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QPAM Exemption Amendment—Key Takeaways and Action Steps for Advisors and Other Stakeholders

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EXECUTIVE SUMMARY

Many investment advisers and other financial institutions rely on the Department of Labor's QPAM Exemption when providing services to, and transacting with, employer-sponsored retirement plans, individual retirement accounts, and certain commingled investment vehicles that have retirement investors. The Department of Labor's amendment to the QPAM Exemption makes material changes to the exemption's conditions effective 3 June 2024. Investment advisers and other stakeholders, including plan sponsors, should analyze the amendment's implications for their businesses and operations and make necessary adjustments prior to the effective date.

On 3 April 2024, the Department of Labor (DOL) adopted a significant amendment (the Amendment) to Prohibited Transaction Exemption 84-14 (referred to as the QPAM Exemption), one of the broadest and most commonly relied on exemptions in the financial services industry, to address the prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA) and Section 4975 of the Internal Revenue Code of 1986, as amended (Code). Without an exemption, most transactions—including purchases, sales, leases, and loans—between an employer-sponsored retirement plan, an individual retirement account, and certain commingled investment vehicles with people or entities closely connected to such parties, including plan service providers, are prohibited.[1] Since many plans deal with an extensive and everchanging array of prohibited counterparties, many stakeholders, including investment managers, routinely rely on the QPAM Exemption rather than attempting to identify, track, and avoid transactions with such counterparties.

For decades, the QPAM Exemption has permitted investment advisers and other financial institutions to engage in a wide range of transactions on behalf of their clients by meeting certain protective conditions. The Amendment changes several of those conditions and adds a handful of new

conditions. As a result, parties relying on the QPAM Exemption will need to take affirmative steps to continue to rely on the exemption, and some parties, such as some smaller investment managers and investment managers that have (or whose affiliates or owners have) engaged in certain wrongdoing may no longer be able to rely on the QPAM Exemption.

The Amendment revises the QPAM Exemption's conditions to:

1. Require a one-time notice to DOL via email that an eligible institution is relying upon the exemption. If an entity's name changes, or if the QPAM wishes to end its reliance on the exemption, it will need to update its notice within 90 days.
2. Substantially raise the amount of assets under management (AUM) and equity thresholds a QPAM must meet in order to qualify as a QPAM, which will continue to increase over a seven-year period.[2]
3. Clarify that a QPAM must act independently with respect to investment decisions and retain sole authority with respect to planning, negotiating, and initiating the transactions covered by the QPAM Exemption.[3]
4. Explicitly include convictions for foreign crimes that are substantially equivalent to certain serious domestic crimes in the list of crimes that cause ineligibility to be a QPAM, unless the conviction or imprisonment occurs in a country that is listed as a "foreign adversary" by the US Department of Commerce.
5. Expand "prohibited misconduct" that causes ineligibility for the exemption to include (a) any conduct that forms the basis for a domestic non-prosecution agreement or deferred prosecution agreement that, if successfully prosecuted, would have constituted a covered crime, not just a conviction; (b) intentionally engaging in conduct that violates, or engaging in a systematic pattern or practice of conduct that violates, the conditions of the QPAM Exemption in connection with otherwise nonexempt prohibited transactions; or (c) providing materially misleading information to DOL or other regulatory authority in connection with the conditions of the QPAM Exemption. Participating in prohibited misconduct would capture anyone not only actively participating, but also knowing approval of the conduct or knowledge of the conduct without taking active steps to prohibit the conduct, such as reporting the conduct to appropriate compliance personnel.
6. Require that a QPAM who becomes ineligible due to a conviction or prohibited misconduct must agree in writing with its plan clients that during the transition period the QPAM (a) will not restrict its plan clients' ability to terminate or withdraw from its arrangement with the QPAM; and (b) will provide indemnification and restoration of losses incurred by its plan clients resulting from a violation of applicable laws, a breach of contract, or any claim arising out of the failure of the QPAM to remain eligible for relief under the QPAM Exemption.
7. Provide a one-year winding-down period to help plans avoid or minimize possible negative impacts of terminating or switching QPAMs or adjusting asset management arrangements when a QPAM becomes ineligible.
8. Provide guidance on the process to follow when requesting an individual exemption for a manager that has become ineligible or anticipates becoming ineligible to be a QPAM.[4]
9. Add a requirement to retain records necessary to demonstrate that the QPAM exemption has been met for six years.

KEY TAKEAWAYS

- Advisers, particularly those with global operations or foreign affiliates, should carefully consider the expanded ineligibility criteria to ensure the adviser can continue to rely on the QPAM Exemption.

- Advisers that engage in merger and acquisition (M&A) activity (or have affiliates that engage in M&A activity) should carefully consider the expanded ineligibility criteria before engaging in transactions.
- The Amendment will make the QPAM Exemption more difficult to rely upon, and, as a result, fewer asset managers may be able to qualify as QPAMs. For example:
  - The increased AUM and equity thresholds may make the QPAM Exemption unavailable to some smaller or start-up advisers.
  - Larger asset managers that are part of complex international organizations may also find it more difficult to rely on this exemption based on the expanded definition of prohibited conduct and its inclusion of non-US convictions.
- A one-time notice to DOL may not be a difficult condition, but overlooking this condition or failing to update the notice in a timely manner when an entity changes its name could result in the QPAM Exemption not being available.
- The notice requirement effectively eliminates the ability of advisers to rely on the QPAM exemption retroactively,[5] such as in a circumstance where an adviser realizes it has been managing plan assets in a commingled investment vehicle unintentionally (e.g., through an error in calculating the "25 percent test"[6]).
- In order to continue managing plan assets, some impacted managers may need to determine whether other applicable prohibited transaction exemptions are available, such as the "service provider" exemption under Section 408(b)(17) of ERISA.[7]

ACTION STEPS FOR ADVISERS

Action Step #1

Determine whether your firm relies on the QPAM exemption.

- Managers may need to review client agreements and trading agreements to confirm whether the firm represents to clients or counterparties that the firm relies on the QPAM Exemption or the firm is a QPAM.
- If your firm does not currently rely on the QPAM Exemption, but may do so in the future, ensure the firm has policies and procedures in place to confirm the firm meets the exemption's conditions (Action Step #2 below) and notify the DOL (Action Step #3 below) prior to (or in any event, within 90 days of) relying on the exemption. This situation could arise in various contexts, including managers of private commingled investment funds that reserve the right to allow ERISA and similar investors to exceed the threshold to become a "plan asset" entity.

Action Step #2

If your firm relies on the QPAM exemption.

- Confirm the firm meets the exemption's new and revised conditions.
- Update ERISA compliance policies and procedures to reflect the exemption's new and revised conditions.
- If your firm or an affiliate of your firm engages in M&A activity, ensure your corporate colleagues are aware of the expansion of the QPAM Exemption's ineligibility condition. Your firm may want to add questions regarding this matter to its due diligence process.

Action Step #3

No later than 15 September 2024, submit a notice email to the DOL setting forth the legal and operating names of the QPAM. Your firm may want to provide the notice by 17 June 2024 (the effective date of the Amendment) to avoid questions from clients, prospective clients, and consultants regarding the firm's status as a QPAM.

Plan sponsors and their advisers regarding investment managers, such as consultants and outsourced chief investment officers, should consider what steps they may want to take to ensure any investment managers that act as QPAMs will continue to do so once the Amendment is effective. Changes to policies and procedures regarding investment manager selection and oversight may be prudent. For example, firms may want to confirm that any advisers that indicate that they are relying on the QPAM Exemption are on the list of entities relying on the QPAM Exemption on the DOL's website. Firms may also want to send representation letters to advisers to confirm that they continue to comply with the QPAM Exemption's conditions, as amended.

FOOTNOTES

[1] ERISA prohibits transactions with "parties in interest" as defined in Section 3(14) of ERISA. The Code includes parallel prohibited transaction rules applicable to "disqualified persons" as defined in Section 4975(e)(2) of the Code. All references herein to a "party in interest" include a "disqualified person."

[2] Currently, any US based asset manager that meets the AUM threshold required to register as an investment adviser with the Securities and Exchange Commission (SEC) meets the AUM threshold for the QPAM Exemption; this will no longer be the case. For SEC-registered advisers, the AUM and equity thresholds will increase as follows: for the fiscal year ending no later than 31 December 2024, the AUM threshold is US$101,956,000, and the equity threshold is US$1,346,000; for the fiscal year ending no later than 31 December 2027, the AUM threshold is US$118,912,000, and the equity threshold is US$1,694,000; for the fiscal year ending no later than 31 December 2030, the AUM threshold is US$135,868,000, and the equity threshold is US$2,040,000.

[3] Questions have been posed regarding whether the "sole authority" language could be interpreted to restrict the use of subadvisers by a QPAM. In particular, in the context of collective investment trusts (CITs), due to certain standards imposed by applicable banking regulations and federal securities laws, neither the sponsoring trust company nor a subadviser appointed by the trust company has "sole" authority over the CIT's assets. DOL cautioned in the adopting release for the QPAM Exemption that parties that participate in arrangements that do not clearly identify the party that has the ultimate responsibility and authority to engage in a particular transaction should not assume that the transaction is permitted by the QPAM Exemption and recommended that affected parties involved in such transactions seek an advisory opinion or request other guidance from the DOL regarding whether the QPAM Exemption is available for such transactions. Sponsors of CITs or their sub-advisers may look to determine whether other applicable prohibited transaction exemptions are available, such as PTE 91-38.

[4] It is common for a manager that has become ineligible to be a QPAM after an affiliate has been convicted of a crime to apply to DOL for an individual exemption in order to allow the manager to continue entering into otherwise prohibited transactions on behalf of plans. These individual exemptions used to be routinely granted, but DOL has increased scrutiny over these situations in recent years.

[5] “Retroactive” reliance may still be possible in limited circumstances if an adviser is still within the initial 90-day period to report or the additional 90-day period to cure inadvertent failures to report.

[6] A private fund can avoid its assets being deemed to be plan assets if equity participation by “benefit plan investors” (i.e., plans subject to ERISA or the Code, or other entities deemed to hold plan assets) is less than 25% of the value of any class of entity interests in the fund.

[7] While the service provider exemption in Section 408(b)(17) is similar in breadth to the QPAM Exemption, some advisers have resisted relying on it, particularly for more complex transactions, because of uncertainty with respect to its conditions and the absence of any clarifying regulations from DOL. These uncertainties include (1) what is meant when the exemption refers to “securities,” and (2) the meaning of “adequate consideration” when there is no generally recognized market.

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