February 29, 2008

Hon. Bradford P. Campbell  
Assistant Secretary of Labor  
Employee Benefits Security Administration  
U.S. Department of Labor  
Frances Perkins Building  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Comments on the New Service Provider Exemption Under Section 408(b)(17) of ERISA

Dear Assistant Secretary Campbell:

Enclosed are comments on the new service provider exemption under section 408(b)(17) of ERISA, as added by the Pension Protection Act of 2006. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stanley L. Blend  
Chair, Section of Taxation

Enclosure

cc: Linda Stiff, Acting Commissioner, Internal Revenue Services  
Donal L. Korb, Chief Counsel, Internal Revenue Service  
Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury  
Alan D. Lebowitz, Deputy Assistant Secretary for Program Operations, Department of Labor  
Lou Campagna, Chief, Division of Fiduciary Interpretation, Department of Labor  
Ivan Strasfeld, Director, Office of Exemption Determinations, Department of Labor  
Robert Doyle, Director, Office of Regulations and Interpretations, Department of Labor
COMMENTS ON THE NEW SERVICE PROVIDER EXEMPTION UNDER SECTION 408(b)(17) OF ERISA, ADDED BY THE PENSION PROTECTION ACT OF 2006

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (“Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Andrew L. Oringer. Substantive contributions were made by John J. Cleary, Beth J. Dickstein, Ellen A. Hennessy, John J. Jacobsen and Eric R. Paley. The Comments were reviewed by David A. Mustone, Chair of the Employee Benefits Committee of the Section (“Committee”) and Kurt L.P. Lawson, Vice Chair of the Committee. The Comments were further reviewed by the Quality Assurance Group of the Committee, which is chaired by Thomas R. Hoecker and whose members are former chairs of the Committee; by Bruce D. Pingree of the Section’s Committee on Government Submissions; and by Priscilla E. Ryan, the Council Director for the Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the rules addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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February 29, 2008
EXECUTIVE SUMMARY

The following Comments pertain to the new “service provider” exemption from the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”)\footnote{All section references herein are to sections of ERISA, unless otherwise indicated.}, which exemption was added as section 408(b)(17) by section 611(d) of the Pension Protection Act of 2006 (“PPA ’06”)\footnote{Pub. L. No. 109-280 (2006)}. These Comments are submitted in response to informal requests made by various representatives of Employee Benefits Security Administration of the Department of Labor (the “Department”) at public meetings of the American Bar Association Section of Taxation and other public meetings seeking comments on those aspects of PPA ’06 affecting ERISA.

We recommend that the Department issue regulations or other guidance or authority (“Regulations”) that provide that:

A. “Adequate consideration” is, for an asset with no established market, defined for purposes of the Service Provider Exemption as fair market value as determined by the applicable plan fiduciary pursuant to commercially reasonable procedures and otherwise in good faith, with a resulting valuation consistent with that which would be used in an arm’s length transaction between unrelated parties.

B. For ongoing transactions, compliance with the Service Provider Exemption is to be tested only at the time transaction is entered into, modified or renewed.

C. Involvement with a plan solely as a directed trustee does not constitute fiduciary status for purposes of the Service Provider Exemption.

D. The fiduciary limitation to the Service Provider Exemption does not apply to a transaction by a commingled investment entity in which plan assets are invested if the party in interest is a fiduciary (or an affiliate thereof) to the plan only at the plan level.

E. “Affiliate” is, for purposes of the Service Provider Exemption, strictly a person controlling, controlled by or under common control with the fiduciary with respect to the assets involved in the transaction.

F. The Service Provider Exemption is available for a transaction with a party in interest if the party in interest is such only because it is a 10% owner, partner or joint-venturer of an entity that is 50% or more owned by an employer whose employees are covered by the plan.

G. The Service Provider Exemption (i) is available regardless of what other statutory or administrative exemptions or other prohibited transaction relief might also potentially apply and (ii) applies not only to simple purchases and sales and other straightforward transactions, but also to more complex transactions, as long as
they satisfy the applicable requirements.

H. A person’s status as a fiduciary with respect to plan assets not involved in a particular transaction would not render the Service Provider Exemption inapplicable in respect of that person if all of the other requirements of the Service Provider Exemption are satisfied.
DISCUSSION

The subject of these Comments is the new Service Provider Exemption in section 408(b)(17), which was added by section 611(d) of PPA '06. This exemption generally exempts transactions between plans and non-fiduciary service providers to the plans (and certain related parties) from certain of the prohibited transaction rules.

Section 406(a) prohibits a broad range of transactions between plans and persons related to such plans – so-called “parties in interest” as defined in section 3(14) – regardless of the fairness of the transactions unless an exemption applies. Certain of the parties covered by the party-in-interest rules are true “insiders” – parties in a position of influence with respect to the plans – such as employers and responsible fiduciaries. However, the definition also applies to persons solely because they provide services to the plans. Such persons rarely have any significant influence over plans in that capacity. In our experience, the application of the prohibited transaction rules to mere service providers has often created a trap for the unwary. At the same time, it has caused many financial organizations to assume automatically that they are or may be a service provider (or affiliated with one). As a result, such organizations have often been unwilling to engage in transactions with plans without an ERISA exemption, which in a wide variety of cases has arguably harmed ERISA plans more than it has helped them.

In our view, the new Service Provider Exemption reflects an understanding on the part of Congress that a service provider relationship (i) does not involve the same potential for abuse that the other party-in-interest relationships might and (ii) requires a lower level of regulatory oversight that is less likely than past rules to impede otherwise valid transactions between plans and mere service providers.

A. Adequate Consideration

1. Summary

One of the conditions of the Service Provider Exemption is that the plan receives no less, or pays no more (as applicable), than “adequate consideration” in connection with the transaction.3 In the case of an asset for which there is no established market, “adequate consideration” is the fair market value of the asset as determined “in good faith” by the plan fiduciary in accordance with regulations of the Department.4

2. Recommendation

We recommend that the Department issue Regulations that provide that “adequate consideration” for an asset with no established market is, for purposes of the Service Provider Exemption, defined as fair market value as determined by the applicable plan fiduciary pursuant to commercially reasonable procedures and otherwise in good faith, with a resulting valuation consistent with that which would be used in an arm’s length transaction between unrelated parties.

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3 See section 408(b)(17)(A).
4 Section 408(b)(17)(B)(ii).
3. **Explanation**

The proposed standard is consistent with the statute and reflects the emphasis in ERISA on deference to a reasonable process undertaken by a responsible plan fiduciary, while also drawing on the arm’s length standard often used by the Department in connection with the granting of exemptions. Moreover, this approach generally furthers Congressional intent and strikes an appropriate balance between permitting valid transactions and protecting the interests of participants and beneficiaries.

It would not be desirable or feasible for the Department to issue regulations that impose any specific procedural or other similar requirement for satisfying the adequate consideration requirement because such an approach could never accommodate the wide range of transactions that plans engage in with mere service providers. For example, many of the types of transactions that would be susceptible to utilization of the Service Provider Exemption are transactions that are done every day in the financial markets, such as securities loans, swaps and other derivatives. A professional fiduciary might well engage in dozens (or even hundreds) of such transactions each and every day. A flexible, generic standard is needed in these circumstances.

There are, of course, certain transactions that are commonly effected in the market only with developed appraisals from independent, third parties, such as certain single-property real estate transactions. The proposed standard would require an appraisal in such a situation, because it would require whatever would be called for by commercially reasonable procedures under the same or similar facts.

While the Department has proposed regulations interpreting the definition of “adequate consideration” in section 3(18), which is similar though not identical to the definition in the Service Provider Exemption, we recommend that these proposed regulations not serve as a guide here. The preamble to those proposed regulations makes it clear that the Department considered more elaborate requirements, including an independent appraisal, to be necessary for purposes of section 3(18) because many of the provisions to which it applies involve plan dealings with the plan sponsor, and “[t]he close relationship between the plan and the plan sponsor in such situations raises a significant potential for conflicts of interest as the fiduciary values assets which are the subject of transactions between the plan and the plan sponsor.”

By contrast, the Service Provider Exemption does not cover transactions with plan sponsors or other true insiders. Thus, applying the standards in the proposed regulations would undermine the intent of Congress in enacting the new exemption, which, as explained above, was to facilitate transactions with mere service providers.

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B. Continuing Transactions

1. Summary

The Department has a long history of generally requiring that compliance of ongoing transactions with prohibited transaction exemptions be determined (with some exceptions) when the transactions are entered into, modified or renewed, rather than on a continuous basis.\(^6\)

2. Recommendation

We recommend that the Department issue Regulations that provide that, for ongoing transactions, compliance with the Service Provider Exemption is to be tested only at the time the transaction is entered into, modified or renewed, not on a continuous basis.

3. Explanation

It is only when a transaction is entered into, modified or renewed that concerns arise about possible undue influence by a service provider in the context of the Service Provider Exemption. Thus, it follows that compliance with the exemption would, like the class exemptions cited in footnote 6, only be tested at those times. To provide otherwise would needlessly compromise the usefulness of the Service Provider Exemption in much the same way as the usefulness of the cited class exemptions would have been had they required that compliance be tested on a continuous basis.

C. Fiduciary Status – Directed Trustees

1. Summary

The Service Provider Exemption is not available if the party in interest is a “fiduciary (or an affiliate) who has or exercises any discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice . . . with respect to those assets.”\(^7\) A substantial number of plans have directed trustees. In addition, a material part of the business of certain financial institutions is the provision of directed-trustee services.

2. Recommendation

We recommend that the Department issue Regulations that provide that involvement with a plan solely as a directed trustee does not constitute fiduciary status for purposes of the Service Provider Exemption.


\(^7\) Section 408(b)(17)(A).
3. **Explanation**

The Service Provider Exemption excludes only fiduciaries who have or exercise discretionary authority or control with respect to the investment of the plan assets involved in the transaction or advise on the investment of those assets. A directed trustee, by definition, does not have the same kind of authority or control and does not advise on the investment of those assets.

At the same time, the Department has viewed similar limiting concepts relevant to class exemptions as not applying to directed trustees. For example, in 2006, it revised the language in Parts II and V of PTCE 75-1 to add language substantially similar to that eventually contained in the Service Provider Exemption. In so doing, the Department expressly provided that directed-trustee status does not render those PTCE 75-1 exemptions unavailable. Thus, PTCE 75-1 now generally provides that the relevant exemptions are unavailable only if the party in interest “has or exercises any discretionary authority or control (except as a directed trustee) with respect to the investment of the plan assets involved in the transaction, or renders investment advice . . . with respect to those assets.” Because considerations regarding this point are substantially the same as in the case of the Service Provider Exemption, it follows that the same approach would apply.

D. **Assets Involved in the Transaction**

1. **Summary**

As noted above, the Service Provider Exemption is not available if the party in interest is a fiduciary who has or exercises discretionary authority or control with respect to the investment of the plan assets involved in the transaction or advises on the investment of those assets. It is not clear whether or how this limitation applies to transactions by a commingled investment entity, where (i) the fiduciary at the entity level might have no knowledge that the counterparty to a transaction is a fiduciary at the plan level, and (ii) the plan-level fiduciary has authority over the plan assets invested in the commingled investment entity but has no discretion with respect to the particular transaction.

2. **Recommendation**

We recommend that the Department issue Regulations that provide that the fiduciary limitation to the Service Provider Exemption does not apply to a transaction by a commingled investment entity in which plan assets are invested if the party in interest is a fiduciary (or an affiliate thereof) to the plan only at the plan level.

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8 The express exclusion of directed trustees from the scope of the limitation on the ability to use the PTCE 75-1 exemptions could be viewed as the Department’s express clarification that status as a directed trustee should not be considered fiduciary status for these purposes. (Such an approach is consistent with the retroactive effective date of the amendment.) Alternatively, it could be viewed as the Department’s making an exception for directed trustees. In either event, we believe that the Department’s position regarding directed trustees as reflected in PTCE 75-1 should be equally applicable with respect to the Service Provider Exemption.

3. **Explanation**

We submit that the better reading of the fiduciary limitation to the Service Provider Exemption is that it applies only where the party in interest on the other side of the transaction is a fiduciary to the plan at the level at which the transaction is effected (i.e., at the plan level if the transaction is with the plan directly, or at the level of an entity in which the plan invests, as applicable). For example, if a plan invests in “plan asset” equity and the entity in which the investment is made independently engages in a transaction with an affiliate of a fiduciary to the plan (the Service Provider), then it would be helpful and consistent with the rationale behind section 408(b)(17) for the Service Provider Exemption to apply. The limitation focuses on the party in interest’s authority or control with respect to assets involved in a particular “transaction.” In these circumstances, we believe that the only authority or control that is relevant for purposes of the Service Provider Exemption is the authority or control over the transaction itself. Thus, the fact that an unrelated fiduciary had made the transaction possible by placing the plan assets with the first fiduciary would not affect the applicability of the exemption.

We recognize that a transaction could potentially qualify under the Service Provider Exemption under our recommended interpretation even though the fiduciary at the plan level knows that the entity will be directing a transaction back to the fiduciary. However, we believe section 406(b) is sufficient to address such self-dealing concerns (as section 406(b) will apply even if the exemption is otherwise applicable).

In the alternative, we recommend that the Service Provider Exemption be available in these circumstances at least in those situations where there is no actual knowledge that the party in interest is a fiduciary with respect to the assets involved in the transaction. Without such an exception, it could be difficult or impossible for a commingled vehicle to consummate nonabusive transactions because of the possibility that there may be an unknown relationship. In addition, because determining whether actual knowledge exists can often be difficult, we further recommend that the Department establish a safe harbor whereby the relevant knowledge is deemed not to exist, and thus the fiduciary limitation does not apply, if the plan’s investment (together with investment by affiliated plans) is less than 10% of the investment in the entity. The 10% rule would provide sufficient protection to participants and beneficiaries, consistent with the Department’s approach in other exemption scenarios.  

E. **Affiliates**

1. **Summary**

Under the Service Provider Exemption, neither a fiduciary with respect to the assets involved in the transaction nor an “affiliate” thereof may be the party in interest. “Affiliate” is not defined for this purpose.

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11 Section 408(b)(17)(A).
2. Recommendation

We recommend that the Department issue regulations that provide that “affiliate” is, for purposes of the Service Provider Exemption, strictly a person controlling, controlled by or under common control with the fiduciary with respect to the assets involved in the transaction.

3. Explanation

We submit that according the ordinary meaning to the term “affiliate” is consistent with Congressional intent and, at the same time, protective of the interests of plan participants and beneficiaries. It is also consistent with a number of exemptions granted by the Department. As discussed above, the fiduciary limitation focuses on the party in interest’s authority or control with respect to assets involved in a particular “transaction.” The more remote an affiliated relationship is, the less likely it is that the party in interest has any influence over the plan with respect to the transaction.

We recognize that the Department has, in some class exemptions, included in the definition of “affiliate” an officer, director, partner, employee or relative of such person, and a corporation or partnership of which such person is an officer, director or partner. However, applying such an extended definition here would undermine the apparent aim of the Service Provider Exemption to streamline the required due diligence. It could also make the determination as to the exemption’s applicability unnecessarily cumbersome. For example, an individual could be a director of a mere service provider and a director of an otherwise unrelated fiduciary, with the possible result that these relatively remote relationships would thereby call into question the applicability of the Service Provider Exemption.

Should the Department opt to apply a more extensive definition of “affiliate,” we recommend that the term be defined to exclude any relationship described above of which the individuals actually negotiating or effecting the transaction on behalf of the plan or the party in interest have no actual knowledge. It is obvious that an affiliate relationship cannot be unduly brought to bear on a plan fiduciary if no such individual is aware that the relationship exists. The ultimate aim here is to define the term in a way that mitigates the unnecessary adverse effects that remote affiliation could otherwise have on the application of the Service Provider Exemption. This approach would minimize the possibility of there being accidental or incidental relationships unknown to any of the individuals responsible for the transaction that could result in unexpected difficulties in using the Service Provider Exemption, and thereby facilitate the apparent intent of Congress to simplify and facilitate the consummation of transactions with parties that do not have real positions of influence regarding the plan.

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12 See, e.g., PTCE 84-14, at § V(c) & (d), 70 Fed. Reg., at 49,311; PTCE 90-1, (§ IV(b)(2) & (3)), 55 Fed Reg. 2,891, 2,894 (January 29, 1990); PTCE 91-38, at § IV(a)(2) & (3), 56 Fed. Reg., at 31,969; 29 C.F.R. § 2510.3-21(c). But see 29 C.F.R. § 2510.3-101(f)(3) (not doing so).
F. Certain Joint Ventures

1. Summary

The Service Provider Exemption is not available for a transaction with a party in interest unless the party in interest is such only by virtue of being a service provider to the plan or having one of the kinds of relationships with such a service provider, or a party related to the service provider, that are listed in the latter part of section 3(14). Thus, for example, the Service Provider Exemption apparently would not be available for a transaction between a plan and an employer whose employees are covered by the plan. It also would not be available for a transaction with an entity that is a party in interest by virtue of having a relationship with such an employer within the meaning of section 3(14)(H) or (I). These relationships can be quite remote. An example would be the relationship that exists in the case of a 10% owner, partner or joint-venturer of an entity that is 50% owned by the employer (a “JV Ownership Relationship”), because an entity that is 50% owned by the employer is treated as a party in interest under section 3(14)(G), and a 10% owner, partner or joint-venturer of an entity described in section 3(14)(G) is treated as a party in interest by section 3(14)(H) and (I).

2. Recommendation

We recommend that the Department issue Regulations that provide that the Service Provider Exemption is available for a transaction with a party in interest if the party in interest is such only because it is a 10% owner, partner or joint-venturer of an entity that is 50% or more owned by an employer whose employees are covered by the plan.

3. Explanation

As discussed above, the more remote the relationship is between a party in interest and a classic insider, the less likely it is that the party in interest could have any influence over the plan whose assets are involved in the transaction. A person or entity who is a party in interest only by virtue of a JV Ownership Relationship is very unlikely have any influence over the plan, much less any control over the terms of the transaction itself. Further, the more remote the relationship is, the less likely it is that the parties actually negotiating the transaction will even be aware of the relationship.

In the absence of the recommended guidance, many providers and plans may be reluctant to enter into entirely permissible transactions under the Service Provider Exemption. It could also compromise the practical utility of the Service Provider Exemption, as it could impede and add expense to the process whereby parties document and perform due-diligence inquiries regarding remote transactions out of a concern that there may be some coincidental joint-venture relationship, notwithstanding that Congress has shown its intent regarding the Service Provider Exemption to facilitate transactions that have diminished potential for abuse.

In the alternative, we recommend, for the reasons explained above, that the Department issue Regulations that provide that the Service Provider Exemption is available for a transaction with a party in interest where none on the individuals actually negotiating or effecting the transaction on behalf of the plan has actual knowledge of the JV Ownership Relationship.
G. **Effect on Other Exemptions; Scope of the Exemption**

1. **Summary**

   Many of the types of transactions that may be covered by the Service Provider Exemption also could be covered by other statutory or administrative exemptions or other relief, with different requirements. Also, the requirement of “adequate consideration” could suggest to some that the services to which the Service Provider Exemption potentially applies are only simple purchases and sales and other straightforward transactions.

2. **Recommendation**

   We recommend that the Department issue Regulations that provide that the Service Provider Exemption (i) is available regardless of whether other statutory or administrative exemptions or other prohibited transaction relief might also potentially apply and (ii) applies not only to simple purchases and sales and other straightforward transactions, but also to more complex transactions, as long as they satisfy the applicable requirements.

3. **Explanation**

   In general, some in the market have had concerns about proceeding with a generally applicable prohibited-transaction exemption where there is a specific one that might apply. However, there is nothing in the wording of, or legislative history to, PPA ’06 to suggest that Congress intended to limit the scope of the Service Provider Exemption in this way. Such a limitation would seem particularly inappropriate if the other exemption were an administrative exemption created under section 408(a), since that would effectively authorize the Department to impose limitations on the Service Provider Exemption that Congress itself chose not to impose. Indeed, the Department took the position that other exceptions do not render the Service Provider Exemption inapplicable in the preamble to the 2006 class exemption relating to securities lending, recognizing that multiple exemptions (whether statutory or administrative) could potentially apply to the same transaction.\(^\text{13}\) We recommend that Department issue Regulations which contain a general statement to that effect.

   More generally, as the Department’s explanatory comments on the Service Provider Exemption in PTCE 2006-16 suggest, we recommend that the Department confirm that the exemption is potentially applicable not only to simple purchases and sales and other straightforward transactions, but to a broad range of complex transactions as long as they satisfy the applicable requirements.

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\(^{13}\) See PTCE 2006-16, 71 Fed. Reg. 63,786, 63,795 (Oct. 31, 2006) (“The Department notes that to the extent that a transaction involving a loan of securities by a plan meets the requirement of ERISA section 408(b)(17), such transaction does not need to comply with the terms of this class exemption.”).
H. Technical Clarification

1. Summary

The Service Provider Exemption is not available for a transaction with a party in interest unless the party in interest is such “solely by reason of providing services to the plan” (or being related to a person who does). This provision could be read to mean that the exemption is unavailable to any fiduciary, even if the fiduciary does not have or exercise any discretionary authority or control with respect to the investment of the plan assets involved in the transaction or render investment advice with respect to those assets. This result arises because a fiduciary is a party in interest not only by virtue of being a service provider to the plan (or being related to such a service provider) but also by virtue of being a fiduciary.

2. Recommendation

We recommend that a person’s status as a fiduciary with respect to plan assets not involved in a particular transaction would not render the Service Provider Exemption inapplicable in respect of that person if all of the other requirements of the Service Provider Exemption are satisfied.

3. Explanation

Interpreting the Service Provider Exemption as not applying to any transaction with a service provider (or a party related to a service provider) because the service provider (or related party) is also a fiduciary, would run contrary to the statute’s focus on authority or control over the particular assets involved in the transaction. Indeed, such a reading would render the entire clause dealing with fiduciaries meaningless since no fiduciary could possibly meet the initial requirement that it be a party in interest only by virtue of being a service provider to the plan or being related to such a service provider. Therefore, we recommend that the Department clarify that status as a fiduciary does not in and of itself render the Service Provider Exemption inapplicable, as long as all of the other requirements of the exemption are satisfied.

14 Section 408(b)(17)(A).
15 See section 3(14)(A).