DOL amends requirements, disqualifying events for widely used manager exemption

Investment managers that utilize a Department of Labor exemption for overseeing ERISA-covered plans and IRAs can lose their exempted status for more types of conduct under a new final amendment, but the department dropped the most onerous proposed change, which has some stakeholders relieved.

Under the Employee Retirement Income Security Act, transactions between financial institutions providing services such as acting as a broker-dealer or bank to 401(k) plans, IRAs and corporate pension plans and those institutions are prohibited unless an exemption is available to the transaction. The qualified professional asset manager exemption, or QPAM exemption, was created in 1984 to address when a plan engages in a transaction with a party that has an interest in that plan, such as a swap that hedges against the plan's currency risk.

The department on April 2 finalized an amendment originally proposed in July 2022 that aims to modernize the exemption to reflect the changes in the financial services industry over the past 40 years.

Arguably the most consequential part of the amendment is a provision stipulating that if a QPAM or affiliate is convicted of a covered crime in a foreign country, they would lose their QPAM eligibility, much like they would if they were convicted of a crime in the U.S.

Affirming that position — and reversing a piece of guidance handed down late in the

Trump administration — was the department's jumping off point for the rule-making, Ali Khawar, principal deputy assistant secretary of the Labor Department's Employee Benefits Security Administration, said in an interview.

In November 2020 under the Trump administration, the Labor Department issued an opinion letter that said foreign convictions weren't disqualifying to obtain a QPAM exemption. But in March 2021 under the Biden administration, the Labor Department revoked that opinion letter and solidified its position in the amendment.

"The longstanding position that we had had was that if that institution or its affiliate commits a crime it doesn't really matter where the crime occurs or where it's prosecuted," Khawar said.

More changes

One of the other major provisions in the amendment requires managers that are relying on the QPAM exemption to notify the department they are doing so.

"I think it's important that the government has insight into who's using the exemptions, how they're being used," Khawar said. "I'm a believer in transparency and I think that transparency is helpful."

Currently, Khawar noted, the department doesn't know how many managers utilize the QPAM designation.

Alexander P. Ryan, a partner in the executive compensation and employee benefits department at law firm Willkie Farr & Gallagher, said the notification requirement will create some concern for managers because it will put the department on notice with respect to their QPAM reliance. "That gives the DOL a source of information that it could use potentially to engage in investigatory or enforcement activities involving that manager," Ryan said.

Under the amendment, the department also increased the assets under management requirement — to $102 million from $85 million — and shareholder capital requirement — to $1.3 million from $1 million — for QPAM eligibility.

Khawar said QPAMs need to act independently, and the department was concerned that certain managers may be receiving too much of their overall AUM from a single QPAM investment management service. "The bigger their AUM is, the more diluted that concern is," he said.

Other key provisions include:

- If a QPAM, an affiliate, or any owner with at least a 5% stake in the QPAM enters into a non-prosecution agreement or deferred prosecution agreement with federal or local officials concerning conduct that, if successfully prosecuted, would have resulted in a criminal conviction, they would be excluded from using the exemption.

- Adds a one-year transition period that focuses on mitigating potential costs and disruption to plans and IRA owners when a QPAM becomes ineligible due to a conviction or participates in other serious misconduct.
- A requirement for QPAMs to maintain records demonstrating compliance with the QPAM exemption, and permit access to those records to both regulators and plan fiduciaries.

The amendment goes into effect June 17.

What impact will the amendment have on managers? For most, not much, according to Steven W. Rabitz, co-chair of Dechert's employee benefits and executive compensation practice who also leads the firm's national fiduciary practice.

"The way I see this is if you're a money manager that will never experience any of these now broadly defined disqualification events, you're going to have to do a little bit more work, but it's not necessarily going to be a change in your overall behavior or operational presence," he said.

Some reprieve

Members of the SPARK Institute, which include investment managers and record keepers, routinely rely on the QPAM exemption, or facilitate its use for plans selecting investments managed by entities that rely on the QPAM exemption.

Tim Rouse, SPARK's executive director, said he's concerned about the amendment's provision concerning foreign convictions and notification requirements but is pleased that the department "removed one of the worst parts of their proposal."

SPARK and other industry groups, including the Investment Company Institute, the Securities Industry and Financial Markets Association and the U.S. Chamber of Commerce, voiced dismay with a provision in the 2022 proposal that would have required managers to update their written contracts, like investment management agreements, to, among other things, indemnify plans for the costs arising out of any future failure of the QPAM exemption.

"Amending tens of thousands of agreements for a theoretical possibility that could be addressed if and when that event ever happened struck many as overkill," Rabitz said.

"Both managers and sponsors would have been burdened by that provision in the proposal had it survived the final," added Ryan of Willkie Farr & Gallagher.

Dennis Simmons, executive director for the Committee on Investment of Employee Benefit Assets, whose 113 members are asset owners with more than $2.1 trillion of defined benefit and defined contribution plan assets, also raised alarm bells during the public comment period over that provision. He said the QPAM exemption has been working fine for 40 years and didn't want to see it upended by a new, onerous requirement.

“The acknowledgement that the exemption is generally working well and that fiduciaries don’t have to change the tires while the car is running is a very good thing,” he said, noting the department’s decision to drop the provision in the final amendment. “We were concerned that something that’s working well would be derailed significantly and we’re pleased that the DOL has listened to comments on that point.”

In the final amendment, the department “sanded off a few of the rough edges that were in that proposal” so there is “unlikely to be a dramatic flight away from the QPAM exemption,” Ryan said.

“Because it so ubiquitous, because it does cover so many day-to-day third-party transactions, and because it’s viewed as a mark of sophistication and quality on the part of various managers, I don’t foresee a dramatic turning away from the exemption,” Ryan added, though he said more managers may be encouraged to consider alternative prohibited transaction exemptions from the department in the future.

--Brian Croce