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CLIENT MEMORANDUM

April 12, 2024

DOL Finalizes Amendments to the QPAM Exemption Under ERISA

On April 3, 2024, the Department of Labor ("DOL") finalized amendments to Prohibited Transaction Class Exemption 84-14 (the "Qualified Professional Asset Manager (QPAM)" or "QPAM Exemption"), first proposed on July 27, 2022. The final amendments (i) impose new reporting and recordkeeping requirements on QPAMs, (ii) broaden the categories of "prohibited misconduct" that can disqualify QPAMs and (iii) increase the net worth, equity, and assets under management thresholds that QPAMs must satisfy. Existing arrangements will not be grandfathered in, so investment managers that have historically relied on the QPAM Exemption should review the amendments and make necessary adjustments prior to June 17, 2024 (the effective date).

Investment managers that have typically relied on structuring their funds to satisfy an exception from the "plan asset" rules under the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA") – such as the "venture capital operating company" ("VCOC") exception or the "<25% exception" – do not generally need to rely on the QPAM Exemption. As such, the final amendments are unlikely to impact their operations.

Background

Fiduciaries of employee benefit plans, accounts or funds subject to Title I of ERISA or Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code") (collectively, "ERISA Clients") are generally prohibited from causing such ERISA Clients to engage in "prohibited transactions" with "parties in interest" under ERISA or "disqualified persons" under the Code, unless an exemption applies. Such "prohibited transactions" potentially include many of the investment activities of ERISA Clients, so most ERISA fiduciaries structure any transaction involving ERISA Client assets so as to satisfy the conditions for relief of one or more exemptions available under ERISA.

The QPAM Exemption is one such widely used administrative exemption, initially granted by the DOL in 1984. The QPAM Exemption provides broad exemptive relief for transactions entered into by "investment funds" (including managed accounts) that are independently managed by QPAMs, which are established and sophisticated investment managers. Conditions for relief under the QPAM Exemption are relatively straightforward to satisfy, so the QPAM Exemption has become a common source of relief from ERISA's and the Code's "prohibited transaction" rules.

Reporting and Recordkeeping

The QPAM Exemption has not historically required QPAMs to report to or file anything with the DOL, and has not imposed recordkeeping requirements as a condition for relief (except for when the QPAM manages the assets of its own ERISA plans). The final amendments to the QPAM Exemption include a new requirement that QPAMs report their status as a QPAM to the DOL and to update that status from time to time with any changes to their legal or business name.[1] The DOL has indicated that it will make the list of QPAMs it gathers publicly available.

1 The initial notice is due to the DOL within 90 days following the first transaction occurring on or after June 17, 2024, for which the QPAM would like to rely on the QPAM Exemption.

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In addition, QPAMs will be required to maintain transaction records sufficient to demonstrate that the conditions of the QPAM Exemption were satisfied for each transaction covered by the exemption, and to make those records available for review by the DOL, the IRS, other state or federal regulators, and ERISA Client fiduciaries, participants and beneficiaries, subject to narrow exceptions for trade secrets, privileged information and personally identifying information. QPAMs will be required to maintain these records for six years.[2]

Integrity

The QPAM Exemption has always prohibited QPAMs from relying on the QPAM Exemption if they, any of their affiliates, or any 5% or more owners of the QPAM has been convicted of various crimes, for a period of 10 years from the date of conviction or release from imprisonment (whichever is later). As the financial industry has consolidated since the QPAM Exemption was first granted, this prohibition has frequently raised "disqualification" questions, which the DOL has sought to address through individual exemptions and other guidance. The final amendments to the QPAM Exemption clarify and expand upon these trends.

The amended QPAM Exemption makes clear that QPAMs can be "disqualified" from relying on the QPAM Exemption if they or certain affiliates are convicted of certain crimes in non-U.S. jurisdictions. In addition, the DOL has added a broader category of disqualifying "prohibited misconduct" that can similarly prevent a QPAM from relying on the QPAM Exemption. Such "prohibited misconduct" includes entering into a non-prosecution or deferred prosecution agreement with a U.S. federal or state prosecutor or regulatory agency, or agreeing to other criminal or civil settlements, if the underlying conduct of the agreement would constitute a disqualifying crime if successfully prosecuted or show a pattern of non-compliance with the requirements of the QPAM Exemption.

Such disqualifying events will automatically trigger a one-year "transition period." During the transition period, the QPAM can continue to rely on the QPAM Exemption, but the QPAM will be required to provide its existing ERISA Clients with the opportunity to withdraw without penalty and indemnify such ERISA Clients for any actual losses stemming from such a transition. QPAMs may seek an exemption from the DOL to extend this transitional relief, but if the DOL does not provide such relief, a disqualified QPAM will no longer be able to rely on the QPAM Exemption after the end of the transition period.

Equity and AUM Thresholds

The QPAM Exemption has also always included certain "net worth," "equity capital," "shareholders' or partners' equity" and "assets under management" thresholds for QPAMs. The purpose of these thresholds is to ensure that QPAMs are able to manage the assets of their ERISA Clients independently, free of undue influence, and are financially accountable for losses stemming from breaches of their fiduciary duties. The final amendments will increase these threshold requirements, beginning as of the end of 2024, with additional increases effective as of the ends of 2027 and 2030, and with further increases to be set on an annual basis thereafter by DOL publication.[3]

Other Considerations and Next Steps

The final amendments confirm the DOL's desire to limit the use of so-called "rent a QPAM" arrangements, where a QPAM is provisionally hired to evaluate a proposed transaction for an ERISA Client involving a "party in interest." In this respect, the DOL's amendments make clear that (i) the QPAM Exemption is available only for the investment activities of ERISA Clients that

[2] The failure to maintain the required records for any particular transaction, or to make them available upon request, will result in the loss of the QPAM Exemption for that particular transaction, but will not otherwise disqualify the QPAM or prevent reliance on the QPAM Exemption for other transactions where adequate records are maintained.

[3] Currently, in order to qualify as a QPAM, a registered investment adviser must have total client assets under management of at least $85 million and shareholders' or partners' equity of at least $1 million (in each case as determined under the QPAM Exemption). Effective as of the end of the last day of the fiscal year ending no later than December 31, 2024, those thresholds will increase to $101,956,000 and $1,346,000, respectively; for December 31, 2027, the thresholds will increase to $118,912,000 and $1,694,000, respectively; and for December 31, 2030, the thresholds will increase to $135,868,000 and $2,040,000, respectively.

are actually negotiated (rather than merely "approved") by the QPAM and (ii) the QPAM Exemption is not available for transactions that are planned, negotiated or initiated by parties in interest to ERISA Clients.

Given the above developments, QPAMs seeking to rely on the QPAM Exemption after June 17, 2024, may wish to consider taking the following steps before or shortly after that date:

- Report the legal and operating name of the QPAM by sending an email to the DOL, at QPAM@dol.gov, within 90 days following June 17, 2024;
- Prior to June 17, 2024, review internal recordkeeping practices to confirm whether they satisfy the QPAM Exemption's new recordkeeping requirements;
- Confirm that the QPAM will satisfy the increased equity and AUM thresholds by December 31, 2024, and will have a process for ensuring continued satisfaction of such thresholds for subsequent increases;
- For QPAMs that are wholly or partially owned by larger financial institutions or holding companies, develop internal processes for monitoring whether any affiliates in the broader corporate structure have been convicted of any disqualifying crimes or engaged in other "prohibited misconduct," within the meaning of the QPAM Exemption;
- Review investment management agreements, side letters and other documents relating to ERISA Clients for any applicable QPAM provisions that may require amendment in light of the amended QPAM Exemption; and
- Consider whether other statutory and administrative exemptions available under ERISA and the Code may better suit the QPAM's investment activities on behalf of ERISA Clients.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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