

Employee Benefits & Executive Compensation Investment Management

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Plan Fiduciaries, Including Investment Advisers and Fund Managers, Take Note – U.S. Department of Labor Proposes Enhanced QPAM Requirements

By **Andrew E. Graw**, **Scott H. Moss**, and **Megan Monson**

On July 26, 2022, the U.S. Department of Labor (DOL) released a proposed amendment to Prohibited Transaction Class Exemption 84-14, known as the Qualified Professional Asset “Manager” (QPAM) exemption. The QPAM exemption is frequently relied on by investment fiduciaries, including fund managers and investment advisers, to avoid engaging in transactions with respect to employee benefit plans that might otherwise be prohibited by the Employee Retirement Income Security Act of 1974 (ERISA) and/or the Internal Revenue Code (IRC). If adopted, the proposed amendment would, among other things, increase the minimum capitalization and assets under management (AUM) requirements for a manager to qualify as a QPAM, require that QPAMs register with the DOL, and require that agreements between QPAMs and their clients be amended to include specific indemnity and other provisions.

Interested parties have 60 days to submit comments to the DOL on the proposed amendment. As drafted, the final amendment would become effective 60 days after it is finalized – without any grandfathering principles for existing QPAMs.

Purpose of the QPAM Exemption. ERISA prohibits transactions between a plan and a “party-in-interest” unless an exemption applies. Similar prohibited transactions apply under the IRC. The QPAM exemption is often relied on by investment managers, including managers of pooled investment vehicles that are deemed to have plan assets for purposes of ERISA, to enable them to engage in transactions that might otherwise be prohibited by ERISA and/or the IRC, including certain transactions with counterparties that might be parties-in-interest.

Existing QPAM Requirements. The existing QPAM exemption set consists of two sets of rules. One

set of rules sets forth the criteria for qualifying as a QPAM. The other sets forth criteria that must be met in order for the QPAM exemption to apply to transactions that the QPAM engages in.

To qualify as a QPAM, an investment manager must be a registered investment adviser that has, as of the last day of its most recent fiscal year, total AUM in excess of \$85 million and have shareholders’ or partners’ equity in excess of \$1 million, as reflected in the most recent balance sheet prepared (in accordance with GAAP) within the two-year period preceding the particular transaction (or have an unconditional guarantee of all the manager’s liabilities by an affiliate with more than \$1 million in equity). A QPAM must acknowledge in a written management agreement that it is a fiduciary with respect to each plan that it manages as a QPAM, but there is currently no filing requirement to be a QPAM.

For a specific transaction to qualify for the QPAM exemption, the transaction must meet each of the following criteria:

- The party-in-interest involved in the transaction must not, as of the time of the transaction, have authority to appoint or terminate the QPAM or authority to negotiate the terms of the QPAM’s engagement. In addition, the party-in-interest must not have exercised such authority within the one-year period preceding the transaction.
- The terms of the transaction must be negotiated on behalf of the plan under the authority and general direction of the QPAM.
- The party-in-interest involved in the transaction cannot be the QPAM or an affiliate of the QPAM.
- The transaction cannot be entered into with a party-in-interest with respect to any plan whose assets managed by the QPAM represent

more than 20 percent of the total client assets managed by the QPAM at the time of the transaction.

- The terms of the transaction must be at least as favorable to the plan as the terms generally available in an arm's-length transaction between unrelated parties.
- Neither the QPAM nor any affiliate of the QPAM can have been convicted of a felony within the 10-year period preceding the transaction.

The QPAM exemption does not apply to self-dealing prohibited transactions or to certain lending and mortgage financing transactions, nor does the exemption shield a QPAM against breach of fiduciary duty claims.

Proposed Changes to the QPAM Exemption. Certain key changes to the QPAM exemption as a result of the proposed regulations are as follows:

- Notification requirement
 - The proposed amendment would require email notice to the DOL that an investment manager is relying on the QPAM exemption. This is a one-time notification (absent a legal name change to the QPAM). As noted above, the existing QPAM exemption does not require any filing.
- Increase in AUM and capital requirements
 - The proposed amendment increases the total AUM from \$85,000,000 to \$135,870,000 and the shareholder/partner equity requirement from \$1,000,000 to \$2,040,000. The proposed amendment provides for these thresholds to be adjusted annually for inflation.
- Expand scope of disqualifying conduct
 - The proposed amendment expands the list of disqualifying crimes to expressly cover foreign convictions. It also extends disqualification to "any conduct that forms the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a crime." Under the proposal, an investment adviser cannot rely on the QPAM exemption if the adviser (i) proactively participates in any of the prohibited misconduct, (ii) knowingly approves the misconduct, or (iii) has knowledge of such misconduct without taking proactive steps toward prevention.
- Expand fiduciary acknowledgement requirement
 - In addition to the existing acknowledgment of fiduciary status, the proposed amendment includes certain standards of integrity that must be set forth in a written management agreement between the QPAM and its clients, including provisions:
 - Permitting a client to terminate the QPAM if the QPAM or its affiliates engage in conduct resulting in a criminal conviction or receipt of written notice from the DOL that the QPAM has engaged in prohibited conduct (referred to as an Ineligibility Notice)

- Requiring the QPAM to indemnify, hold harmless, and promptly restore actual losses to each client for any damages directly 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 as a result of conduct that leads to a criminal conviction or Ineligibility Notice
- Restricting the QPAM from employing or knowingly engaging any individual who participated in conduct that is the subject of a criminal conviction or Ineligibility Notice within the past 10 years.

- Wind-down period
 - The proposed amendment allows for a one-year wind-down period during which the QPAM exemption can still apply to a manager subject to a criminal conviction or a written Ineligibility Notice in order to unwind transactions existing at the time of disqualification, though the QPAM cannot rely on the exemption for other transactions.
- Enhanced recordkeeping
 - The existing QPAM exemption does not include a recordkeeping component. The proposed amendment will require QPAMs to maintain transaction records for a period of six years following the date of a covered transaction.

Conclusion. Investment advisers relying on the QPAM exemption should review the proposal and be mindful of the proposed changes and how those changes may impact their ability to rely on the QPAM exemption going forward. If the proposed amendment is finalized in its current form, a number of important changes to processes and procedures will be required, including amending existing investment management agreements and administrative manuals, and managing compliance with the new AUM and capitalization requirements. In addition, QPAMs will need to notify the DOL. If the proposed amendment is adopted without any grandfathering rules, existing QPAMs will have little time to prepare before the changes take effect.

Our ERISA and Investment Management teams will continue to monitor and report on developments. For more information or to discuss the QPAM obligations, please contact **Andrew E. Graw** or **Megan Monson**.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

ANDREW E. GRAW

Partner

Chair, Employee Benefits & Executive Compensation

T: 973.597.2588

agraw@lowenstein.com

SCOTT H. MOSS

Partner

Chair, Fund Regulatory & Compliance

T: 646.414.6874

smoss@lowenstein.com

MEGAN MONSON

Partner

T: 973.597.2570

mmonson@lowenstein.com

NEW YORK

PALO ALTO

NEW JERSEY

UTAH

WASHINGTON, D.C.

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