APRIL 10, 2024

QPAM Amendment: What Plan Fiduciaries Need to Know

by R. Sterling Perkinson , Sanyam D. Parikh

The Department of Labor ("DOL") issued the final amendment to the qualified professional asset manager ("QPAM") prohibited transaction class exemption on April 3, 2024, with an effective date 75 days later (*i.e.*, June 17, 2024). The final QPAM amendment includes a number of changes that impose stricter qualification and compliance obligations on the investment managers (including managers of investment funds that manage retirement plan assets) seeking to qualify as QPAMs and expands the types of "prohibited misconduct" that can cause a QPAM to be ineligible for the exemption. These changes carry implications for investment fiduciaries of retirement plans subject to ERISA and individual retirement accounts under Section 408 of the Code (each, a "plan" and each fiduciary, a "plan fiduciary") that engage QPAMs for their plans.

Fortunately, no immediate action is required of plan fiduciaries as a result of the final QPAM amendment with respect to any existing written management agreements with their QPAMs. While the proposed QPAM amendment previously issued by DOL would have required all written management agreements between QPAMs and plan investors to be amended to include specific indemnities triggered upon the investment manager's violation of laws or failing to qualify as a QPAM, the final amendment dropped this requirement.

However, going forward plan fiduciaries should consider the new QPAM requirements when appointing investment managers or subscribing for interests in private funds that employ a QPAM strategy. In addition, plan fiduciaries will need to familiarize themselves with the QPAM amendment so that they can appropriately discharge their fiduciary duties in the event that an investment manager fails to satisfy any of the conditions of the QPAM exemption, as described further below.

I. QPAM Exemption Background

Plan fiduciaries are subject to number of fiduciary duties under ERISA and the Code to ensure that plan assets are managed in the best interest of participants and beneficiaries, including the requirement that plan fiduciaries avoid engaging in "prohibited transactions." Prohibited transactions can occur when a plan fiduciary causes the plan to engage in a sale or exchange, leasing of property, loan or extension of credit, or the furnishing of goods, services or facilities, between the plan and any "party in interest [1]," and there isn't an individual or class exemption covering the transaction.

The QPAM exemption is an important and commonly used prohibited transaction class exemption that enables many large fiduciary investment managers to carry out core investment functions for their client plans where the investment functions involve a party in interest to the plan or any plan fiduciary. This exemption provides relief for many transactions between the QPAM (registered investment advisers, banks, savings and loan associations and insurance companies) and parties in interest to a plan or plan

fiduciary if the conditions of the exemption are met. QPAM relief may apply in cases where an investment manager is managing plan assets directly (such as through a separate account) or through a fund that is deemed to hold assets of the plan[2].

II. Amendments to the QPAM Exemption

The final amendment provides a number of amendments and clarifications to the QPAM exemption. Some of the most significant items for plan fiduciaries are described below.

Criminal Convictions and Prohibited Misconduct. One of the conditions of the general QPAM exemption was that none of the QPAM, an affiliate of the QPAM, or any 5% or more owner of the QPAM was, in the 10 years immediately preceding the transaction that is to be covered by the exemption, convicted of certain felonies described in the exemption. The final QPAM amendment clarifies that this ineligibility provision covers criminal convictions of the QPAM's affiliates in foreign jurisdictions and expands it to include certain non-prosecution agreements and deferred prosecution agreements (referred to as "Prohibited Misconduct" in the final amendment), subject to some exceptions.

Transition Period. Historically, if an investment manager ceased to qualify as a QPAM (for example, due to a criminal conviction of an affiliate), it needed to apply to the DOL for an individual exemption that would allow it to continue to operate as a QPAM. The final QPAM amendment provides a one-year transition period during which the QPAM exemption will continue to provide relief for transactions (including past transactions) initiated by the QPAM for any plan client that had a written management agreement in place with the QPAM on the date the date the QPAM lost eligibility to rely on the exemption, as long as the QPAM provides appropriate written notice to the DOL and each of its plan clients and meets certain other requirements in the final amendment. During this period, the QPAM may apply for an individual exemption from the DOL to continue to operate as a QPAM after the transition period ends.

During the transition period, the QPAM must meet certain requirements, including the following:

Offer Withdrawal Rights. The QPAM may not restrict the ability of a client plan or IRA to terminate or withdraw from its arrangement with the QPAM, and may not impose any fees, penalties, or charges on client plans or IRAs that terminate or withdraw from the QPAM relationship (other than certain reasonable fees, appropriately disclosed in advance). The DOL recognizes that there may be circumstances with illiquid investments (such as private equity) where withdrawal is not immediately available without risking harm to the client plans. In those circumstances, the DOL notes that the QPAM may need to apply for relief under an individual exemption that would enable it to continue to act as a QPAM.

Provide Indemnities. The QPAM must agree to indemnify, hold harmless, and promptly restore actual losses (including excise taxes and costs related to unwinding potential prohibited transaction) to the client plans that arise due to the loss QPAM eligibility. As noted above, the proposed QPAM amendment may have required amendments to existing written investment management agreements to provide for these indemnities, even if the agreement already includes general indemnity language for violations of law, breaches of fiduciary duty, and breaches of contract. However, the final amendment does not require amendments to existing agreements.

QPAM Registration. The final QPAM amendment provides a new requirement that QPAMs register with the DOL. The DOL will make available a list of registered QPAMs on a website. Before the amendment, no QPAM registration was required, and investment managers could qualify for the QPAM relief automatically if they met the requirements.

Independent Judgement of QPAM. The QPAM is required to exercise authority independent of the plan sponsors of its client plans or other parties in interest to the client plans. QPAM relief would not be available if the QPAM "uncritically" approves transactions negotiated, proposed, or approved by the plan sponsor or other parties in interest. However, the DOL clarified that this rule does not preclude the plan fiduciaries from regularly interacting with the QPAM as part of their fiduciary responsibility to monitor the QPAM, or to provide investment guidelines to the QPAM.

III. Further Considerations for Plan Fiduciaries

Changes to Investment Management Agreements. Plan fiduciaries should evaluate the extent to which changes should be made to investment management agreements to incorporate terms of the final QPAM amendment. For example, investment management agreements may be updated to reflect new representations and covenants regarding QPAM status, and to incorporate the indemnities and withdrawal rights that may arise in the event of a violation of the QPAM conditions. These changes may be incorporated into new investment management agreements. Plan fiduciaries may also consider whether to request amendments to existing investment management agreements to reflect these changes, even though this is not required by the final QPAM amendment.

Actions upon Notice of Loss of QPAM Status. In the event that a plan fiduciary receives notice that a QPAM has violated a QPAM condition, the plan fiduciaries will need to follow a prudent process to protect the interest of the plan. This process should consider, among other things:

- The extent to which a criminal conviction or prohibited misconduct of the QPAM or an affiliate presents risks to the plan or brings into question the QPAM's integrity or ability to carry out its investment mandate.
- The QPAM's proposed strategy for managing assets following the end of the transition period, such as applying for an individual exemption.
- Whether to exercise withdrawal rights during the transition period.
- Whether there may be losses to the plan or plan fiduciaries that may be recoverable under indemnities.

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[1] "Party in interest" is a broad term that captures a wide range of potential service providers to the plan sponsor or the plan. These terms include not only the plan sponsor and any other named fiduciaries of the plan, but also include any person providing services to the plan, any employer whose employees are covered by the plan and any of certain affiliates. The prohibited transaction rules in the Code include a similar concept but rather than "party in interest," the person or entity is a "disqualified person."

[2] Generally, when a plan invests in an investment fund that is not publicly traded, the fund is considered to hold "plan assets" of the investing funds, unless an exception applies. An exception may apply when the fund limits investment by benefit plan investors or the fund is structured so that it is deemed to be an operating company under DOL regulations.