CLIENT ALERT

DOL Makes Substantial Changes to Qualified Professional Asset Manager (QPAM) Exemption

April 12, 2024

AUTHORS

Alexander P. Ryan | Steven C. Matos | Eli S. Schwartz

I. Introduction

On April 2, 2024, the U.S. Department of Labor (the "DOL") adopted an amendment to the qualified professional asset manager ("QPAM") class prohibited transaction exemption (the "QPAM Exemption") promulgated under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The adopted amendment (the "Adopted Amendment"), originally proposed in July 2022 (the "Proposal"),[1] clarifies, adds, and modifies certain criminal conduct-related and noncriminal conduct-related components of the QPAM Exemption.

The Adopted Amendment takes effect 75 days after publication, on June 17, 2024.

II. Background

Title I of ERISA prohibits certain transactions between an employee benefit plan subject to ERISA (e.g., a corporate pension plan) and "parties in interest" (e.g., plan fiduciaries, plan service providers, and other parties with certain relationships to the plan). Title II of ERISA codifies parallel provisions in Section 4975 of the Internal Revenue Code (the "Code"), which prohibit transactions between certain tax-qualified plans, including IRAs, and "disqualified persons." "Disqualified person" has a definition that is similar, though not identical, to "parties in interest" under ERISA.[2] ERISA provides certain statutory exemptions from the prohibited transaction provisions in ERISA and the Code. The DOL also has the authority to grant

1 Please refer to our prior Client Alert summarizing the Proposal here.
2 References throughout this Client Alert to "ERISA," "plan," and "party in interest" include the Code's parallel concepts.

additional prohibited transaction exemptions on an individual or class basis. The QPAM Exemption is one such class exemption.

Managers of investment funds and separate investment accounts that hold “plan assets” of ERISA plans (and certain tax-qualified plans) are fiduciaries under ERISA (and the Code) with respect to plan investors. And Section 406(a) of ERISA (and parallel provisions under Section 4975 of the Code) prohibits fiduciaries from engaging in various transactions with “parties in interest” to such investors, including sales, exchanges, or leases of property, extensions of credit, furnishing of goods or services, or transfers of “plan assets” to or with a “party in interest.” While these prohibited transaction provisions are intended to protect plans (and their participants and beneficiaries) from potential abuse and conflicts, they also preclude many benign and essential commercial transactions routinely carried out by managers of “plan assets.”[3] The QPAM Exemption permits many of these transactions to go forward on an exempt basis, and many asset managers would be unable to manage “plan assets” without the QPAM Exemption.

III. Summary of Current QPAM Exemption Requirements

Currently, an investment manager relying on the QPAM Exemption must be one of the following: (1) a bank or savings and loan association with equity capital in excess of $1,000,000; (2) an insurance company with net worth in excess of $1,000,000; and (3) a registered investment adviser with (a) more than $85,000,000 of total assets under management (“AUM”) and (b) shareholders’ (or partners’) equity in excess of $1,000,000.[4]

In addition to the requirements regarding QPAM qualification described in the preceding paragraph, the QPAM Exemption requires the manager to acknowledge in a written agreement that it is a fiduciary with respect to investing plans. In order to utilize the QPAM Exemption, the manager must have the sole responsibility to negotiate and decide investments for the “plan assets” it manages (e.g., an employer sponsoring an investing plan may not negotiate an investment transaction and then present it to the QPAM for approval). Further, a manager is ineligible under the current QPAM Exemption if within the last ten (10) years such manager, any of its affiliates, or any of its direct or indirect five percent (5%) owners has been convicted (or released from prison, if later than the conviction date) of certain enumerated crimes.[5]

Importantly, the QPAM Exemption does not exempt *all* prohibited transactions under ERISA and the Code. For example, the QPAM Exemption does not exempt transactions with a “party in interest” that (1) is the QPAM itself; (2) has the ability

[3] For example, Section 406(a) of ERISA would, in the absence of an exemption, prohibit an investment fund holding “plan assets” from, in the normal course of its operations, entering into a transaction with another entity that happens to be a service provider with respect to an investing plan.

[4] As an alternative to this shareholder equity requirement, an investment adviser can satisfy this requirement if payment of its liabilities is guaranteed by an affiliate, another entity satisfying the conditions of the QPAM Exemption, or a broker-dealer with a net worth in excess of $1,000,000.

[5] These include: convictions for any felony involving abuse or misuse of a plan position or employment with a labor organization; any felony arising out of the conduct of the business of a broker, dealer, investment adviser, bank, insurance company or fiduciary; income tax evasion; any felony involving larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; conspiracy or attempt to commit any such crimes or a crime in which any of the foregoing crimes is an element; or a crime identified in Section 411 of ERISA.

to appoint or terminate the QPAM (or is an affiliate of such an entity); or (3) is a "party in interest" with respect to a plan whose assets comprise more than twenty percent (20%) of the manager's total AUM. Notwithstanding these limitations, the QPAM Exemption is widely used for ordinary-course investment transactions with third parties, and changes to the QPAM Exemption tend to attract attention from plans and managers alike.

IV. Summary of Adopted Amendment

One of the primary changes in the Adopted Amendment relates to the QPAM Exemption's ineligibility provisions. Over the past decade, many global asset managers have requested, and often obtained, individual exemptive relief from the DOL to affirm eligibility under the QPAM Exemption notwithstanding criminal convictions of such managers' affiliates in non-U.S. jurisdictions. This focus on non-U.S. criminal convictions appears to be the primary impetus for the Adopted Amendment. However, the Adopted Amendment also includes several other changes that impact asset managers relying on the QPAM Exemption.

A brief summary of the changes to the QPAM Exemption follows:

a. Conduct Resulting in Ineligibility. The Adopted Amendment retains the list of crimes currently in the QPAM Exemption resulting in QPAM ineligibility, and, notably, clarifies that convictions of similar crimes under non-U.S. laws would also result in QPAM ineligibility.[6] This clarification is significant because some market participants have understood that criminal convictions under non-U.S. laws would not necessarily result in QPAM Exemption ineligibility. For example, on November 3, 2020, the DOL issued an opinion letter to the Securities Industry and Financial Markets Association ("SIFMA") stating that the DOL would not view a conviction under foreign law as a disqualifying event under the QPAM Exemption. However, the Biden Administration's DOL issued a follow-up opinion letter to SIFMA on March 23, 2021, which withdrew the prior opinion letter on the grounds it was "issued through a flawed process and was based on a legal analysis that was inadequate to support abandoning the [DOL's] long standing position."

   In addition to U.S. and non-U.S. criminal conviction ineligibility, like the Proposal, the Adopted Amendment expands the categories of conduct that would result in ineligibility—referred to in the Adopted Amendment as "Prohibited Misconduct."

[6] The DOL excluded foreign convictions and imprisonments that occur within foreign jurisdictions that are included on the Department of Commerce's list of "foreign adversaries." The list of foreign adversaries currently includes the following foreign governments and non-government persons: The People's Republic of China, including the Hong Kong Special Administrative Region (China); the Republic of Cuba (Cuba); the Islamic Republic of Iran (Iran); the Democratic People's Republic of Korea (North Korea); the Russian Federation (Russia); and Venezuelan politician Nicolás Maduro (Maduro Regime).

Prohibited Misconduct includes a QPAM, any affiliates thereof, or any owner, direct or indirect, of a five percent (5%) or more interest in the QPAM (collectively, "QPAM Related Persons"), participating in:

- conduct forming the basis for a non-prosecution ("NPA") or deferred prosecution agreement ("DPA") with a U.S. federal or state prosecutor's office or regulatory agency that, if successfully prosecuted, would have constituted one of the QPAM Exemption's enumerated crimes;
- a systematic pattern or practice of violating the conditions of the QPAM Exemption;
- intentionally violating the conditions of the QPAM Exemption; or
- providing materially misleading information to the DOL or another federal agency, state regulator or a state attorney general, in connection with the conditions of the QPAM Exemption.

The Adopted Amendment also provides that "participating in" Prohibited Misconduct includes not only active participation but also knowingly approving such conduct or having knowledge of such conduct without taking proactive steps to thwart it. The DOL clarifies that the Prohibited Misconduct provisions will apply only on a *prospective* basis.

In a change from the Proposal, the Adopted Amendment removes foreign-equivalent DPAs and NPAs from the definition of Prohibited Misconduct. However, the Adopted Amendment adds a requirement that a QPAM notify the DOL within thirty (30) days after a QPAM Related Person (i) enters into a foreign equivalent of a DPA or NPA or (ii) participates in Prohibited Misconduct.

With respect to ineligibility potentially stemming from Prohibited Misconduct, the Proposal included certain due process protections, including a written warning letter and the right to a hearing by the DOL. The Adopted Amendment removes this protocol and instead provides that a QPAM will be deemed ineligible as a result of Prohibited Misconduct only if (i) factual determinations for the Prohibited Misconduct have been made in a final judgment, or court-approved settlement by a federal or state criminal or civil court or (ii) a QPAM Related Person enters into a domestic DPA or NPA. The DOL reasons that the aforementioned change will provide QPAMs with due process protections that are not overseen by the DOL, thereby adding greater objectivity to the ineligibility process.

b. One-Year Transition Period. Like the Proposal, the Adopted Amendment includes a mandatory one-year transition period that begins on the date a QPAM is deemed ineligible for the QPAM Exemption. The DOL reasons that the year-long transition period gives plans sufficient time to search for an alternative QPAM or other asset manager. Within thirty (30) days of its ineligibility, the QPAM must provide notice to the DOL and each of its client plans of the initiation of the one-year transition period, which notice must include: (i) an

objective description of the facts and circumstances upon which the conduct rendering the QPAM ineligible for the QPAM Exemption (the "Ineligibility Conduct") was based and (ii) a statement that during the transition period the QPAM:[7]

- agrees not to restrict a client plan's ability to terminate or withdraw from its arrangement with the QPAM;
- subject to certain exceptions, will not impose any fees, penalties, or charges in connection with a client plan's withdrawing from the QPAM-managed fund;[8]
- agrees 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 Ineligibility Conduct; and
- will not employ or knowingly engage any individual that participated in the Ineligibility Conduct.

The transition period relief applies to transactions (including past transactions) during the transition period. Importantly, the Adopted Amendment, unlike the Proposal, does not prohibit the QPAM from entering into new transactions for existing client plans after the QPAM's ineligibility date during the transition period. After the expiration of the transition period, the QPAM generally may not rely on the QPAM Exemption until the expiration of the 10-year ineligibility period described in Section III above unless it obtains an individual exemption from the DOL.

c. Notice Requirement. The Adopted Amendment retains from the Proposal, with certain modifications, the requirement for QPAMs to report to the DOL by email the legal name of each business entity relying on the QPAM Exemption (and any name the QPAM may be operating under). This is a one-time notice requirement, unless there is a relevant name change. If a QPAM does not report its reliance on the QPAM Exemption within ninety (90) days, it must notify the DOL within an additional ninety (90) days of its reliance on the QPAM Exemption and provide an explanation for its failure to provide timely notice. If, after one hundred eighty (180) days from the starting date of its reliance on the QPAM Exemption, a QPAM has not so notified the DOL, the QPAM will be unable to avail itself of the QPAM Exemption until the QPAM cures the reporting failure. However,

[7] This is a change from the Proposal, which would have required all QPAMs to include certain of these terms up front in "Written Management Agreements" that would apply only *in the event of* QPAM ineligibility. The Adopted Amendment instead requires the QPAM only to agree to such terms in the event it actually becomes ineligible, and it is not expressly required that they be incorporated into the "Written Management Agreements" with client plans.

[8] The DOL excepts certain reasonable fees disclosed in advance "that are specifically designed to (a) prevent generally recognized abusive investment practices, or (b) 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 that such fees are applied consistently and in a like manner to all such investors."

the DOL confirms that an isolated instance of failing to report generally would not be considered Prohibited Misconduct.

The DOL will maintain on its publicly available website a list of entities relying on the QPAM Exemption. If a business entity relying on the QPAM Exemption ceases to rely on the QPAM Exemption, it may notify the DOL at any time, which will remove it from the list.

d. Increased AUM and Equity Thresholds. The Adopted Amendment increases the minimum size thresholds in the QPAM definition. Unlike the Proposal, which would have increased the AUM thresholds on a one-time basis, the Adopted Amendment increases the AUM thresholds gradually, in three-year increments. These thresholds are designed to ensure that QPAMs are large enough to withstand improper influence from “parties in interest.” These increases mark the first modification to the minimum size thresholds since 2005 (and only the second in the QPAM Exemption’s nearly four-decade history).

The threshold increases in the Adopted Amendment are as follows:

- For registered investment advisers:

RIA Threshold	Current Amount	For Fiscal Years Ending in 2024	For Fiscal Years Ending in 2027	For Fiscal Years Ending in 2030
AUM	> $85,000,000	> $101,956,000	> $118,912,000	> $135,868,000
Equity Capital	> $1,000,000	> $1,346,000	> $1,694,000	> $2,040,000

- For banks, savings and loan associations and insurance companies:

Entity	Threshold	Current Amount	For Fiscal Years Ending in 2024	For Fiscal Years Ending in 2027	For Fiscal Years Ending in 2030
Banks	Equity Capital	> $1,000,000	> $1,570,300	> $2,140,600	> $2,720,000
Savings and Loan Associations	Equity Capital or Net Worth	> $1,000,000	> $1,570,300	> $2,140,600	> $2,720,000
Insurance Companies	Net Worth	> $1,000,000	> $1,570,300	> $2,140,600	> $2,720,000

The Adopted Amendment also provides that the DOL will annually (i.e., by January 31 of each year) publish in the Federal Register adjustments to the thresholds for inflation, rounded to the nearest $10,000.

The threshold increases may not be problematic for large asset managers currently relying on the QPAM Exemption. However, for QPAMs straddling the increased thresholds, it may be necessary to adopt enhanced accounting and monitoring procedures to ensure compliance. In addition, for startup asset managers looking to market to benefit plan investors, the increased thresholds may present a greater barrier to entry.

e. Sole Responsibility Requirement. Similar to the Proposal, the Adopted Amendment generally provides that the QPAM Exemption does not apply to any transaction that has been planned, negotiated, or initiated by a "party in interest" if the QPAM would not have "sole responsibility" with respect to the transaction. The DOL positions this change as merely clarifying. Further, the DOL notes that the "sole responsibility" requirement does not preclude client plans from having ongoing dialogue with a QPAM or providing investment guidelines to a QPAM. The DOL received industry comments on the Proposal suggesting that the "sole responsibility" requirement could be interpreted to restrict a QPAM's ability to use sub-advisers, including with respect to collective investment trusts. The DOL addresses this concern in the Adopted Amendment release and notes that a QPAM's delegation of certain investment-related responsibilities would not, on its own, violate the conditions of the QPAM Exemption so long as the QPAM retains sole authority with respect to the transactions covered by the QPAM Exemption. However, this change could significantly impact investment products for which sub-advisers are utilized or transactions in which a plan sponsor or other non-QPAM fiduciary has significant involvement.

f. Recordkeeping Requirement. The Adopted Amendment requires QPAMs to maintain for a period of six (6) years from the date of a transaction records necessary to enable the DOL, fiduciaries, contributing employers, and plan participants to determine that the QPAM Exemption requirements have been met with respect to such transaction. Failing this requirement would jeopardize exemption only for the specific transaction(s) affected by the recordkeeping failure (and would not result in a broader loss of relief under the QPAM Exemption). Note that other prohibited transaction class exemptions include similar recordkeeping requirements. This requirement is substantially unchanged from the corresponding provision of the Proposal.

V. Takeaways

The Adopted Amendment includes not only clarifying guidance but also a number of new requirements for asset managers relying on the QPAM Exemption. Therefore, existing QPAMs, as well as asset managers who anticipate managing ERISA plan assets in the future, should familiarize themselves with the Adopted Amendment and the various requirements and conditions of the QPAM Exemption, as amended. In addition to reviewing existing compliance strategies in light of the

Adopted Amendment, asset managers should, with the assistance of counsel, evaluate potential alternatives to QPAM Exemption reliance, should that become necessary.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Alexander P. Ryan
202 303 1129
aryan@willkie.com

Steven C. Matos
212 728 8757
smatos@willkie.com

Eli S. Schwartz
212 728 3226
eschwartz@willkie.com

Copyright © 2024 Willkie Farr & Gallagher LLP.

This alert is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This alert may be considered advertising under applicable state laws.

Willkie Farr & Gallagher LLP is an international law firm with offices in Brussels, Chicago, Frankfurt, Houston, London, Los Angeles, Milan, Munich, New York, Palo Alto, Paris, Rome, San Francisco and Washington. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.