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Department of Labor Proposes Significant Changes to QPAM Exemption

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The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), imposes certain prohibited transaction restrictions on investment managers and other fiduciaries who manage "plan assets". ERISA contains statutory exemptions, and the Department of Labor (the "DOL") has issued prohibited transaction class exemptions ("PTCEs"), which allow fiduciaries to engage in certain transactions without triggering a prohibited transaction and subjecting the fiduciary and/or counterparties to an excise tax and other penalties.[1]

The "Qualified Professional Asset Manager" Exemption, commonly known as the QPAM Exemption (PTCE 84-14, as amended), is one of the most widely used prohibited transaction exemptions for investment managers. The QPAM Exemption provides exemptive relief for transactions entered into by an investment fund that is managed by a "qualified professional asset manager" (a "QPAM"), subject to certain requirements.

On July 27, 2022, the DOL released a proposed amendment to the QPAM Exemption, which, if finalized, would make several substantial changes and affect all managers that rely on this relief. Notably, the proposed amendment does not contain any "grandfathering" provision or otherwise exempt current funds or accounts from the changes.

Summary of Proposed Changes

- ***Registration with the DOL.*** The DOL has proposed that, for the first time, each QPAM will need to notify the DOL, through a one-time email registration, that it is acting as a QPAM. The DOL proposes to maintain a publicly available list of QPAMs.

- ***Recordkeeping.*** The proposed amendment would require each QPAM to maintain, for six years, records demonstrating compliance with the QPAM Exemption. With respect to a fund or account managed by a QPAM, the QPAM must make such records available to the DOL, IRS and other federal or state regulators; plan fiduciaries of plans invested in the fund or account; contributing employers and unions whose members are covered by a plan invested in the fund or account; and participants and beneficiaries of a plan or IRA owner invested in the fund or account.
- ***Mandatory Contract Provisions.*** The proposed amendment would require each QPAM to enter into a written management agreement with its plan clients containing specific withdrawal rights and indemnification provisions that will apply if the QPAM has a loss of eligibility due to criminal activity or other misconduct by the QPAM or an affiliate, including:
  - In the event of criminal conviction, or receipt of a notice of ineligibility from the DOL, the investor may terminate the agreement and withdraw without fee or penalty, other than reasonable fees disclosed in advance;
  - The QPAM will indemnify the plan for any damages that directly result from a violation of applicable law, breach of contract, or other claim arising out of the QPAM's loss of eligibility or the conduct leading to such loss of eligibility; and
  - The QPAM will not, for a period of at least 10 years, employ or knowingly engage any individual that participated in the conduct giving rise to the QPAM's loss of eligibility.

- ***Capitalization and AUM Requirements.*** The proposed amendment significantly raises the capitalization requirements and AUM minimums for financial institutions that rely on the QPAM exemption. For example, registered investment advisors ("RIAs") will be required to have more than $135,870,000 total client assets under management and control and either (i) more than $2,040,000 shareholders' or partners' equity or (ii) have payment of liabilities be unconditionally guaranteed (including by an affiliate, if the RIA and its affiliate have shareholders' or partners' equity, in the aggregate, in excess of $2,040,000). Going forward, these numbers would be increased annually.
- ***Foreign Crimes and QPAM Disqualifications.*** Under the DOL's proposal, the list of crimes which could result in QPAM disqualification would expressly include foreign crimes that are substantially equivalent to the crimes currently listed in the QPAM exemption. In addition, the DOL's proposal includes an additional category of "prohibited misconduct" (domestic or foreign) that could result in QPAM disqualification, including (i) any conduct that forms the basis for a non-prosecution or deferred prosecution agreement (or foreign equivalent) that, if successfully prosecuted, would have constituted a listed crime or its foreign equivalent, (ii)

systematic or intentional violations of QPAM exemption requirements, and (iii) providing materially misleading information to the DOL in connection with the QPAM exemption. A QPAM's active participation, knowing approval, or knowledge of the conduct without taking appropriate and proactive steps to prevent the conduct, would all be treated as having participated in any prohibited misconduct.

- ***One Year Wind-Down.*** The DOL's proposal includes a one-year wind-down period for disqualified QPAMs and their clients and identifies certain steps a QPAM must follow to take advantage of the one-year wind-down. The DOL's proposal also outlines procedures for seeking an individual exemption in the event a QPAM loses its eligibility. Generally, a QPAM that obtains an individual exemption will be permitted to continue to act as a QPAM, subject to the requirements set forth in the individual exemption.

The DOL is currently seeking comments to the proposed amendment. The comment period will expire on September 26, 2022. The amendment, if granted, will be effective 60 days after the final amendment is published.

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1. Similar prohibitions and exemptive relief, including the QPAM Exemption, apply to fiduciaries of individual retirement accounts and certain other plans under Section 4975 of the Internal Revenue Code, as amended. ↩

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