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DOL Unveils Final Amendment to QPAM Exemption

Employee Benefits & Executive Compensation on **April 17, 2024**

On April 3, 2024, the U.S. Department of Labor (the "DOL") published in the federal register a final amendment to Prohibited Transaction Class Exemption 84-14 (the "QPAM Exemption") that makes considerable changes to the exemption's conditions (the "Final Amendment"). Although the Final Amendment trims back some of the more onerous requirements floated in the proposed amendment issued by the DOL in July 2022 (which we blogged about here) (the "Proposal"), the Final Amendment includes significant changes that will impact the QPAM Exemption 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, and the DOL will publish a list of QPAMs on its website;
- Specifically including foreign criminal convictions in the list of criminal convictions that will make a QPAM ineligible to rely on the exemption;
- Adding new types of "prohibited misconduct" that will make a QPAM ineligible to rely on the exemption;
- Providing for a one-year transition period following a QPAM's criminal conviction or prohibited misconduct to minimize the impact of the QPAM losing the ability to rely on the exemption;
- 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.

Despite the adjustments from the Proposal, the Final Amendment, which is effective June 17, 2024, will still 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 Final Amendment significantly impacts 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.

How Did We Get Here?

The prohibited transaction rules under ERISA (and the mirror provisions under Section 4975 of the Code) 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" (or "disqualified persons" under Section 4975 of the Code). In light of the broad definition of "party in interest," many assume for purposes of practicality that every counterparty in a transaction involving a Plan is a prohibited "party in interest" and, therefore, that every transaction involving a Plan requires an exemption from the prohibited transaction rules.

Enter the QPAM Exemption, which 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.

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 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 Final Amendment

Below is a high-level summary of the changes to the QPAM Exemption in the Final Amendment.

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

The Final Amendment increases the financial thresholds necessary for an entity to qualify as a QPAM. In a change from the Proposal, the Final Amendment implements these threshold increases in three-year increments beginning in the year 2024 and ending in 2030 (rather than immediately as per the Proposal). The increases are described below:

- 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:
  - As of December 31, 2024: $1,570,300
  - As of December 31, 2027: $2,140,600
  - As of December 31, 2030: $2,720,000

- The current assets under management threshold for a registered investment adviser would increase from $85,000,000 to:
  - As of December 31, 2024: $101,956,000
  - As of December 31, 2027: $118,912,000
  - As of December 31, 2030: $135,868,000

- The shareholders' or partners' equity threshold for a registered investment adviser would increase from $1,000,000 to:
  - As of December 31, 2024: $1,346,000
  - As of December 31, 2027: $1,694,000
  - As of December 31, 2030: $2,040,000

The increases go into effect as of the last day of the QPAM's fiscal year ending no later than the applicable date set forth above. Thereafter, the threshold amounts will be subject to future annual inflation adjustments, which the DOL will publish no later than January 31st each year (to take effect as of the last day of the QPAM's fiscal year ending no later than December 31st of such year).

Requirement to notify DOL that QPAM will be relying on the exemption

The Final Amendment requires a QPAM to notify the DOL by email at *QPAM@dol.gov* that it is relying on the QPAM Exemption as follows:

- 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 need only be provided once, unless the QPAM changes its legal or operating name.
- The notice must be provided within 90 days of the QPAM's reliance on the exemption or a change to its legal or operating name.
- The DOL will publish on its website a list of QPAMs who have provided such notification to the DOL.
- If a QPAM is no longer relying on the exemption, it can notify the DOL and have its name removed from the list of QPAMs on the DOL's website.

ACTION ITEM TO NOTE FOR INVESTMENT MANAGERS: Investment managers that are relying on the QPAM Exemption as of June 17, 2024, will need to submit the required notice to the DOL within 90 days thereafter.

The DOL also included a 90-day cure period for inadvertent failures to notify the DOL during the 90-day reporting period described above. In order to "cure" the failure, the QPAM must provide an explanation to the DOL of why it failed to provide the notice during the 90-day reporting period. Additionally, the DOL confirmed in the regulatory preamble that "isolated" instances of failing to report generally would not result in QPAM ineligibility.

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

The Final Amendment generally follows the Proposal in providing that a QPAM will 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—including foreign criminal convictions. However, to address comments that criminal convictions may occur in foreign nations with the intent to harm U.S.-based investment managers, the Final Amendment excludes convictions and imprisonments that occur within a foreign country that is included in the U.S. Department of Commerce's list of foreign adversaries (which currently include China, Cuba, Iran, North Korea, and the Maduro Regime of Venezuela).

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

The Final Amendment includes a new category of misconduct that will lead to a QPAM's ineligibility to rely on the QPAM Exemption for 10 years (similar to covered criminal convictions), referred to as "participating in prohibited misconduct," which is triggered if the QPAM, its affiliate, or a 5 percent or more owner:

- Enters into a non-prosecution agreement ("NPA") or deferred prosecution agreement ("DPA") with a federal or state prosecutor where the factual allegations that form the basis of the NPA or DPA would have constituted a covered criminal conviction if they were successfully prosecuted; or
- Is found or determined in a final judgment or court-approved settlement in a proceeding brought by certain federal or state regulators that it:
    - Engaged in a systematic pattern or practice of violating the conditions of the exemption;
    - Intentionally violated the conditions of the exemption; or
    - Provided materially misleading information to a federal or state regulator in connection with the conditions of the exemption.

"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.

The Final Amendment made a number of changes from the prohibited misconduct provisions contained in the Proposal, including:

- ***Prohibited misconduct determined in final judgment or court-approved settlement***: The Proposal had provided that a QPAM would become ineligible as a result of prohibited misconduct as determined through "an investigation by the appropriate field office" of the DOL. In response to comments that this procedure did not afford sufficient due process to QPAMs, the Final Amendment instead provides that a QPAM will become ineligible on account of participating in prohibited misconduct only if the factual basis for determining that such prohibited misconduct occurred is set forth in a final judgment or court-approved settlement brought by certain federal or state regulators (although the court need not specifically consider the exemption so long as the facts set forth in the judgment or settlement confirm that such misconduct occurred).

- ***Removal of foreign equivalent NPAs or DPAs from definition of "prohibited misconduct"***: Acknowledging the limited information that the DOL has about the use of NPAs or DPAs outside the United States, the DOL removed foreign equivalent NPAs and DPAs as prohibited misconduct that would trigger QPAM ineligibility. However, entering into a foreign NPA or DPA will trigger a notice to the DOL, as explained below.
- ***New DOL notice requirement upon entering into foreign equivalent NPA or DPA***: If a QPAM, its affiliate, or any owner of a five percent or more interest in the QPAM enter into a foreign equivalent of an NPA or DPA, the QPAM is required to notify the DOL by email within 30 calendar days following execution of the foreign equivalent NPA or DPA.

Final Amendment eliminates requirement to include upfront terms in all written management agreements

The Proposal would have required QPAMs to include upfront terms in all written management agreements generally providing for penalty-free withdrawal and indemnification provisions upon a QPAM becoming ineligible for the QPAM Exemption as a result of a criminal conviction or prohibited misconduct, which would have required an amendment to all existing QPAM management agreements. However, the Final Amendment does not include this requirement. Instead, as discussed in further detail below, such requirements will apply only during the one-year transition period to the extent the QPAM desires to be able to rely on the exemption during the transition period.

One-year transition period to minimize the impact of a QPAM losing the ability to rely on the exemption

Any QPAM that becomes ineligible to rely on the exemption on account of a criminal conviction or participating in prohibited misconduct must provide a one-year "transition period" for then-existing Plan clients to the extent the QPAM desires to be able to rely on the exemption during the transition period. During such one-year transition 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 of the "ineligibility date" (discussed below), the QPAM must provide notice to the DOL and each of its client Plans stating:

- Its failure to satisfy such condition of the exemption and the resultinginitiation of the one-year transition period;
- That during the transition period the QPAM:
  - Will not restrict the client Plan's ability to terminate or withdraw from its arrangement with the QPAM;
  - Will not impose fees, penalties, or charges on the client Plan in connection with such termination or withdrawal (other than certain reasonable fees disclosed in advance that are designed to prevent abusive investment practices or to ensure equitable treatment of pooled fund investors);
  - Will indemnify, hold harmless, and promptly restore actual losses to the client Plan resulting therefrom (including the costs of unwinding transactions and transitioning to a new manager); and
  - Will not employ or knowingly engage any individual that participated in the conduct that was the subject of the criminal conviction or the prohibited misconduct; and
- An objective description of the facts and circumstances upon which the criminal conviction or prohibited misconduct 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.

- As of the ineligibility date, the QPAM must not employ or knowingly engage any individual that participated in the conduct that was the subject of the criminal conviction or the prohibited misconduct.

In a change from the Proposal, the Final Amendment permits a QPAM to utilize the exemption for new transactions on behalf of existing client Plans during the one-year transition period. However, the exemption will not be available for new clients Plans during the transition period, and after the transition 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 Final Amendment clarifies that for purposes of determining the date on which the 10-year ineligibility period starts, the "ineligibility date" is as follows: (1) for a criminal conviction, the date on which the trial court enters its judgment; and (2) for participation in prohibited misconduct, the date on which the NPA or DPA is executed, or the date of the final judgment in federal or state court or the court-approved settlement, as applicable.

The Final Amendment further provides that if a QPAM becomes ineligible (or anticipates that it will become ineligible) due to a criminal conviction or prohibited misconduct, the QPAM may apply for an individual exemption from the DOL to continue to rely on the relief provided under the QPAM Exemption beyond the one-year transition period. In the preamble, the DOL cautioned that, in such circumstances, QPAMs should apply for an individual exemption as soon as possible in order to be in the best position to obtain exemptive relief prior to the expiration of the transition period.

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

The Final Amendment provides that the terms of the applicable transaction, whether to enter into the transaction, and any associated negotiations must be determined by the QPAM (or under its authority and direction), and the transaction must not be designed to benefit a party in interest. In this regard, the transaction must be based on the QPAM's own independent exercise of fiduciary judgment and free from any bias in favor of the Plan sponsor or other parties in interest (in other words, it cannot be appointed to uncritically approve a transaction negotiated, proposed or approved by the Plan sponsor or another party in interest). Further, the exemption will not be available for any transaction that has been planned, negotiated or initiated in whole or in part by a party in interest and presented to a QPAM for approval to the extent the QPAM would not have the requisite sole responsibility over the transaction.

Addition of a recordkeeping requirement

The Final Amendment requires a QPAM to maintain records for six years demonstrating compliance with the exemption. In the preamble, the DOL noted that the extent to which transaction-by-transaction records are necessary depends on the facts and circumstances, and that this recordkeeping condition is focused on requiring the QPAM to retain records satisfactory to prove compliance with the applicable conditions for any section of the exemption the QPAM relied upon, such as satisfying the definition of QPAM and limiting the involvement of parties in interest in investment transactions. 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 Internal Revenue Service, 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 Plan-related 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, the Final Amendment will 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.

In addition, for fiduciaries of ERISA-covered Plans, it is 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.

As always, we are available to answer any questions you may have with respect to the Final Amendment or otherwise regarding compliance with the QPAM Exemption or any other prohibited transaction exemptions.

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