

Proposed QPAM Amendment Would Expand Criminal Disqualification Rules and Add Contractual Protections for Plans

August 12, 2022

On July 27, 2022, the U.S. Department of Labor (the “DOL”) published a proposed amendment (the “Amendment”) to prohibited transaction class exemption 84-14 (the “Exemption”) that would expand the categories of disqualifying criminal conduct for “qualified professional asset managers” (“QPAMs”) and add important new compliance requirements for the Exemption.

The QPAM Exemption has been in place since the early 1980s and has been widely used by asset managers to conduct their trading activities on behalf of employee benefit plans (“Plans”) free of the risk of violating certain of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). While the existing Exemption imposes a number of technical compliance requirements, the Exemption nevertheless has been a useful tool for asset managers to engage in transactions involving Plan assets that could otherwise be barred by ERISA. The Amendment would expand these technical requirements, especially in circumstances where an asset manager or one of its affiliates has engaged in certain criminal (or potentially criminal) activity. Because of the potential economic and reputational cost to engaging in prohibited transactions, any expansion of the Exemption’s requirements, however technical, should be viewed as a serious regulatory change.

In recent years, there have been a substantial number of requests to the DOL for relief from the provision of the Exemption that disqualifies a QPAM because it or an affiliate engages in specified criminal activity. The proposed Amendment appears primarily focused on enhancing this condition, including by: (1) codifying a Biden administration interpretation to expressly include foreign crimes; (2) expanding the conduct that can be deemed disqualifying; and (3) affording the DOL greater leverage in addressing the circumstances where this condition is not satisfied. The Amendment would also incorporate directly into the Exemption remedies and protections for Plan clients harmed by wrongdoing; these remedies and protections are largely based on conditions the DOL has previously imposed for granting individual relief from disqualification. Part of the expressed rationale for the Amendment is the growth in the footprint of many large asset managers, for example in foreign jurisdictions and in connection with

joint ventures, and there is a recognition in the explanation of the Amendment that large asset managers that use the Exemption need to diligently monitor the compliance of unrelated business units in control relationships with the QPAM.

- **Foreign Crimes and Additional “Prohibited Misconduct”:** While the DOL already interprets the criminal eligibility provisions of the Exemption to include foreign convictions “substantially equivalent” to the offenses enumerated in the Exemption, the Amendment would expressly add these offenses to the list of disqualifying crimes. In addition, the Amendment would establish a procedure that would allow the DOL, after due process, to disqualify QPAMs for “Prohibited Misconduct,” such as: (i) conduct subject to a non-prosecution or deferred prosecution agreement (or foreign equivalent) that, if successfully prosecuted, would have constituted a disqualifying crime; (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 addition of the Prohibited Misconduct provision could have a significant impact on asset managers with compliance shortcomings that permit rank-and-file traders to engage in criminal activity, as a common strategy in that situation has been to fire the traders and negotiate civil penalties for the institution that would not result in disqualification under the Exemption’s current terms.
- **Required Changes to Management Agreements:** The Amendment would require a management agreement between the QPAM and each client Plan to expressly provide that the QPAM: (i) will not restrict the Plan’s ability to terminate or withdraw from its arrangement with the QPAM if the manager were to lose its QPAM qualification and (ii) will 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. The proposed Amendment does not appear to make this condition prospective only, potentially requiring all QPAMs to amend all existing agreements. QPAMs must also agree not to employ individuals involved in such disqualifying criminal activity for a minimum of 10 years following the subject conduct.
- **One-Year Winding Down Period:** To mitigate disruption to Plans, the Amendment would permit a one-year “winding down” 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. Thus, the relief of the winding-down period appears to be quite limited. In addition, while this change may appear to be a “give” by the DOL, the DOL intends to employ this portion of the

Amendment to foreclose arguments by QPAMs that immediate disqualification would be detrimental to their Plan clients, bolstering the argument for the need to provide individual exemptive relief from this condition to the affected manager. With the wind-down period built into the Exemption, the DOL argues that Plan clients will have adequate time to migrate their assets to other managers.

- **Recordkeeping:** The Amendment would add a new recordkeeping provision, requiring QPAMs to maintain records of compliance with the Exemption's requirements for six years and make these records available for inspection by Plan fiduciaries, contributing employers and sponsoring organizations; Plan participants and beneficiaries; and the DOL, the IRS and other federal and state regulators. These inspection requirements would be subject to limitations to protect the QPAM's trade secrets and, in the case of Plan parties, limited to records pertaining only to the relevant Plan and not to other clients of the QPAM. Compliance with the recordkeeping requirement with respect to a transaction would be a condition to the relief provided by the Exemption for such transaction.
- **Clarification of QPAM's Independent Authority over Transactions:** The Amendment would add, as an express condition to the Exemption, that the investment of assets managed by the QPAM is the sole responsibility of the QPAM (i.e., that parties in interest must not be permitted to make decisions regarding Plan investments under the QPAM's control). The scope of this clarification is not very clear, although it does appear to be intended to codify the DOL's prior statement as to the ineffectiveness of using a so-called "QPAM for a day" to perfunctorily bless transactions negotiated by parties in interest.
- **Public Notice:** Entities intending to rely on the Exemption would be required to send a one-time email notifying the DOL of their reliance on the Exemption. The DOL has stated that it intends to use these submissions to create a public database of QPAMs.
- **Capitalization and AUM Updates:** For QPAMs that are registered investment advisers, the Amendment would also increase: (i) assets under management requirements from greater than \$85,000,000 to greater than \$137,870,000 and (ii) equity capitalization requirements from greater than \$1,000,000 to greater than \$2,040,000. Capitalization requirements would also be increased for any bank, savings and loan association or insurance company seeking to qualify as a QPAM. Under the Amendment, these thresholds would also be subject to annual cost-of-living increases.

Written comments on the proposed Amendment must be submitted to the DOL by September 26, 2022. If adopted, the Amendment would be effective 60 days after its final publication.

* * *

Please do not hesitate to contact us with any questions.

NEW YORK



Lawrence K. Cagney
lkcagney@debevoise.com



Jonathan F. Lewis
jflewis@debevoise.com



Franklin L. Mitchell
flmitchell@debevoise.com

WASHINGTON, D.C.



Douglas M. Hirn
dmhirn@debevoise.com



Alison E. Buckley-Serfass
aebuckleyserfass@debevoise.com