Federated Hermes

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Office of Exemption Determinations
Employee Benefits Security Administration
200 Constitution Ave NW
Suite 400
Washington, DC 20210
Attn: Application No. D–12022
Docket ID: EBSA–2022–0008

Submitted via regulations.gov

Re: Proposed Amendment to Prohibited Transaction Class Exemption 84–14 (the QPAM Exemption); Application No. D–12022; Docket ID: EBSA–2022–0008

Dear Ladies and Gentlemen:

Federated Hermes, Inc., and its affiliates ("Federated Hermes") appreciates the opportunity to provide input on the Department of Labor's (the "DOL") notice of proposed amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption) ("Proposal").

Federated Hermes is a global investment manager of more than $600 billion in assets and has been focused on fiduciary principles for over 50 years. As a fiduciary and as a registered investment adviser we manage $63.3 billion in Employee Retirement Income Security Act ("ERISA") plan assets, including $4.1 billion through institutional separate accounts, over $3.8 billion through collective investment funds, and $55.4 billion through plan investments in mutual funds. We take our fiduciary duty to our clients seriously and strive to strictly comply with applicable ERISA requirements. As a matter of longstanding practice, we also endeavor to engage with the DOL on matters of particular interest to our ERISA clients, including many trust departments and trust companies throughout the country.

As an active manager, the goal of our investment process is to produce superior, risk-adjusted returns for our clients. To achieve this goal in the context of ERISA plan assets, Federated Hermes relies upon prohibited transaction class exemptions and especially the QPAM Exemption.

It is in this context that, while we appreciate the DOL's desire to update and clarify the QPAM Exemption, we have concerns regarding certain aspects of the Proposal. As such, Federated Hermes fully endorses and supports the comments and recommendations provided by the Investment Company Institute dated October 11, 2022, and the Securities Industry Financial Markets Association of even date thereto. We agree with these letters particularly in respect of the concerns that they have raised regarding the problematic constraints the proposed changes to

Section I(c) would impose on trading counterparties and service providers for plans, the unprecedented nature of imposing contractual terms, the DOL's proposal to determine equivalency on its own and thereby revoke a manager's QPAM designation, and the establishment of a QPAM registration list. Additionally, we join with these organizations in requesting further information regarding the DOL's policy objectives behind the proposed changes which in our view remains unclear even after the public hearing.

Executive Summary

We strongly urge the proposed amendment to Section I(c) be removed from the Proposal, as the alteration proposed to Section I(c) will create ambiguity and cause unintended consequences as applied both to the unique requirements of collective investment trusts ("CITs") and to other arrangements, including managers of institutional separate accounts which have a separate consultant. The existing language in Section I(c), that requires the qualified professional asset manager ("QPAM") to be the decision-making entity, is well understood and already serves the purpose of ensuring that the applicable QPAM(s) have and exercise discretion over the commitments and investments of plan assets and the related negotiations. This standard is flexible and is used in a variety of different advisory structures, including the common structures found in CITs.

By contrast, as discussed in more detail below, the proposed amendment to Section I(c), which would require a QPAM to have "sole" responsibility for transactions, is not compatible with the CIT regulatory structure permitted by both the Securities and Exchange Commission ("SEC") and the Office of the Comptroller of the Currency ("OCC"), that both allows delegation of investment management authority but requires the trustee to maintain substantial investment responsibility over the CIT. The QPAM Exemption is commonly relied upon in connection with the management of CITs; if the proposed amendment with its "sole" responsibility requirement is adopted, the QPAM Exemption will become categorically unavailable to fiduciaries of CITs because in the context of a CIT structure the QPAM could not meet the condition that it have the "sole" responsibility with respect to the transaction and employers may hesitate to add CITs to investment menus, thereby limiting investment options for plan participants.

In addition, we recommend:

- Removing the proposed registration requirement, where each QPAM must report its reliance to the DOL.
- Reducing the scope of the proposed expansions to disqualification in Section I(g) of the QPAM Exemption.
- Removing the Proposal's requirement for contract provisions in every investment management agreement.

The DOL Should Modify or Withdraw the Proposed Amendment to Section I(c) of the QPAM Exemption

Collective Investment Trusts

During its Public Hearing on the Proposal, DOL staff requested additional information on advisory structures that rely on the QPAM Exemption and that would be impacted by the proposed amendment to Section I(c).

Federated Investors Trust Company, a Pennsylvania trust company and subsidiary of Federated Hermes, is the trustee for certain CITs. Federated Investment Management Company, a Delaware statutory trust, subsidiary of Federated Hermes, and a registered investment adviser, serves as the investment adviser for CITs where Federated Investors Trust Company is trustee. In addition, Federated Investment Management Company serves as the investment adviser for certain CITs for which another bank serves as trustee. These entities would be directly and adversely impacted by the proposed amendment to Section I(c).

As other commenters have pointed out to the DOL, CITs are different from mutual funds subject to the Investment Company Act of 1940 ("1940 Act") and are subject to unique regulatory requirements under the federal securities laws and OCC Regulation 9 ("Reg. 9"). In part as a result of these unique regulatory requirements, CITs commonly have investment structures involving multiple layers of managers and investment discretion.

CITs are organized as trusts maintained by a bank or trust company and are specifically designed for eligible retirement plans. CITs are often very desirable investment options for retirement plans, because they are cost-effective, flexible, and protective of retirement plan interests. CITs operate pursuant to an exemption from mutual fund registration set forth in Section 3(c)(11) of the 1940 Act. This exemption requires that a CIT be "maintained by" a bank.[1]

Although the 1940 Act does not explain the "maintained by" requirement, SEC staff guidance provides that to meet this requirement, the bank must exercise "substantial investment responsibility" over the trust funds in the CIT, which must include more than acting in a "mere custodial or similar capacity."[2] Further, SEC staff guidance indicates that where a CIT trustee engages and delegates investment management authority to investment advisers, the bank must

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[1] The definition of bank includes a trust company.
[2] Employee Benefit Plans, Securities Act Release No. 6188 (Feb. 1, 1980), 45 Fed. Reg. 8960, 8972 (Feb 11, 1980).

still exercise such substantial investment responsibility over the investment adviser.[3] Similarly, OCC Reg. 9 provides that "a bank administering a [CIT] shall have exclusive management thereof, except as a prudent person might delegate responsibilities to others."[4] Both SEC staff and OCC guidance therefore recognizes that a CIT structure can involve multiple layers of discretionary investment management authority.

It is very common in our experience for CITs to have one or more investment advisers that have been delegated discretionary management authority in addition to the trustee which exercises substantial investment responsibility and the ultimate discretion over investment decisions. Both CIT trustees and investment advisers to CITs are ERISA fiduciaries to ERISA plans invested in the CITs. This layering of fiduciary oversight is desirable and provides considerable protection to retirement plans, because each layer is subject to ERISA's fiduciary duties and protections.

The QPAM Exemption has been one of the most widely relied upon exemptions from ERISA's prohibited transaction restrictions, and, depending upon the facts and circumstances, both CIT trustees, and investment advisers to CITs, may be QPAMs that rely upon the QPAM Exemption for particular investment decisions.

The current language in Section I(c) of the QPAM Exemption conditions relief on the terms of the transaction being "negotiated on behalf of the investment fund by, or under the authority and general direction of, the QPAM" and the QPAM making "the decision on behalf of the investment fund to enter into the transaction, provided that the transaction is not part of an agreement, arrangement or understanding designed to benefit a party in interest." This is both a clear standard that requires the QPAM to be the decision-making entity, protecting the plan from arrangements designed to benefit parties in interest instead of the plan, and a flexible standard that can be used in different advisory structures, including the common structures found in CITs.

The proposed amendment to Section I(c) in the Proposal would provide that the QPAM Exemption will only provide relief with respect to transactions where the "terms of the transaction, commitments, and investment of fund assets, and any associated negotiations on behalf of the Investment Fund are the sole responsibility of the QPAM." The Proposal would further add language to the end of Section I(c) that provides that "[n]o 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 a QPAM for approval because the QPAM would not have sole responsibility with respect to the transaction as required by this Section I(c)."

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

We believe that the proposed amendment to Section I(c) is not compatible with the CIT regulatory structure that both allows delegation of investment management authority but requires the trustee to have substantial investment responsibility over the CIT in order to be considered to be "maintaining" the CIT. This layering of discretionary management, and fiduciary, authority would mean that under the Proposal the QPAM Exemption would be unavailable for most, if not all, CIT investment transactions, because the QPAM could not meet the condition that it have the "sole" responsibility with respect to the transaction.

Because the QPAM Exemption is so commonly relied upon, employers may hesitate to add CITs to investment menus if the QPAM Exemption becomes categorically unavailable to fiduciaries of CITs. Given the benefits of CITs, including their ERISA fiduciary protections and cost-effectiveness, this limitation of choice would disadvantage plans and participants and would be a truly unfortunate unintended consequence of the proposed amendment to Section I(c).

Institutional Separate Accounts

The proposed changes to Section I(c) would also cause problems for managers of institutional separate accounts comprised of ERISA assets. Because the proposed changes are so broad, they could capture any transaction where a party other than the QPAM "initiates" or brings a transaction to the QPAM's attention. Many large institutional retirement plan clients have consultants who share research with a manager or bring a potential transaction to a manager's attention. The current text of the Proposal would seem to prevent the manager from then relying on the QPAM Exemption if, after prudent fiduciary consideration, it decides to engage in such a transaction. If a manager cannot rely on the QPAM Exemption for transactions brought to its attention by others, such as plan consultants, it may avoid interacting with parties such as consultants, and may lack knowledge of transactions that would otherwise be beneficial for the plan to enter into.

<u>The Proposed Registration Requirement is Unnecessary, Unprecedented, and Unjustified</u>

The Proposal would require all managers who use the QPAM Exemption to register with the DOL for inclusion on a public list on the DOL's website. This requirement is unprecedented; no other exemption has ever required such registration. The DOL has not explained why it needs all these names or why it wants to publish the list.

We echo the concerns of other commentators that have described the potential problems with inadvertent failures to comply with this requirement, including as a result of a name-change or when the manager of a private fund inadvertently becomes a fiduciary because the fund temporarily exceeds the 25% plan asset threshold. But even if the Proposal is revised to include a correction procedure, we are concerned about the implications of this registration requirement. The DOL has previously expressed concern regarding QPAM status being viewed as a seal of

approval for a manager. A list such as this would seem to exacerbate those concerns. Such a list creates the perception that managers on the list (and only such managers) are approved by the DOL. If such a public list exists, would a plan fiduciary be imprudent if it does not check the list to verify that a manager qualifies as a QPAM before hiring that manager? Would a plan fiduciary be imprudent if it relies on the list, but the manager ceased to qualify as a QPAM? This proposed requirement has the potential to have many unintended consequences and, therefore, we urge the DOL to gather additional public and industry input in order to better understand the potential adverse effect on providers of fiduciary services to ERISA plans.

“Equivalency” Should be More Precisely Defined before Considering Expanding the Disqualification to Non-Criminal Conduct

We appreciate the DOL’s clarification in the Proposal that foreign crimes that are equivalent to the domestic crimes covered in Section I(g) would be cause for disqualification as a QPAM. However, the Proposal needs more clarity on how, and according to what rules-based standards or procedures, foreign crimes would be deemed “equivalent” to the domestic crimes covered in Section I(g). A speeding ticket in a foreign jurisdiction may be criminal but should obviously not be disqualifying. Perhaps a standard linked to crimes involving fraud, deceit, and intentional violation of AML and similar laws. A fiduciary should not be disqualified for a foreign “foot fault”.

We also respectfully request that the DOL modify or remove its proposal to expand the scope of the proposed changes to Section I(g) with respect to the inclusion of non-criminal activity. The power that the Proposal would give to the DOL to unilaterally disqualify a manager from QPAM status for non-criminal activity raises serious due process concerns.

If these changes are not removed, a process for the appointment of an independent decision-maker should be implemented, and the scope of non-criminal activity ought to be limited to conduct that has nevertheless been condemned pursuant to government or regulatory action that is subject to due process. We view Section 9(a)(2) of the1940 Act as a model approach to capture potentially disqualifying non-criminal fiduciary misconduct.

The Proposal’s Mandated Contractual Provisions Are Unduly Burdensome

The Proposal would require every manager that might ever use the QPAM Exemption to amend every one of its investment management agreements with every retirement plan client to include mandated language, including indemnification provisions. For large institutions such as Federated Hermes, this obligation would be incalculably time consuming and costly. There are many versions of investment management agreements, such that a single template amendment for every agreement is unrealistic. In addition, investment management agreements are already highly negotiated and reopening these previously negotiated agreements would be disruptive, unnecessary, and costly both for us and our retirement plan clients.

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Conclusion

Federated Hermes recommends withdrawing the proposed amendments to Section I(c) of the QPAM Exemption as set forth in the Proposal and otherwise revising the Proposal as discussed above.

We would be happy to meet with you at your convenience to discuss this or any other issues related to the Proposal.

Sincerely,

Peter J. Germain
Chief Legal Officer