to come into compliance with any contractual mandates.

2. Reporting Obligation Raises Concerns – To ensure that the Department is aware of entities that rely on the QPAM Exemption, the Proposal would require each QPAM to provide a one-time report to the Department of reliance on the Exemption, including the legal name of each business entity relying on the Exemption and any name the QPAM may be operating under. The one time e-mail notice to the Department is a fraught with opportunities for inadvertent errors, as old arrangements may be overlooked, new entities will be created, and old entities may be renamed or establish new operating names. The cost assumption that this is a one-time 15-minute activity seems to drastically understate the true cost. The Department has not articulated any evidence that the prior absence of such a requirement has been problematic. Further, the Department has not provided evidence of the need for, or the utility of, a published list. Reliance on the QPAM Exemption is routinely documented in agreements among parties that need to rely on the Exemption. As a result, we request that the reporting obligation be withdrawn.

3. The Costs and Burdens Associated with the Written Management Agreement are Prohibitively High

   The Proposal's mandate that existing management agreements be amended to include indemnification and related language and specific contractual provisions that would require QPAMs to pick up all costs associated with unwinding investment transactions is unprecedented and unnecessarily punitive in its scope. As such, a number of industry groups have or can be expected to submit detailed comments to the Department describing the costs, burdens and unintended consequences associated with this part of the Proposal. In this regard, the American Bankers Association ("ABA"), Securities Industry and Financial Markets Association ("SIFMA") and Society of Professional Recordkeepers and Asset Managers ("SPARK Institute"), among others, have submitted comment letters regarding the Proposal and the Coalition wishes to express our support for the comments offered by these industry organizations to highlight and amplify the concerns raised in the letter with regard to the costs and burdens associated with the amendments to section I(g) of the Proposed Exemption.[11] The Coalition concurs with the recommended actions outlined in those letters and requests that the Department adopt these recommendations in any final version of the Proposal.

[11] In particular, we draw the Department's attention to sections III.B. and E. of the ABA letter, which describe the challenges and potential inability of QPAMs to unilaterally amend investment management agreements with clients and estimates the cost of industry compliance at nearly $1billion, as well as sections II.C. and III. B and C of the SIFMA letter, which also detail the costs and inefficacy of the Proposal's contractual obligations and wind-down period. Further, we highlight the discussion in the SPARK Institute letter that describes the burdens faced by a single member CIT trustee in needing to amend an estimated 15,000 participation agreements in order to comply with the Proposal's mandates. Extrapolating this metric to the roughly 50 Coalition members, it reasonably may be expected that this could equate to the need to amend as many as 750,000 or more participation agreements within this group alone, which would lead to market-wide burdens well beyond the scope of Department's current cost and resource estimates.

CONCLUSION

Once again, the Coalition appreciates the opportunity to provide these comments regarding the Proposal. We strongly encourage the Department to withdraw the Proposal as written or, alternatively, to release a substantially revised proposal that addresses the comments provided by the Coalition and other industry groups referenced herein.

Respectfully submitted,

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FOR THE COALITION OF COLLECTIVE INVESTMENT TRUSTS