

# DOL Proposes Significant Changes to the QPAM Exemption – What You Need to Know

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On July 27, 2022, the U.S. Department of Labor (the “DOL”) issued [notice of a proposed amendment](#) (the “Proposed Amendment”) to Prohibited Transaction Class Exemption 84-14 (which is commonly referred to as the “QPAM Exemption”) that would (as described in more detail below) significantly amend certain of the exemption’s conditions, including:

- increasing the equity/net worth and assets under management thresholds to qualify as a “qualified professional asset manager” (“QPAM”);
- adding a new requirement for a QPAM to notify the DOL if it will be relying on the exemption;
- specifically including foreign criminal convictions in the list of criminal convictions that would make a QPAM ineligible to rely on the exemption;
- adding new types of prohibited misconduct that would make a QPAM ineligible to rely on the exemption;
- requiring upfront terms in the QPAM’s written management agreement that would apply in the event the QPAM became ineligible to rely on the exemption as a result of a specified criminal conviction or participation in prohibited misconduct (including indemnification for certain resulting losses/costs);
- providing for a one-year winding-down period to minimize the impact of a QPAM losing the ability to rely on the exemption as a result of a specified criminal conviction or participation in prohibited misconduct;

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- clarifying the requirement that the terms of the applicable transaction and related negotiations be the sole responsibility of the QPAM; and
  - adding a recordkeeping requirement.

If finalized, the Proposed Amendment would have far-reaching effects on employee benefit plans subject to Title I of ERISA and individual retirement accounts (“IRAs”) subject to Section 4975 of the Code (collectively, “Plans”), and investment funds and separate accounts holding “plan assets” of one or more such Plans (“Plan Asset Entities”). The Proposed Amendment would affect investment managers managing Plan Asset Entities (including eliminating the ability of certain managers to qualify as a QPAM), employers/plan sponsors of Plans, IRA owners and other fiduciaries responsible for engaging or monitoring investment managers, as well as counterparties to Plan Asset Entities seeking to rely on the QPAM Exemption.

## **Background**

The prohibited transaction rules under Section 406(a)(1)(A)-(D) of ERISA prohibit, among other things, sales, leases, loans and the provision of services between Plans and certain parties related to those Plans referred to as “parties in interest.”<sup>[1]</sup> In light of how broadly the term “party in interest” is defined, some Plans could have hundreds or thousands of “parties in interest,” which often results in the practical assumption that every counterparty is a prohibited “party in interest” and every transaction requires an exemption from the prohibited transaction rules. The alternative would require potentially extremely costly and burdensome (as well as potentially inaccurate) “party in interest” diligence for every transaction involving a Plan (which would be even more difficult for a Plan Asset Entity holding “plan assets” of many Plans).

Thankfully, the QPAM Exemption provides broad exemptive relief from those prohibited transaction restrictions for transactions between a “party in interest” with respect to a Plan and a Plan Asset Entity holding “plan assets” of such a Plan, where the Plan Asset Entity is managed by a QPAM and the other Plan protective conditions of the QPAM Exemption are met. If the QPAM Exemption is available, it minimizes the need to perform any such “party in interest” diligence and often provides comfort to the parties to the transaction that a “party in interest” prohibited transaction will not occur. Accordingly, it is quite common for Plan fiduciaries, investment managers and counterparties to seek or require compliance with the QPAM Exemption whenever available (even where it might not be necessary because, for example, another exemption is available or an exemption might not be required because the transaction is not likely to otherwise be prohibited).

In order to qualify as a QPAM with respect to a Plan, the relevant entity must be either a bank, a savings and loan association, an insurance company, or a registered investment adviser that meets certain financial requirements and acknowledges in writing that it is a fiduciary to the Plan. However, one of the Plan protective conditions of the exemption (which is particularly relevant to the Proposed Amendment) provides that a QPAM would become ineligible to rely on the exemption for a period of 10 years if the QPAM, or various affiliates or five percent or more owners of the QPAM, are convicted of certain crimes.

## **The Proposed Amendment**

In light of significant changes in the financial services industry since the exemption was originally drafted in 1984, the DOL is now seeking (in its view) to modernize the QPAM Exemption

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accordingly. Below is a high-level summary of the material aspects of the DOL's proposed changes.

The DOL is accepting comments on the Proposed Amendment through September 26, 2022. The Proposed Amendment provides that, if finalized, it would become effective 60 days after the date of publication of the final amendment in the Federal Register. The Proposed Amendment does not provide for any grandfathering of existing QPAMs or QPAM management agreements. Accordingly, if the Proposed Amendment is finalized in its current form, existing QPAM management agreements would need to be amended in order to comply with the revised conditions of the exemption.

### ***Increase of equity/net worth and assets under management thresholds to qualify as a QPAM***

The Proposed Amendment would increase the financial thresholds necessary for an entity to qualify as a QPAM, to reflect prior inflation (and provides that the DOL would also publish future annual inflation adjustments) as follows:

- The equity capital or net worth threshold (as applicable) for a bank, a savings and loan association and an insurance company would increase from \$1,000,000 to \$2,720,000;
- The current assets under management threshold for a registered investment adviser would increase from \$85,000,000 to \$135,870,000; and
- The shareholders' or partners' equity threshold for a registered investment adviser would increase from \$1,000,000 to \$2,040,000.

### ***Requirement for a QPAM to notify the DOL if it will be relying on the exemption***

The Proposed Amendment would add a new requirement that a QPAM must notify the DOL by email that it is relying on the QPAM Exemption.

- A QPAM must report the legal name of each business entity relying on the exemption and any name under which the QPAM may be operating.
- The notice will only need to be provided once, unless the QPAM changes its legal or operating name, or the QPAM is no longer relying on the exemption.
- The DOL will publish on its website a list of QPAMs who have provided such notification to the DOL.

### ***Specific inclusion of foreign criminal convictions in the list of criminal convictions that would make a QPAM ineligible to rely on the exemption***

As noted above, a QPAM would become ineligible to rely on the QPAM Exemption for a period of 10 years if the QPAM, or various affiliates or five percent or more owners of the QPAM, are convicted of certain crimes (a "Criminal Conviction"). Although there has been some uncertainty as to whether foreign criminal convictions were included, the Proposed Amendment would remove any such ambiguity and provide that foreign criminal convictions, in addition to domestic criminal convictions, would make a QPAM ineligible to rely on the exemption. Such foreign criminal convictions would include convictions "by a foreign court of competent jurisdiction for any crime ... however

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denominated by the laws of the relevant foreign government, that is substantially equivalent to” one of the enumerated U.S. federal or state crimes identified in the exemption.

***Addition of new types of prohibited misconduct that would make a QPAM ineligible to rely on the exemption***

The Proposed Amendment would add a new category of misconduct that may lead to ineligibility to rely on the QPAM Exemption for 10 years, referred to as “participating in Prohibited Misconduct.”

- “Prohibited Misconduct” would be defined as: (i) any conduct that forms the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a Criminal Conviction; (ii) any conduct that forms the basis for an agreement, however denominated by the laws of the relevant foreign government, that is substantially equivalent to a non-prosecution agreement or deferred prosecution agreement described above; (iii) engaging in a systematic pattern or practice of violating the conditions of the exemption; (iv) intentionally violating the conditions of the exemption; or (v) providing materially misleading information to the DOL in connection with the conditions of the exemption. Prohibited Misconduct described in clauses (iii) through (v) above would be determined through “an investigation by the appropriate field office” of the DOL.
- “Participating in” such misconduct includes not only active participation but also knowingly approving of the conduct or having knowledge of such conduct without taking appropriate and proactive steps to prevent such conduct from occurring, including reporting the conduct to appropriate compliance personnel.
- When a QPAM’s ineligibility is linked to participating in Prohibited Misconduct, the DOL will provide the QPAM with a written warning and an opportunity to be heard. If the QPAM does not respond to the warning or fails to convince the DOL otherwise, the DOL will issue a “Written Ineligibility Notice” to the QPAM.

***Requirement to include new upfront terms in the QPAM’s written management agreement***

The Proposed Amendment would require a QPAM to include certain standards of integrity, considered by the DOL to be a fundamental requirement of a QPAM, in the QPAM’s written management agreement with its client Plans.

- Specifically, the Proposed Amendment would require the QPAM’s written management agreement to provide that in the event the QPAM, or an its affiliate or a five percent or more owner of the QPAM, (i) engages in conduct resulting in a Criminal Conviction or (ii) receives a Written Ineligibility Notice from the DOL, the QPAM would not restrict its client Plan’s ability to terminate its arrangement with the QPAM or withdraw from the applicable Plan Asset Entity managed by the QPAM for at least a period of 10 years.
- The QPAM would be prohibited from imposing any fees, penalties, or charges on the client Plan in connection with such termination or withdrawal (except for reasonable fees, appropriately disclosed in advance, that are specifically designed to prevent generally recognized abusive investment practices or to ensure equitable treatment of all investors in a pooled fund in the event such withdrawal or termination may have adverse consequences for all other investors, provided any such fees are applied consistently and in a like manner to all

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such investors).

- The QPAM's written management agreement would be required to include a provision requiring the QPAM to indemnify, hold harmless, and promptly restore actual losses to each client Plan for any damages directly resulting from a violation of applicable laws, a breach of contract, or any claim arising out of the QPAM's ineligibility to rely on the exemption as a result of a Criminal Conviction or receipt of a Written Ineligibility Notice. Actual losses include losses and costs arising from unwinding transactions with third parties and from transitioning Plan assets to an alternative asset manager as well as costs associated with any exposure to excise taxes under Section 4975 of the Code.
- The QPAM would also be required to contractually agree not to employ or knowingly engage any individual that participated in the conduct that is the subject of a Criminal Conviction or Written Ineligibility Notice.

***One-year winding-down period to minimize the impact of a QPAM losing the ability to rely on the exemption as a result of a Criminal Conviction or receipt of a Written Ineligibility Notice***

Any QPAM that becomes ineligible to rely on the exemption as a result of a Criminal Conviction or receipt of a Written Ineligibility Notice must engage in a winding-down period, which is only available to existing Plan clients. During such one-year period, the QPAM must fully comply with the conditions of the exemption, it must ensure that it manages each Plan's assets prudently and loyally, and it must comply with the following additional conditions:

- Within 30 days, the QPAM must provide notice to the DOL and each of its client Plans stating: (i) its failure to satisfy such condition of the exemption and the resulting initiation of the one-year winding-down period; (ii) that it will not restrict the ability of its client Plans to terminate or withdraw from its arrangement with the QPAM nor impose fees, penalties, or charges on the client Plan in connection with such terminating or withdrawal; and agrees to indemnify, hold harmless, and promptly restore losses to the client Plan resulting therefrom; and (iii) an objective description of the facts and circumstances upon which the Criminal Conviction or Written Ineligibility Notice is based, written with sufficient detail to fully inform the client Plan's fiduciary of the nature and severity of the conduct so that such fiduciary can satisfy its fiduciary duties of prudence and loyalty with respect to hiring, monitoring, evaluating, and retaining the QPAM in a non-QPAM capacity;
- No later than the date it becomes ineligible to rely on the exemption, the QPAM must not employ or knowingly engage any individual that participated in the conduct that was the subject of the Criminal Conviction or Written Ineligibility Notice;
- The QPAM may not engage in new transactions in reliance on the exemption for existing client Plans; and
- After the one-year winding-down period expires, the QPAM may not rely on the exemption until the expiration of the 10-year ineligibility period unless it obtains an individual exemption from the DOL permitting it to do so. The Proposed Amendment would also add new requirements with respect to any application for such an individual exemption.

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***Clarification of the requirement that the terms of the applicable transaction and related negotiations be the sole responsibility of the QPAM***

The Proposed Amendment would clarify that a QPAM must not permit other “parties in interest” to make decisions regarding Plan investments under the QPAM’s control, and that the QPAM must have sole responsibility over the terms of transactions, commitments, investment of Plan assets, and any associated negotiations.

- A “party in interest” should not be involved in any aspect of a transaction, aside from certain ministerial duties and oversight associated with Plan transactions, such as providing general investment guidelines to the QPAM. Under the Proposed Amendment, there would be no relief under the exemption for any transaction that has been planned, negotiated or initiated in whole or in part by a “party in interest” to the Plan and presented to the QPAM for approval.
- The Proposed Amendment would also provide that the exemption would apply only in connection with a Plan Asset Entity that is “established primarily for investment purposes” and that no relief would be available for any transaction that is 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 such a transaction and the role of the QPAM is not to act as a mere independent approver of a transaction.

***Addition of a recordkeeping requirement***

The Proposed Amendment would requires a QPAM to maintain records for six years demonstrating compliance with the exemption.

- The records must be maintained in a manner that is reasonably accessible at a QPAM’s customary business location during normal business hours for examination by the DOL, the IRS, other federal or state regulators, any Plan fiduciary, any contributing employer or employee organization whose members are covered by the Plan, and any Plan participant or beneficiary.
- However, such parties are only permitted to access records relevant to their transactions, and the QPAM does not need to provide access to privileged trade secrets or privileged commercial or financial information of the QPAM.

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As noted above, if finalized in its current form, the Proposed Amendment would significantly impact investment managers acting or seeking to act as QPAMs, Plan fiduciaries responsible for engaging or monitoring QPAMs and counterparties relying or seeking to rely on the QPAM Exemption.

For ERISA Plan fiduciaries, it is also important to recognize that ERISA’s fiduciary duties of prudence and loyalty apply in the context of hiring, monitoring and retaining/firing an investment manager regardless of whether the investment manager qualifies as a QPAM or may utilize the QPAM Exemption.

**FOOTNOTES**

[1] Similar rules exist under Code Section 4975(c)(1)(A)-(D)) with respect to “disqualified persons.” For purposes of this discussion, any references to the prohibited transaction rules under Section 406 of ERISA and “parties in interest” apply equally to the prohibited transaction rules under Section 4975 of the Code and “disqualified persons.”

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