PTS-22-11-00-CoverFInal.qxp_Journal covers 10/18/22 3:35 PM Page 1

THOMSON REUTERS
CHECKPOINT™

November 2022

Offers in Compromise

Opportunity Zones

The R&D Tax Credit

Managing Retirement Plan Assets: The QPAM Exemption

THOMSON REUTERS®

PTS-22-11-06-KOPPEL.qxp_PTS_Article_template_3 10/17/22 4:53 PM Page 23

PAUL KOPPEL

On 7/27/2022, the U.S. Department of Labor (DOL) published a proposed amendment to the Qualified Professional Asset Manager (QPAM) Exemption rule that many fund managers rely on to manage the money of ERISA plans and IRAs (plan money). The 99-page proposal would radically alter the 38-year-old rule, introducing expanded circumstances for ineligibility and imposing new substantive requirements for managers of plan money.

The QPAM exemption

Typical transactions (e.g., sales, purchases, leases, loans, provisions of services, etc.) between plans and so-called parties in interest to those plans are per se prohibited under ERISA and the Internal Revenue Code. The prohibited transaction prohibitions are designed to protect plans from abusive and unfair transactions that could occur between plans and those who are already connected to or affiliated with the plans.

The protection starts with a ban on typical transactions between plans and their parties in interest. However, many such transactions between plans and their parties in interest are permitted if they are negotiated by, controlled by, and managed by certain sophisticated independent fiduciaries, as long as certain qualifications and conditions are met. The most common and well-known exemption to the per se prohibited transaction prohibitions is Prohibited Transaction Class Exemption 84-14, relating to qualified professional asset managers, or "QPAMs", which is otherwise known as the "QPAM Exemption."

The QPAM Exemption permits investment funds that are treated as the assets of the investing plans to participate in many typical commercial transactions with parties in interest. The QPAM Exemption has historically been the most widely recognized and readily accepted prohibited transaction exemption in the market.

The current proposal

If this proposed amendment to the QPAM Exemption is finalized, it will be much more difficult for registered investment advisers, banks, and insurance companies to manage funds that hold plan assets – investments from ERISA plans and

If the Department of Labor's proposed amendment to the QPAM Exemption is finalized, it will be much more difficult for registered investment advisers, banks, and insurance companies to manage funds that hold plan assets – investments from ERISA plans and IRAs.

PAUL KOPPEL is a Partner at Clifford Chance in New York, where he is the firm's Head of ERISA. He regularly advises clients regarding a broad range of ERISA and executive compensation matters.

PTS-22-11-06-KOPPEL.qxp_PTS_Article_template_3 10/17/22 4:53 PM Page 24

IRAs. The amendment in its current form will have two key consequences: (1) fewer managers will be willing or able to act as a QPAM, and (2) the QPAM Exemption will not be available in more transaction situations. Managers will need to work with their counsel to learn how to rely on other prohibited transaction exemptions when managing plan money.

The 99-page proposal would radically alter the QPAM Exemption, which provides relief for certain per se prohibited transactions under Section 406(a) of ERISA and Section 4975 of the Internal Revenue Code. Among other changes, the proposal would further limit who may qualify as a QPAM and will impose new substantive requirements that many managers may be unwilling or unable to satisfy. Those managers may also find that they may not be able to live up to existing covenants made to plan investors in fund documents.

Significant changes

The following are among the significant changes in the proposal:

- *All affected managers will need to notify the DOL that they are relying on the QPAM Exemption.* There are no current notification or registration requirements for QPAMs. In a change from this longstanding practice, the DOL is proposing a new requirement that QPAMs notify the DOL of their status. The DOL also intends to list all QPAMs on its website. This requirement may deter some entities from serving as QPAMs; while every entity that acts as a QPAM today is already a regulated entity (bank, savings and loan association, insurance company, or registered investment adviser), not every entity will want to also register with the DOL.
- *Existing QPAM management agreements will need to be amended.* The DOL is proposing that every relationship between a QPAM and a plan will need to be promptly covered by a written management agreement stating that if the QPAM, certain of its affiliates, or 5% owners engage in conduct that results in a "Criminal Conviction" or an "Ineligibility Notice" from the DOL, the plans would not be restricted from terminating their arrangement with the QPAM or withdrawing from the investment fund. More important, the management agreement would need to provide expansive indemnities to client plans.
- In addition to the revised management agreements, within 60 days after the final QPAM amendment is published in the Federal Register, it may be that even swap, hedging, and lending agreements will need to be amended to reflect the new rules regarding indemnification of plan clients, depending on the wording of the existing agreements. Fund managers and GPs who have promised in fund documents to act as QPAMs if their funds become plan assets will need to revisit and revise those fund document provisions.
- *The list of crimes that make one ineligible to act as a QPAM is growing.* The conviction of a QPAM, certain affiliates, or shareholders of one of a list of U.S. federal and state crimes will currently make a manager ineligible to rely on the QPAM Exemption for 10 years. As amended, crimes that trigger QPAM ineligibility will include convictions "by a foreign court of competent jurisdiction for any crime … however denominated by the laws of the relevant foreign government, that is substantially equivalent to" one of the U.S. federal or state crimes identified in the exemption. The DOL believes that such convictions show a culture of noncompliance in an organization, and the DOL currently believes that such organizations should not be managing plan money. Query, however, whether the conviction of a foreign affiliate that has nothing to do with a manager's plan asset management business should have any bearing on the manager's continuing qualification as a QPAM.
- *The circumstances that can lead to QPAM ineligibility are expanding.* The proposed amendment includes new paths for managers to become ineligible to act as QPAMs. Participation in one of (or sometimes just approving of or not stopping) one of five kinds of "Prohibited Misconduct" will lead to ineligibility just as a conviction of a crime would. Managers who become ineligible to act as QPAMs will be required to wind down their QPAM businesses over a one-year period.
- *The amendment makes clear that a QPAM cannot allow others to make decisions that are supposed to be controlled by the QPAM.* The DOL has said in the preamble to the amendment that a

manager relying on the QPAM Exemption must not "act as a mere independent approver of transactions. Rather, the QPAM must have and exercise discretion over the commitments and investments of [p]lan assets and the related negotiations with respect to a fund that is established primarily for investment purposes in order for the relief provided under the exemption to apply." Managers and their advisers will need to think carefully about how this new language limits what QPAMs may delegate to subadvisors.

- *Managers will need to meet increased assets under management and shareholder equity eligibility thresholds.* The QPAM Exemption requires managers to have minimum equity and assets under management. For registered investment advisers, the amendment increases the shareholders' and partners' net worth thresholds from $1,000,000 to $2,040,000, and assets under management from $85,000,000 to $135,870,000, to be adjusted in the future for inflation.
- *QPAMs will need to satisfy new substantive recordkeeping requirements.* The amendment would require each QPAM to keep records for six years showing how the QPAM complied with the QPAM Exemption. The DOL wants there to be "evidence of compliance" "available for review." The recordkeeping requirement could dramatically change the administrative procedures and burdens that QPAMs face, and some existing QPAMs may be unwilling or incapable of taking on these burdens.

Conclusion — key issues

The following are key issues concerning the proposed amendment:

- If this proposed amendment is finalized, it will be much more difficult for registered investment advisers, banks, and insurance companies to manage funds that hold plan assets – investments from ERISA plans and IRAs.
- All affected managers will need to notify the DOL that they are relying on the QPAM Exemption, and existing QPAM management agreements will need to be amended.
- The circumstances that can lead to QPAM ineligibility are expanding.
- Managers will need to meet increased assets under management and shareholder equity eligibility thresholds, and QPAMs will need to satisfy new substantive recordkeeping requirements.