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April 25, 2024

Department of Labor Publishes Final Amendment to the QPAM Exemption

Department Significantly Expands Events that Result in Ineligibility to Rely on QPAM Exemption, Including NPAs or DPAs with Federal and State Prosecutors; in Addition, Ineligibility Could Result from Certain Foreign Criminal Convictions and Resolutions, Civil Court Findings, and Court-Approved Settlements with State and Federal Regulatory Agencies

SUMMARY

On April 2, 2024, the Department of Labor (the "Department") finalized an amendment (the "Final Amendment") to the Qualified Professional Asset Manager ("QPAM") Class Prohibited Transaction Exemption 84-14 (the "QPAM Exemption").[1] The most significant aspect of the Final Amendment is its modification of the QPAM Exemption's Section I(g), which provides that a QPAM is ineligible to rely on the exemption for a period of 10 years if the QPAM, any Affiliate[2], or any direct or indirect owner of a five percent or more interest in the QPAM ("Five-Percent Owner") has been convicted of certain crimes. The Final Amendment expands the events that result in ineligibility to include entry into non-prosecution agreements ("NPAs") and deferred-prosecution agreements ("DPAs") where the alleged conduct could have, if successfully prosecuted, resulted in a conviction of the enumerated crimes. In addition, consistent with long-standing Department practice, the Final Amendment makes explicit that convictions for foreign crimes that are substantially equivalent to the enumerated crimes also result in ineligibility, and entry into certain foreign NPA and DPA equivalents may also result in ineligibility, although this is not automatic. In addition, factual findings in certain civil actions and court-approved settlements that indicate that a QPAM has violated the conditions of the QPAM Exemption also will result in a QPAM's ineligibility in actions brought by certain federal authorities. As a result of the changes, asset managers could be prohibited from relying on the exemption for a much wider range of activities that, in the Department's view, call into

question a firm's overall "culture of compliance." If an asset manager loses its eligibility to use the QPAM Exemption, it will have to rely on an alternative regulatory exemption, apply for an individual exemption, or be subject to the full set of restrictions imposed by ERISA which, as a practical matter, could significantly undermine its ability to serve benefit plans.

The Final Amendment also:

- provides a one-year transition period from its effective date, during which a QPAM can assess if it continues to satisfy the QPAM Exemption and benefit plan clients can amend or exit arrangements with the QPAM;
- requires an ineligible QPAM to allow its benefit plan clients to withdraw their funds without penalty and indemnify them for any losses resulting from the conduct that led to the QPAM's ineligibility;
- imposes a one-time notice requirement for all asset managers relying on the QPAM Exemption to register with Department their reliance on the exemption;
- raises the equity and asset management thresholds for the QPAM Exemption in line with inflation;
- requires QPAMs to maintain records sufficient to demonstrate their eligibility to rely on the QPAM Exemption for the prior six years.

The Final Amendment will become effective on June 17, 2024.

BACKGROUND

When financial institutions hold assets for benefit plans such as 401(k) plans or individual retirement accounts, the managers become fiduciaries under ERISA. ERISA fiduciary standards are often considered the highest fiduciary standards under U.S. law, and include a prohibition from causing the plans to engage in certain transactions, including sale, exchange, or leasing of property, and loan or extension of credit, with any "party in interest."[3] A "party in interest" with respect to a plan is defined very broadly, and includes any plan fiduciaries, service providers, and employers whose employees are covered by the plan.[4] For example, the independent auditor of a plan's financial statements is a service provider to the plan, and is considered a party in interest. As a result of this broad prohibition, many ordinary-course business arrangements could be treated as prohibited transactions. The Department, which has been authorized to promulgate regulations in this area, has provided a number of exemptions that permit plan fiduciaries satisfying certain conditions to engage in otherwise prohibited transactions. Non-exempt prohibited transactions can be subject to civil penalties, excise taxes, reimbursement obligations, and a requirement to unwind the offending transaction. Therefore, as a practical matter, plan investors and counterparties almost always require that a plan fiduciary qualify for an exemption.

The QPAM Exemption is one of the most well-established exemptions, and is available to certain registered investment advisers, banks, savings and loan associations, and insurance companies.[5] The policy rationale for the exemption was that large and sophisticated financial institutions—which are generally subject to separate state or federal regulation—are reasonably able to resist undue influence on transaction terms by

a party in interest. However, when such an institution's integrity is called into doubt—such as when an institution is convicted of certain crimes—Section I(g) of the QPAM Exemption generally disqualifies that institution from relying on the exemption. Under such circumstance, a QPAM could still apply for an individual exemption by demonstrating that it is nevertheless capable of acting solely in the interest of its plan investors, but such applications are lengthy and costly, with no guarantee that they will be granted.

THE FINAL AMENDMENT

Currently, Section I(g) provides that a QPAM is ineligible to rely on the QPAM Exemption if the QPAM, any Affiliate or any Five-Percent Owner has been convicted of any domestic felony arising out of the conduct of the business of a broker-dealer, investment adviser, bank, insurance company or fiduciary; income tax evasion, any felony involving larceny, theft, robbery extortion, forgery, counterfeiting, fraudulent concealment, fraudulent conversion, or misappropriation of funds or securities, or conspiracy or attempt to commit any such crime (collectively, "Criminal Convictions"). Such conviction makes the QPAM ineligible to rely on the Exemption for 10 years.[6]

The Final Amendment will expand ineligibility to trigger not just on criminal conviction, but also on execution of NPAs and DPAs, as well as certain foreign criminal convictions and resolutions, civil court orders, and court-approved settlements.

Non-Prosecution and Deferred-Prosecution Agreements

In addition to the enumerated criminal convictions, the Department created a new category of events that triggers ineligibility, which it refers to as "Prohibited Misconduct." Under the Final Amendment, a QPAM will be ineligible to rely on the QPAM Exemption when the QPAM, any Affiliate, or any Five-Percent Owner enters into an NPA or a DPA with a U.S. federal or state prosecutor's office or regulatory agency, where the factual allegations that form the basis for the NPA or DPA, if proven, would have constituted a crime that would result in a Criminal Conviction (defined below). That entering into such an NPA or DPA will result in *automatic ineligibility* in the Final Amendment is a significant departure from the 2022 proposed version of the Amendment (the "Proposed Amendment"), which provided that the Department would issue a written warning to the affected QPAM on the execution of an NPA or DPA and provide the QPAM with an opportunity to be heard on why the agreement should not render the QPAM ineligible.

In the Proposed Amendment, the Department explained that it "intends to rely on its enforcement authority and program to detect a QPAM's participation in the types of misconduct" included in the Proposed Amendment.[7] The Department built in due process components so that ineligibility "occurs only in limited circumstances, and even in those circumstances, the process to make the QPAM ineligible would have begun only after two initial steps: (1) an investigation by the appropriate field office, and (2) receipt by the QPAM thereafter of a written warning that the Department was contemplating issuing a Written Ineligibility

Notice."[8] This process would have allowed the QPAM the opportunity to be heard before the Department issued an actual notice that would have made the QPAM ineligible to rely on the QPAM Exemption.

Commenters overwhelmingly objected to the inclusion of NPAs and DPAs as events that should give rise to ineligibility. Some stated that the expansion eroded the certainty that the QPAM Exemption provides regarding eligibility. Others suggested that the Department was "mischaracterizing the nature and use of NPAs and DPAs, as well as their objectives (such as avoiding the collateral consequences of penalizing innocent parties)."[9] Some commenters asserted that "even where an institution believes it has not engaged in wrongdoing and would prevail on the merits in a court of law, they may prefer to enter into a NPA or DPA for a variety of reasons."[10] Finally, some commenters expressed concern that financial institutions will be less willing to enter into NPAs or DPAs if doing so would result in ineligibility under the Exemption. The Department noted one comment that "if entering into a DPA or NPA would effectively end a firm's ERISA investment management business, the firm may not be able to enter into the agreement, even when doing so is the best resolution for the government prosecutor involved."[11]

In the Final Amendment, the Department stated that it consulted with the DOJ and with the SEC to "affirm its understanding of NPAs and DPAs, particularly the level of culpability on the part of the QPAM that would accompany such an agreement. Based on these consultations, the Department understands that, as a matter of course, these domestic NPAs and DPAs are accompanied by Statements of Fact that establish the basis for criminal liability. In most cases, the offending party avoids prosecution for the crime on the basis of the party's agreement to enter into, and comply with the terms of the agreement."[12]

In support of its inclusion of NPAs and DPAs as events resulting in *automatic* ineligibility, and without providing the QPAM with notice and the opportunity to be heard in respect of NPAs and DPAs, the Department said, in cases where the QPAM, any Affiliate, or any Five-Percent Owner has executed an NPA or DPA,

> the Department has precisely the same concerns about the QPAM's compliance culture, and its ability and willingness to adhere to its fiduciary obligations and the exemption conditions, as it does when any of these parties have been formally convicted of the crime. The cause for concern about the QPAM is not the conviction *per se*, but rather the serious misconduct that underlies the conviction. In these cases, responsible federal or state officials have resolved serious claims of misconduct against parties through the execution of a formal agreement voluntarily entered into with the parties. In these circumstances, if the alleged misconduct is sufficient to form the basis for an NPA or DPA that is entered into by the [QPAM, Affiliate, or Five-Percent Owner], it is appropriate to treat the agreement as cause for ineligibility under Section I(g).[13]

The Department continued:

> any due process concerns with including NPAs and DPAs . . . are addressed by the change to the Prohibited Misconduct provision in the

> Final Amendment providing that ineligibility does not occur until after a [QPAM, any Affiliate, or any Five-Percent Owner] has executed an NPA or DPA. Those agreements result from criminal investigations and are voluntarily entered into by the parties. QPAMs and other affected entities that enter into an NPA or DPA generally will be afforded the numerous due process protections that are associated with criminal investigations and negotiating these agreements.[14]

Ineligibility will result from NPAs and DPAs executed on or after June 17, 2024.

NPAs and DPAs with Foreign Governments

The Proposed Amendment would have treated the "substantial equivalent" to an NPA or DPA with a foreign government the same as an NPA or DPA entered into with the U.S. federal or state government authorities. Commenters expressed that the proposal provided the Department with "unfettered discretion" to determine whether a foreign NPA or DPA was "substantially equivalent" to a domestic NPA or DPA and questioned whether the Department has the "necessary proficiency in criminal justice and international law, or jurisdictional authority to make such determinations."[15] Other commenters suggested it would be difficult for the Department to apply the substantially equivalent standard in the context of foreign NPAs and DPAs due to differences in foreign laws and prosecutorial practices, as well as due process protections.

In response to these comments, in the Final Amendment, the Department revised its approach with respect to NPAs and DPAs entered into with foreign governments. Such NPAs and DPAs will not trigger automatic ineligibility. Rather, Section I(g)(2) will require that the QPAM submit a notice to the Department if the QPAM, any Affiliate, or any Five-Percent Owner enters into an agreement with a foreign government that is "substantially equivalent" to a domestic NPA or DPA that would trigger ineligibility. The QPAM must submit such notice within 30 days of the execution date of the foreign NPA or DPA equivalent and must include a description of the allegations underlying the agreement.

Foreign Convictions

While Section I(g) did not previously expressly include convictions in foreign jurisdictions, the Department has long taken the view that a foreign conviction that is "substantially equivalent" to a domestic conviction has the same effect on eligibility as a domestic conviction. The Proposed Amendment defined "Criminal Conviction" to include convictions "by a foreign court . . . as a result of a crime, however denominated by the laws of the relevant foreign government, that is substantially equivalent" to any of the above-mentioned crimes, to address perceived uncertainty about the effect of foreign convictions.[16]

Commenters raised concerns that the Proposed Amendment did not provide the intended certainty regarding foreign convictions because there could be difficulty in determining whether any given foreign crime is a felony in the foreign jurisdiction, or is substantially equivalent to a felony under U.S. law. Commenters also questioned the proposed "substantially equivalent" standard with respect to the nature seriousness of the crimes, and raised concerns that foreign jurisdictions might not adhere to basic due

process protections. Many commenters suggested that the Department establish a formal process by which a QPAM can request a determination from the Department regarding whether a foreign conviction is "substantially equivalent" to a domestic conviction before such conviction results in ineligibility.

The Department declined to add a formal process to the Final Amendment to make determinations of "substantial equivalence," stating: "The Department does not expect that questions of this nature will arise frequently, but when they do, impacted entities may contact the Office of Exemption Determinations for guidance, as they have done for many years. In general, the Department has not had difficulty determining whether the foreign crimes were substantially equivalent to domestic crimes and does not expect to have any difficult with these determinations."[17] The Department added that "the One-Year Transition Period [addressed more fully below], and the ability to apply for an individual exemption, provide parties with the time and the opportunity to address any issues about the import of any specific foreign conviction and its relevance to ongoing relief from full application of the prohibited transaction provisions."[18]

Under the Final Amendment, a conviction in a foreign jurisdiction of a substantially equivalent crime will have the same effect as if the conviction occurred in a domestic court — ineligibility will commence automatically on "conviction" (the precise timing of which may depend on foreign criminal procedure), and the QPAM must make an application to the Department to be able to continue to rely on the QPAM Exemption. In the Department's view, "[m]isconduct that results in a criminal conviction of an entity under Section I(g) of the QPAM Exemption, whether domestic or foreign, calls into serious question whether the QPAM has the integrity and culture of compliance on which the exemption is premised."[19]

The Final Amendment will follow the Proposed Amendment's definition of "Criminal Conviction" to include convictions in foreign courts but will exclude convictions that occur "within a foreign country that is included on the Department of Commerce's list of 'foreign adversaries.'"[20]

Court Judgments and Court-Approved Settlements

Under the Final Amendment, a QPAM will become ineligible if the QPAM, any Affiliate, or any Five-Percent Owner is determined in a final judgment or court-approved settlement in a proceeding brought by certain federal agencies[21] or any state regulator or state attorney general to have Participated In (defined below) a systematic pattern or practice of conduct that violates, or intentional conduct that violates, the conditions of the Exemption in connection with otherwise non-exempt prohibited transactions, or has provided materially misleading information to the Department or any of these agencies in connection with the Exemption.[22] The Final Amendment provides that ineligibility will be *automatic* on the entry of the judgment or court-approved settlement.

Importantly, the term "Participate In" refers "not only to active participation in Prohibited Misconduct, but also to knowing approval of the conduct, or knowledge of such conduct without taking active steps to prohibit such conduct, including reporting the conduct to the appropriate compliance personnel." In addition, the court does not need to have specifically considered the Exemption or its terms for the order or settlement

to be disqualifying. Rather, the court need only find that the QPAM, any Affiliate, or any Five-Percent Owner Participated In the Prohibited Misconduct.

The Proposed Amendment contemplated that the Department would issue a Written Ineligibility Notice process, and that ineligibility on the basis of a court's final judgment, or a court-approved settlement would take effect only after the Department determined that the QPAM, Affiliate, or Five-Percent Owner had Participated In Prohibited Misconduct. Commenters expressed concern with the Department's "potentially unlimited discretion" to decide what types of misconduct would trigger ineligibility.

The Department expressed its belief that the Final Amendment would satisfy the necessary due process concerns relating to automatic ineligibility because such factual findings will be made through an independently adjudicated, adversarial process: "Section V(s)(2) is much narrower than the proposal inasmuch as it covers the types of misconduct specified in the proposal only when the misconduct is established in court proceedings brought by state or federal regulators. It ensures that the finding of misconduct was subject to the robust procedural protections provided by such proceedings." Concern remains, however, as to whether the revised approach provides sufficient due process protection because it does not require a court to make the legal determination that a specific factual finding constitutes Prohibited Misconduct.

Commenters requested the Department provide examples of the Prohibited Misconduct of providing misleading statements. Others requested clarification that inadvertent technical errors, such as failure to timely notify the Department of a legal name-change, should not be deemed to constitute "providing materially misleading information." The Department declined to provide examples, but noted that "inadvertent technical errors do not result in Prohibited Misconduct, particularly when such errors are corrected consistent with ERISA and Code standards, as applicable. Similar to Criminal Convictions, the exemption's Prohibited Misconduct provisions are aimed at protecting Plans and IRA owners from conduct that calls into question a QPAM's integrity and compliance culture and inadvertent technical errors, especially such errors that are promptly corrected, should not amount to such conduct."

Timing of Ineligibility

Section I(h) retains the ineligibility start date for a Criminal Conviction as the date the trial court enters its judgment of conviction (irrespective of whether there is an appeal).[23] The ineligibility period for participating In Prohibited Misconduct begins on the date the QPAM, any Affiliate or any Five-Percent Owner executes an NPA or DPA, or is found or determined in a final judgment in certain federal or state court proceedings or a court-approved settlement to have Participated In conduct that meets the definition of Prohibited Misconduct (the "Ineligibility Date").

One-Year Transition Period After Ineligibility

As part of the Proposed Amendment, the Department included a mandatory one-year "Winding-Down Period" that would have begun on the Ineligibility Date, during which time the QPAM Exemption would be

available only for existing clients of the QPAM and with respect to transactions entered before the Ineligibility Date. The Winding-Down Period (renamed the "Transition Period" in the Final Amendment[24]) was intended "to give a QPAM's client plans time to decide whether to hire an alternative discretionary asset manager that is eligible to operate as a QPAM or continue their relationship with the ineligible QPAM."[25]

Commenters argued that the proposed prohibition on the QPAM engaging in any new transactions during the Transition Period, even for existing clients, should be removed, indicating that "when QPAMs have been engaged to carry out an investment strategy that requires them to continually make new investments, the proposed prohibition on engaging in new transactions for existing clients could be particularly detrimental."[26] Commenters also indicated that the process for replacing a larger plan's investment manager typically takes more than one year and suggested alternative timeframes for the Transition Period.

The Department acknowledged that benefit plan clients could suffer harm if their investments are effectively frozen, and removed the prohibition on QPAMs entering into new transactions for existing client plans during the Transition Period. The Department opted not to change the timeframe for the Transition Period in the Final Amendment, noting that where a longer Transition Period could be necessary, such extensions would be managed on a case-by-case basis through the individual exemption process.

The Final Amendment provides that, on Ineligibility Date, a QPAM will have a one-year Transition Period and will be permitted to continue to execute new and existing transactions for a plan if the QPAM meets the associated conditions. During the Transition Period, the QPAM:

- must, within 30 days after the Ineligibility Date, provide notice to the Department and each client plan advising of the Ineligibility and the initiation of the Transition Period;
- must include in that notice an objective description of the facts and circumstances upon which the Criminal Conviction or Prohibited Misconduct is based as well as the QPAM's agreement that it will not restrict the ability of a client plan to terminate or withdraw from its arrangement with the QPAM, will not impose fees, penalties, or charges on client plans in connection with the process of terminating or withdrawing from the QPAM's management, and will indemnify losses to the client plans for damages resulting to the plans from the Criminal Conviction or Prohibited Misconduct; and
- must not employ or knowingly engage any individual that Participated In the conduct that is the subject of the Criminal Conviction or that Participated In the Prohibited Misconduct causing the QPAM's ineligibility.[27]

Some commenters objected to the Transition Period indemnification requirement, noting that ERISA already contains indemnification requirements. The Department clarified that the new requirement is specifically intended to cover collateral consequences, citing to recent individual exemptions that included explicit references to costs arising from unwinding transactions with third parties and from transitioning plan assets to an alternative asset manager.

One-Time Notification to the Department

Section I(k) of the Final Amendment will require any entity relying on the QPAM Exemption to provide notification to the Department. Each entity that relies on the exemption must report the legal name of the entity relying on the exemption in an email to the Department, as well as the operating name of the QPAM. The notice needs to be made via an email to the Department at QPAM@dol.gov within 90 days of the QPAM's reliance on the Exemption. The notice needs to be made only once unless there is a change to the legal or operating name of the QPAM or when the QPAM no longer is relying on the exemption. All QPAMs relying on the exemption on the Effective Date must submit notice to the Department no later than September 15, 2024.

In the case of an inadvertent failure to provide timely notice in the initial 90-day period, the QPAM will have an additional 90 days to cure the failure by providing notice of reliance on the exemption and an explanation for the failure to timely submit notice in the initial 90-day period. Failure to provide notice within the cure period (i.e., within 180 days) will render the QPAM being unable to rely on the exemption until the QPAM provides notice and an explanation for the failure.

The Department will maintain on its website a list of entities currently relying on the QPAM Exemption.

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ENDNOTES

[1] Amendment to Prohibited Transaction Class Exemption 84-14 for Transactions Determined by Independent Qualified Professional Asset Managers (the QPAM Exemption), 89 Fed. Reg. 23090 (April 3, 2024), *available at* https://www.federalregister.gov/documents/2024/04/03/2024-06059/amendment-to-prohibited-transaction-class-exemption-84-14-for-transactions-determined-by-independent.

[2] Section VI(d) defines the term “Affiliate” to include any entity that controls, is controlled by, or is under common control with the QPAM. “Control” means the “power to exercise a controlling influence over the management or polices of a person other than an individual.”

[3] ERISA § 406(a); Internal Revenue Code § 4975(c)(1) (which uses the term “disqualified person” for the same general concept).

[4] ERISA §3(14).

[5] QPAM Exemption § V(a).

[6] Id, § VI(r); ERISA § 411.

[7] 87 Fed. Reg. 23209.

[8] Id, 23209.

[9] 89 Fed. Reg. 23100.

[10] Id, 23100.

[11] Id, 23100.

[12] Id, 23100.

[13] Id, 23101.

[14] Id, 23101.

[15] Id, 23100.

[16] Proposed Amendment to Prohibited Transaction Class Exemption 84–14 (the QPAM Exemption), 87 Fed. Reg. 45204, 23232 (July 27, 2022).

[17] 89 Fed. Reg. 23090, 23097.

[18] Id, 23097.

[19] Id, 23098.

[20] The list of foreign adversaries currently includes the following foreign governments and non-government persons: China, Cuba, Iran, North Korea, Russia, and the Venezuelan politician Nicolas Madura (Maduro Regime).

[21] This provision of “Prohibited Misconduct” would relate to proceedings brought by the Department, the Department of Treasury, the Internal Revenue Service, the Securities and Exchange Commission, the Department of Justice, the Federal Reserve Bank, the Office of the Comptroller of the Currency the Federal Depository Insurance Corporation, the Commodities Futures Trading Commission, and any state regulator or state attorney general.

[22] 87 Fed. Reg. 23209.

[23] Id, 23139.

[24] Id, 23139.

[25] Id, 23105.

[26] Id, 23106.

[27] Id, 23106.

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