

Memorandum

DOL Proposes Significant Amendments to Prominent ERISA Exemption

July 29, 2022

On July 27, 2022, the U.S. Department of Labor (the “**DOL**”) proposed major changes (the “**Proposal**”)¹ to a core exemption used by many investment managers that have discretionary responsibility over the assets of funds and accounts that are deemed to hold “plan assets” under the U.S. Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”).² The exemption, commonly known as the “**QPAM Exemption**,”³ allows a manager of a “plan assets” fund or account (*i.e.*, the “**QPAM**”) to enter into a myriad of transactions on behalf of the fund/account that would otherwise be prohibited under Section 406(a) of ERISA and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended.

Should the DOL finalize these amendments, those that manage “plan assets” on a discretionary basis should reconsider whether it can, or is willing to, continue relying on the QPAM Exemption. Moreover, investment managers would most likely need to revise investment management agreements and provisions in ISDAs and other trading agreements, if representations regarding QPAM-status are included. Private fund sponsors will also be affected, namely, they will need to (i) evaluate whether the QPAM Exemption remains available, if a fund holds “plan assets,” and, if not, whether an alternative exemption may be available, (ii) revise, as necessary, subscription and offering documents that refer to the QPAM Exemption, and (iii) consider whether any of its portfolio companies act or intend to act as a QPAM and whether such companies can continue doing so.⁴

Summary of Proposal

- **Non-U.S. Crimes May Now Disqualify the QPAM.** One key condition of the QPAM Exemption is that it is not available if the QPAM, its affiliates, or any five percent or more owner of the QPAM, has been convicted of any of the U.S. crimes that are listed in Section I(g) of the current QPAM Exemption. The Proposal expressly provides that the conviction by a *non*-U.S. court of a crime that is “substantially

¹ 87 FR 45204 (July 27, 2022), <https://www.federalregister.gov/documents/2022/07/27/2022-15702/proposed-amendment-to-prohibited-transaction-class-exemption-84-14-the-qpam-exemption>.

² Many fund sponsors structure their funds to avoid being deemed to hold “plan assets,” such as by relying on the “venture capital operating company” and “real estate operating company” exceptions or by satisfying the “25% Test.” In those instances, ERISA is **not** applicable to the management of those funds and reliance on the QPAM Exemption (or any other exemption) is **not** necessary.

³ DOL Prohibited Transaction Class Exemption 84-14 (49 FR 9494 (Mar. 13, 1984)), as amended.

⁴ The Proposal provides that, if finalized, the amendments would be effective 60 days after the date they are published in the Federal Register. This lack of grandfathering/transition relief could complicate compliance efforts.

equivalent” to a U.S.-listed crime would also disqualify the QPAM from relying on the QPAM Exemption (each such U.S. and non-U.S.-covered conviction, a “**Disqualifying Conviction**”). Thus, an investment manager of a “plan assets” fund would not be able to rely on the QPAM Exemption for 10 years following a Disqualifying Conviction, whether such conviction arises from a judgment in the U.S. or elsewhere.⁵

- **Non-Criminal Conduct May Now Disqualify the QPAM.** The Proposal also markedly expands the circumstances under which a QPAM is disqualified by including non-criminal conduct. Specifically, an investment manager of a “plan assets” fund/account would no longer be able to rely on the QPAM Exemption for ten years, if such investment manager, an affiliate or any owner (direct or indirect) of a five percent or more interest in such investment manager, actively engages in, knowingly approves of, or has knowledge (without taking active steps to prohibit) of, any of the following:
 - Conduct that forms the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a listed U.S. or its substantially equivalent non-U.S. crime under Section I(g) of the QPAM Exemption; and
 - Conduct that results in a “systematic pattern or practice of violating”⁶ or intentionally violating, the QPAM Exemption (each, “**Prohibited Misconduct**”).⁷
- **Newly-Required Contractual Terms.** Under the current QPAM Exemption, the QPAM must acknowledge its fiduciary status in a “written management agreement.” In the funds context, this would typically occur in the offering memorandum, subscription agreement and/or Limited Partnership Agreement (or its equivalent) of the fund. The Proposal materially broadens the type of content that must be included in this written agreement. Specifically, the agreement would have to include a statement that, in the event of a Disqualifying Conviction or a Written Ineligibility Notice, and for at least 10 years thereafter, the QPAM:
 - Agrees not to restrict the ability of a plan client to terminate or withdraw from the fund, or impose any fees, penalties or charges on plan clients in connection with withdrawing from the fund (except for reasonable fees, disclosed in advance, that are specifically designed to ensure the equitable treatment of all investors in the fund in the event such withdrawal may have adverse consequences for all other investors, provided that such fees are applied consistently and in a like manner to all such investors);

⁵ The Proposal would not amend Section 411 of ERISA, which separately provides that certain crimes disqualify an entity from acting as an ERISA fiduciary.

⁶ Notably, the DOL indicated in the preamble to the Proposal that, “[i]n connection with a robust compliance infrastructure, a minor number of isolated violations of [the QPAM Exemption] would not constitute a systemic pattern or practice.”

⁷ The Proposal includes a “due process” mechanism. First, the DOL would issue a “written warning” to the QPAM identifying the specific Prohibited Misconduct. Second, the DOL would provide the QPAM “the opportunity to be heard” in person, in writing or combination thereof, provided the QPAM requests such hearing within 20 days from the date of the written warning. Third, if the DOL remains convinced that Prohibited Misconduct occurred, the DOL would issue a “**Written Ineligibility Notice**” to the QPAM, an affiliate, or a five percent or more owner of the QPAM. Upon issuance of a Written Ineligibility Notice, the QPAM would not be able to rely on the QPAM Exemption for 10 years from the date of such notice.

- Agrees to indemnify, hold harmless and promptly restore actual losses to the plan clients for any damages that directly result from the conduct giving rise to the Disqualifying Conviction, Written Ineligibility Notice, or breach of contract; and
- Agrees that it will not employ or knowingly engage any individual that participated in the conduct that is the subject of the Disqualifying Conviction or Written Ineligibility Notice.⁸
- **New Recordkeeping Requirement.** The Proposal would impose a new obligation on a QPAM to maintain records for a period of six years from the date of any transaction utilizing the QPAM Exemption sufficient to enable the DOL, a plan fiduciary, the plan sponsor, and participants and beneficiaries to determine that the conditions of the QPAM Exemption have been met. It appears that only the DOL will have access to trade secret and proprietary information.
- **One-Time Notice to the DOL of QPAM's Reliance on the QPAM Exemption.** The QPAM must report the legal name of each business entity relying upon the QPAM Exemption, as well as any name the QPAM may be operating under, in an email to the DOL. The DOL intends that the list of QPAMs will be made publicly available on its website.
- **Other Requirements For QPAM Qualification.** For registered investment advisers, under the Proposal the total client assets under management requirement has been increased from \$85,000,000 to \$135,870,000 and the shareholder equity requirement has been increased from \$1,000,000 to \$2,040,000 (in each case subject to annual adjustments to account for inflation).

Written comments to the Proposal must be submitted to the DOL by September 26, 2022.

⁸ The Proposal provides that a QPAM that is precluded from relying on the QPAM Exemption due to a Disqualifying Conviction or Written Ineligibility Notice will have a one-year grace or "wind-down" period to continue relying on the QPAM Exemption for existing plan clients, subject to certain requirements, including disclosure to clients.

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