STRADLEY RONON

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U.S. Department of Labor Proposes Substantial Amendments to QPAM Exemption

Introduction

On July 27, 2022, the U.S. Department of Labor's Employee Benefits Security Administration proposed significant amendments to the Prohibited Transaction Class Exemption 84-14 for qualified professional asset managers, also known as the "QPAM Exemption."

The proposed amendments (the Proposal) are summarized below. Comments are due to the DOL by Sept. 26, 2022.

Background

The prohibited transaction rules of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) generally prohibit most transactions between an ERISA plan and a "party in interest."1 Prohibited transaction exemptions allow for an ERISA plan to engage in otherwise prohibited transactions.

The QPAM Exemption provides broad relief from the prohibited transaction rules. Where a QPAM complies with the terms and conditions of the Exemption, the QPAM is permitted to transact on behalf of a plan or IRA without having to verify whether a counterparty is a party in interest. Because of the broad relief that the Exemption provides, it has become common practice for managers to make representations regarding their QPAM status in agreements with clients and service providers.

Summary of the Proposed Amendments

The proposed amendments would:

1. **Require that a QPAM Notify DOL of Their Reliance on the Exemption**
   The Proposal would require a QPAM to notify the DOL, by email, of the legal name of each business entity relying upon the Exemption and any name the QPAM may be operating under. QPAMs would be required to update the notification if there are any changes in the information.

2. **Limit the Scope of Transactions for Which the Exemption is Available**
   The proposed amendments state that the Exemption would provide relief only in connection with an account managed by the QPAM that is established primarily for investment purposes. The DOL explains in the preamble that the Exemption is unavailable in connection with non-investment transactions, such as, for example, hiring a party in interest to provide services to a plan.

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In addition, the Exemption would not provide relief 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." Currently, there is no such limitation in the Exemption.

3. Expand Disqualifying Conduct to Include Foreign Crimes and "Participating in Prohibited Misconduct"

Foreign Crimes

The Proposal would make explicitly clear that a QPAM would be disqualified from relying on the Exemption if the QPAM or any affiliate was convicted in a foreign jurisdiction of crimes that are substantially equivalent to the U.S. federal or state crimes enumerated in the Exemption.

"Prohibited Misconduct"

The Proposal would add a new category of misconduct that would disqualify a QPAM from relying on the Exemption. "Participating in Prohibited Misconduct" would include: any conduct that forms the basis for a non-prosecution or deferred prosecution agreement that – if successfully prosecuted – would have led to a disqualifying conviction of any of the crimes enumerated in the Exemption (and any foreign equivalents); engaging in a systemic pattern of practice of violating the conditions of the Exemption; intentionally violating the conditions of the Exemption; and the provision of materially misleading statements to the DOL in connection with the Exemption.

The Proposal also sets forth an administrative procedure by which the DOL would be able to disqualify a QPAM that participated in Prohibited Misconduct. The DOL would first issue a warning and then provide the QPAM an opportunity to be heard, subject to certain timelines.

4. Required Contractual Terms – Hold Harmless and Indemnification of Plan Clients in Connection With Disqualification

The amendments would also require that a QPAM state, in writing, to plan clients that, if the QPAM is disqualified from relying on the Exemption (and for ten years thereafter), the QPAM:

- agrees not to restrict the ability of a plan client to terminate or withdraw from its arrangement with the QPAM
- will not impose fees, charges, or penalties on plan clients in connection with the plan client's decision to terminate the QPAM
- agrees to indemnify, hold harmless and promptly restore actual losses to each plan client for certain damages arising out of the failure of the QPAM to remain eligible for relief under the QPAM Exemption
- will not employ or knowingly engage any individual that participated in the disqualifying conduct

5. Require a One-Year Wind-Down Period

The Proposal would require that a disqualified QPAM be subject to a mandatory one-year wind-down period. This is intended to provide existing plan clients with time to decide whether to terminate the QPAM and to transition plan assets from the QPAM to another manager, if necessary.

The wind-down period would not provide relief for any new transactions or for transactions with respect to new plan clients of the QPAM. Within 30 days of its disqualification, the QPAM would be required to provide a notice of its disqualification to its plan clients and to the DOL stating that the QPAM has failed to comply with the Exemption, the start of the one-year winding-down period, the clear and objective description of the facts underlying the disqualifying conduct, and the Exemption's required contractual terms (as summarized in 4 above).

6. Individual Exemption Process

The Proposal provides that a QPAM who becomes disqualified or anticipates becoming disqualified may apply for an individual exemption. This provision explains that the QPAM should anticipate the same conditions as provided in the most recently granted individual exemptions involving similar relief. To the extent that a QPAM requests any deviations therefrom, it must explain in detail why such variation is necessary and in the interest and protection of the affected plans, plan participants and beneficiaries and/or IRA owners. The application would also be required to quantify the specific cost or harms, if any, that the client plans would suffer if the firm could not rely on the Exemption after the winding-down period.

7. Require that Records be Kept for Six Years and Available for Inspection

Consistent with other prohibited transaction exemptions, the Proposal would require a QPAM to retain for six years records sufficient to demonstrate the QPAM's compliance with the Exemption. The Proposal would require that the records be available for inspection by certain relevant people, including the DOL, IRS, plan fiduciaries, plan sponsors, plan participants, and IRA owners.

8. Increase AUM and Equity Thresholds to Qualify as a QPAM

The Proposal would make the following adjustments with respect to AUM and equity thresholds:

- For registered investment advisers, increase the assets under management threshold from $85 million to $135.87 million and the owners' equity threshold from $1 million to $2.04 million.

- For banks, savings and loan associates, and insurance companies, increase the owners' equity threshold from $1 million to $2.72 million.

The DOL would be able to make annual adjustments for inflation to the thresholds.

Key Takeaways

These amendments would significantly impact entities that rely on the QPAM Exemption, as well as plans, plan fiduciaries, counterparties to transactions involving QPAMs and others. The amendments would impose significant compliance burdens and costs on QPAMs, including the need to amend existing agreements to comply with the conditions. Additionally, the indemnification and hold harmless provisions are likely to increase the potential liabilities of a QPAM that becomes disqualified. The DOL proposes that a final rule would become effective 60 days after publication in the Federal Register. Interested parties should consider submitting comments to the DOL.

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[1] Similar prohibitions apply with respect to individual retirement accounts under Section 4975 of the Internal Revenue Code. The QPAM Exemption is available for transactions on behalf of such accounts, as well.

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