

Proposed Changes to the Qualified Professional Asset Manager Exemption

August 2022



On July 27, 2022, the Department of Labor (the “DOL”) issued a proposed amendment to the Prohibited Transaction Class Exemption 84-14 (the “QPAM Exemption”). In general, investment managers that have managed “plan assets” subject to the Employee Retirement Income Security Act of 1974 (“ERISA”) have steadily relied on the broad relief of the QPAM Exemption provides to exempt transactions with a “party in interest” that would have otherwise been prohibited under ERISA.

The proposed changes to the QPAM Exemption, if finalized, will force investment managers who rely on the QPAM Exemption to comply with additional conditions and potentially make certain changes to contractual arrangements with ERISA clients in order to continue to rely on the QPAM Exemption. Below is a summary of the proposals that could have a significant effect on investment managers’ ability to use the QPAM Exemption.

QPAM Equity and Assets Under Management Qualification

In 2005 the DOL adjusted the equity and asset management thresholds under the exemption that were originally created in 1984. Currently, a bank, savings and loan association, an insurance company, or a registered investment advisor (“RIA”) needs to have \$1,000,000 in shareholders’ or partners’ equity and \$85,000,000 in assets under management as of the end of its taxable year as a condition to qualify as a qualified professional asset manager (“QPAM”). The DOL is proposing to increase the equity threshold to \$2,040,000 for RIAs and \$2,720,000 for banks, savings and loans and insurance companies and the assets under management threshold to \$135,870,000. In addition, the DOL has proposed that such threshold amounts be updated as of January 31st of each year for inflation.

Notification to the DOL of QPAM Status

The DOL has proposed a new condition on QPAMs requiring notification, by way of email, to the DOL of an entity’s reliance on the QPAM Exemption. QPAMs would be required to report the legal name of each entity relying on the exemption. The notification would only need to be provided once, unless the QPAM’s name changes. The DOL intends to display a list of all QPAMs on its

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website. There is a risk that the DOL may use this list to target future audits and investigations.

Changes to QPAM Ineligible Status

The DOL has proposed that the list of crimes that would disqualify an entity from becoming a QPAM include crimes committed outside the United States that are substantially similar to the crimes currently listed in the QPAM Exemption. In addition, the DOL would like to expand the circumstances that lead to ineligibility by broadening the types of serious misconduct a QPAM could participate in, or have knowledge of and fail to take proactive steps to stop, such as violating conditions of the exemption or providing misleading information to the DOL.

The DOL is also proposing that management agreements contain terms that would apply in the event the QPAM becomes ineligible. If finalized, management agreements would need to allow the ERISA client to withdraw from its arrangement with the QPAM without fees or penalties in the event the QPAM becomes ineligible under the QPAM Exemption. The QPAM would also be required to indemnify the ERISA client and restore any losses incurred by such client due to the QPAM's actions which lead to the QPAM becoming ineligible. Existing management agreements would most likely need to be amended to account for a QPAM's potential ineligibility event.

Lastly, the DOL has proposed a mandatory one-year winding-down period that would begin upon a QPAM becoming ineligible. The one-year period would be for the benefit of the ERISA client to wind-down its relationship with the QPAM and settle all current affairs, as well as to find a suitable replacement for the QPAM and transition to the new replacement.

QPAM Involvement in Investment Decisions

The DOL believes that many QPAMs are not necessarily driving the investment decisions on certain transactions, but rather the terms and conditions of the transaction are being determined prior to the QPAM's involvement, and then the QPAM is rubberstamping the transaction and relying on the QPAM Exemption. The DOL believes this is contrary to the original intent of the QPAM Exemption when created in 1984. The DOL wants the QPAM to be the ultimate decision-maker with respect to investment decisions regarding assets under its management. The DOL has proposed language in the QPAM exemption that prohibits other parties from making decisions or having influence with respect to assets managed by the QPAM other than ministerial duties and oversight associated with any transaction. The emphasis on the argument that the QPAM itself be solely responsible for investment decisions creates concern around the use, for example, of sub advisers who are not QPAMs or other types of advisers who may participate in the investment decision-making process.

The DOL has also proposed language requiring that the relief provided under the QPAM Exemption only apply "in connection with an Investment Fund that is established primarily for investment purposes." The DOL's use of "primarily" could indicate that it is looking to remove the QPAM Exemption from applying to

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certain investment-related transactions by asset pools established for mixed purposes. The DOL should provide additional color as to its use of “primarily” and if it is intended to affect certain investment-related transactions.

Recordkeeping

The DOL is proposing to have records regarding the compliance with the QPAM Exemption maintained by the QPAM for six years. This proposal is consistent with other DOL prohibited transaction exemptions recordkeeping requirements and would require the records be available for inspection by the DOL or other federal regulators as well as any fiduciary of the ERISA client or employer or employee organization who has plan assets managed by the QPAM for six years.

Conclusion

It has been more than a decade since the DOL made changes to the QPAM exemption. It is realistic to assume that the equity and assets under management thresholds will be increased and that stricter compliance will be required for the QPAM to be solely responsible for the negotiations regarding plan assets used in a potential prohibited transaction. In addition, investment managers should not forget that the so-called “service provider exemption”, which also exempts many transactions between a plan and a “party in interest,” could be an attractive alternative to the QPAM Exemption if the changes prove to be overly burdensome.

The DOL has provided for 60 days to submit formal comments on their proposed rule. We would expect that many investment managers will take the opportunity to voice concerns that the proposed changes make the QPAM Exemption less attractive or possibly unavailable in certain situations and/or make suggestions to the proposed rules, especially with respect to ineligibility conditions, where costs may be incurred, with respect to existing management agreements and notification to the DOL of QPAM status. If you would like to make a formal comment on the proposed rules or would like to discuss the proposed rule, please feel free to contact Andrew Gaines at 1-212-903-9478, Craig Spenner at 1-212-903-9215, David Miller at 1-212-903-9359 or Jason Behrens at 1-212-903-9358.

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