U.S. Department of Labor Finalizes Tighter Standards for "QPAMs"

April 9, 2024

On April 2, 2024, the U.S. Department of Labor (the "DOL") finalized an amendment (referred to below as the "Final Amendment") to prohibited transaction class exemption 84-14 (the "Exemption"), expanding the categories of disqualifying criminal conduct for "qualified professional asset managers," commonly referred to as "QPAMs." The Final Amendment also added new compliance requirements to the Exemption.

Taken together, these largely technical changes only modestly impact the day-to-day use of the Exemption but will significantly limit the use of the Exemption by QPAMs who violate, or are alleged to violate, applicable law. However, given the importance of the Exemption as a primary basis for trading by asset managers on behalf of employee benefit plans ("Plans") without risking violations of certain of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), the Final Amendment is an important development. Also, even fully compliant QPAMs will need to make a one-time filing with the DOL at or around the time the Amendment becomes effective on June 17, 2024.

Below is our summary of the key changes from the DOL's proposed amendment to the Exemption published on July 27, 2022 (the "Proposed Amendment"). For a full analysis of the Proposed Amendment, please refer to our August 12, 2022 client update.

Changes Related to QPAM Disqualification for Criminal Acts

- **Changes to "Prohibited Misconduct" Disqualification Process:** In addition to the Exemption's disqualification rules for specified crimes, the Proposed Amendment provided a mechanism for the DOL to disqualify a QPAM, after due process consisting of written notice and the opportunity to be heard by the DOL, if the QPAM (or its affiliates or owners of 5% or more of the QPAM) participated in"Prohibited Misconduct," meaning: (i) conduct subject to a non-prosecution agreement ("NPA"), deferred prosecution agreement ("DPA") or a "foreign equivalent" of an NPA or DPA, if the allegations that resulted in the NPA, DPA or foreign equivalent described one of the Exemption's disqualifying crimes; (ii)

intentional violations or systematic patterns of violations of the Exemption's conditions; and (iii) providing materially misleading information to the DOL in connection with the conditions of the Exemption.

The Final Amendment retains the concept of disqualification for Prohibited Misconduct but limits the DOL's role in the accompanying due process for Prohibited Misconduct not subject to an NPA or DPA (i.e., conduct described in (ii) and (iii) above), replacing it with a condition that, in order for such Prohibited Misconduct to result in disqualification, the QPAM's participation in the conduct must be determined in a final judgment or court-approved settlement by a federal or state court in a proceeding brought by the DOL, the Department of Treasury, the Internal Revenue Service, the Securities and Exchange Commission, the Department of Justice, the Federal Reserve Bank, the Office of the Comptroller of the Currency, the Federal Depository Insurance Corporation, the Commodities Futures Trading Commission, a state regulator or a state attorney general. The Final Amendment includes a corresponding expansion of the "materially misleading information" prong of the definition of Prohibited Misconduct to include the provision of materially misleading information to any of these agencies and officials.

The Final Amendment also removes "foreign equivalents" of domestic NPAs and DPAs from the definition of Prohibited Misconduct. A QPAM must nonetheless notify the DOL if it enters into an agreement with a foreign government that is "substantially equivalent" to a domestic NPA or DPA.

While the Final Amendment generally retains the Proposed Amendment's broad scope of disqualifying "Prohibited Misconduct," QPAMs should welcome the Final Amendment's requirement that underlying factual determinations for Prohibited Misconduct not subject to NPAs and DPAs be subject to a judicially supervised proceeding.

- **Exceptions to Disqualification for Certain Foreign Convictions:** The Proposed Amendment expressly added foreign convictions "substantially equivalent" to the existing list of offenses enumerated in the Exemption that would result in the QPAM's disqualification. The Final Exemption retains this addition but excludes convictions occurring in foreign countries included on the Department of Commerce's list of "foreign adversaries" on the purported basis that convictions in such jurisdictions have occurred with the intention to harm U.S.-based asset managers.

- **Removal of New Management Agreement Requirements:** The Proposed Amendment would have required each management agreement between a QPAM and a client Plan to expressly provide that the QPAM would comply with certain

conditions intended to minimize disruption and provide transition protections for the Plan if the manager were to lose its QPAM qualification. As we noted in our 2022 update, the Proposed Amendment did not exempt existing management agreements from this requirement, meaning QPAMs would have been required to amend all existing management agreements with Plans to add these terms.

The Final Amendment eliminates the requirement that QPAMs include these terms in management agreements but retains the substantive protections for Plans in the event of a QPAM's disqualification (though with a one-year limit on the applicability of these protections). This means that new management agreements will not need to include these terms expressly, and existing management agreements will not need to be amended to add them. However, regardless of the terms of its management agreement with a Plan, during the year following a QPAM's disqualification for Prohibited Misconduct, the QPAM (i) must not restrict the Plan's ability to terminate or withdraw from its arrangement with the QPAM and (ii) must indemnify the Plan against losses resulting from the QPAM's failure to remain eligible for the Exemption, including losses resulting from unwinding ineligible transactions and transitioning the Plan's assets to another manager, except for certain limited fees disclosed in advance to the Plan.

- **Allowance for New Transactions during One-Year Transition Period:** The Proposed Amendment provided for a one-year "winding down" period (referred to in the Final Amendment as the "Transition Period") for disqualified QPAMs, during which the manager could continue to rely on the Exemption, but only for existing Plan clients and only for pre-disqualification transactions, and subject to continued compliance with the other conditions of the Exemption and provision of notice to all Plan clients of the circumstances surrounding the disqualification. The Final Amendment relaxes this provision, permitting QPAMs to rely on the Exemption with respect to any new transactions for existing Plan clients during the Transition Period, not just pre-disqualification transactions.

Additional Administrative Changes

- **Clarification of "Sole Responsibility" Requirement:** The Proposed Amendment included an express condition that the terms and associated negotiation of a transaction subject to the Exemption be "the sole responsibility of the QPAM." In our 2022 update, we noted that this condition appeared to be an attempt to codify the DOL's previously articulated position that the Exemption does not apply to a so-called "QPAM for a day" hired to ratify a transaction substantially negotiated by another plan fiduciary. The Final Amendment confirms this reading, replacing the

"sole responsibility" language with an express requirement that the negotiation and terms of the transaction be determined by the QPAM that represents the interest of the investment fund engaged in the transaction, based on the QPAM's own "independent exercise of fiduciary judgment and free from any bias in favor of the interests of the Plan sponsor or other parties in interest."

- **Public Notice:** The Proposed Amendment included a requirement that entities relying on the Exemption send a one-time email notifying the DOL of their reliance on the Exemption. The Final Amendment retains this requirement but adds a 90-day compliance window starting on the date on which the entity relies on the Exemption, after which an additional 90-day cure period will apply to inadvertent failures to notify the DOL during the initial 90-day window.

- **Phase-In for Capitalization and AUM Updates:** For QPAMs that are registered investment advisers, the Proposed Amendment called for increased minimums for assets under management (from $85,000,000 to $137,870,000) and increased minimum equity capitalization requirements (from $1,000,000 to $2,040,000), with corresponding capitalization requirement increases for QPAMs that are banks, savings and loan associations and insurance companies. The Proposed Amendment also provided that these thresholds be subject to annual adjustment for inflation based on changes in the U.S. Bureau of Labor Statistics' Consumer Price Index.

  The Final Amendment retains these increases, with a minor adjustment in the minimum assets under management requirement for registered investment advisors, but provides for a graduated implementation of the assets under management minimum ($101,956,000 effective as of the last day of the fiscal year ending no later than December 31, 2004, $118,912,000 effective as of the last day of the fiscal year ending no later than December 31, 2027 and $135,868,000 effective as of the last day of the fiscal year ending no later than December 31, 2030) and the equity capitalization minimum ($1,570,300 effective as of the last day of the fiscal year ending no later than December 31, 2024, $2,140,600 effective as of the last day of the fiscal year ending no later than December 31, 2027 and $2,720,000 effective as of the last day of the fiscal year ending no later than December 31, 2030).

The Final Amendment takes effect June 17, 2024.

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Please do not hesitate to contact us with any questions.

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