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A legal update from Dechert's Employee Benefits and Executive Compensation and Financial Services Groups

DOL Amends "QPAM" Exemption

On September 3, 2003, the Department of Labor ("DOL") published proposed amendments to the Prohibited Transaction Class Exemption 84-14 ("QPAM Exemption").¹ The QPAM Exemption is frequently relied upon by persons engaging in transactions with accounts holding retirement plan assets. The DOL has now adopted, generally effective August 23, 2005, various amendments to the QPAM Exemption.²

The final amendments are similar to the proposed amendments from 2003, with certain modifications. While the amendments generally increase the circumstances in which the QPAM Exemption is available, they also make certain requirements for qualifying or acting as a QPAM more stringent.

The Pre-Amendment QPAM Exemption

Generally, the QPAM Exemption permits an account or investment fund, which is managed by a "qualified professional asset manager" or "QPAM," to engage in a broad range of transactions (such as sales, exchanges, leases, extensions of credit, and the provision of services, goods, or facilities), which would otherwise be prohibited by ERISA (and the Internal Revenue Code), with almost any party in interest of a plan which invests in the fund other than the QPAM itself and those parties most likely to have the power to influence the QPAM.

The QPAM Exemption does not apply to a transaction between an investment fund and a

party in interest of an investing plan, if such party in interest (or its "affiliate"):

- Is authorized to appoint or terminate the QPAM as a manager of any of the investing plan's assets
- Is authorized to negotiate the terms of the management agreement with the QPAM on behalf of an investing plan
- Has exercised any such authority during the immediately preceding one-year period. In addition, the QPAM Exemption does not apply to a transaction with a party in interest of an investing plan who is "related" to the QPAM, or with a party in interest of any investing plan the assets of which, when combined with the assets of other plans maintained by the same employer or its affiliates, constitutes more than 20% of the total client assets managed by the QPAM

A "party in interest" is generally a person who has a particular relationship, as defined in Section 3(14) of ERISA, with a plan.³ The QPAM Exemption itself has specific definitions of "QPAM," "affiliate," and "related," and does not apply to a transaction unless the terms of the transaction are negotiated by the QPAM.

The Amendments

The following amendments have been made to the QPAM Exemption.

¹ 68 F.R. 52419 (2003).

² 70 F.R. 49305 (2005).

³ Under section 3(14) of ERISA, the term "party in interest" includes, among others, a fiduciary of the plan, any person providing services to the plan, the employer or union maintaining the plan, and certain affiliates of each.

Authority to Appoint the QPAM

The “one year look-back rule”, under which the QPAM Exemption does not apply to a transaction with a party in interest who has exercised its right to appoint the QPAM during the immediately preceding one-year period, has been deleted. The amendments clarify that the power of a party in interest to appoint or terminate the QPAM, or to negotiate the management agreement with the QPAM, refers only to the power to appoint or terminate the QPAM as manager of, or to negotiate a management agreement covering, the assets involved in the transaction in question, as opposed to any of the plan’s investing assets.

The amendments also specify that, notwithstanding any authority of a party in interest of an investing plan to appoint or terminate the QPAM or negotiate its management agreement, the QPAM Exemption may apply to a transaction between an investment fund and the party in interest, if the interest of the plan in the fund, when aggregated with the interests in the fund of any other plans maintained by the same employer or its affiliates, represents less than 10% of the fund’s total assets.

Definitions of “Affiliate” and “Related”

Prior to the amendments, under the QPAM Exemption, an “affiliate” of a party in interest was, among others, (a) any corporation, partnership, trust, or unincorporated enterprise of which the party in interest was an officer, director, 5% partner, or employee (but only if the employer of this employee was the plan sponsor), or (b) any director or employee of the party in interest who had authority over plan assets. Further, a named fiduciary of an investing plan, and an employer whose employees were covered by that plan, were “affiliates” if the employer (or its affiliate) had authority to appoint or terminate the named fiduciary or negotiate the terms of the fiduciary’s employment agreement (the “named fiduciary affiliate rule”).

The amendments revise (a) above by increasing the required ownership percentage in a partnership from 5% to 10%, and by requiring that an employee be a highly-compensated employee within the meaning of Section 4975(e)(2)(H) of the Internal Revenue Code. The amendments revise (b) above to require that a director or employee of a party in interest must have authority over the plan assets involved in the transaction, as opposed to any assets of an investing plan. Similarly, under the amendments, the named fiduciary affiliate

rule will not apply unless the named fiduciary has such position with respect to the plan assets involved in the transaction.

Prior to the amendments, a QPAM and a party in interest were “related” if the QPAM or the party in interest (or a person controlling, or controlled by, the QPAM or the party in interest) had an ownership interest in the other entity of at least 5%. The definition of “related” has been amended to provide that a QPAM is “related” to a party in interest if the QPAM or the party in interest has an ownership interest of at least 10% in the other entity, or a person controlling, or controlled by, the QPAM or the party in interest has either:

- An ownership interest of at least 20% in the other entity
- An ownership interest exceeding 10% in the other entity and exercises control over the management or policies of the other entity by reason of its ownership interest

Further, the amendments provide that the determination of whether the QPAM is “related” to a party in interest is made as of the last day of the QPAM’s most recent calendar quarter, and that ownership interests held in a fiduciary capacity are disregarded in applying the ownership percentage thresholds.

QPAM Independence

In addition, the amendments specifically provide that the QPAM Exemption will not apply unless the QPAM is independent of any employer maintaining a plan which invests in the investment fund managed by the QPAM. In this regard, the amendments provide transitional relief under which a financial institution or financial services entity may presently act as a QPAM for its own in-house plan. The DOL has published a separate notice of proposed amendment to the QPAM Exemption that would expressly permit a financial institution or financial services entity to so act if certain conditions are met.

QPAM Definition and Requirements

Prior to the amendments, under the QPAM Exemption, the term “QPAM” included, among other persons, a registered investment adviser that had, as of the last day of its most recent fiscal year, total client assets

under its management and control in excess of \$50 million, and shareholder's or partner's equity in excess of \$750,000.

The definition of QPAM has been amended to clarify that the phrase "as of the last day of its most recent fiscal year" only modifies the term "total client assets under its management and control in excess of \$50 million," and does not refer to the shareholders' or partners' equity requirement. Rather, the amount of shareholders' or partners' equity is determined on the basis of the most recent GAAP-compliant balance sheet prepared during the two-year period immediately preceding the transaction in question. Also, the \$50 million of client assets under management threshold to qualify as a QPAM has been increased to \$85 million, and the shareholders' and partners' equity threshold to qualify as a QPAM has been increased from \$750,000 to \$1 million.

Effective Dates

The amendments to the QPAM Exemption generally are effective August 23, 2005. As an exception, the new \$85 million client assets under management threshold and the new \$1 million shareholders'/partners' equity requirement threshold will become effective as of the final day of the first fiscal year of the QPAM, beginning on or after August 23, 2005. In addition, there is transitional relief for financial institutions and financial services entities from the QPAM independence requirement, as described above.

Amendments Not Made

It is worth noting that, in adopting the amendments to the QPAM Exemption, the DOL expressly rejected suggestions from the public which included:

- The QPAM Exemption use a 20% instead of 10% threshold, as the required level of ownership interest for a QPAM and a party in interest to be "related"
- The QPAM Exemption allow a newly-formed investment adviser to satisfy the client assets under management dollar threshold as of the final day of its last fiscal quarter as demonstrated on a quarterly balance sheet
- The QPAM Exemption allow plan officials to retain ultimate investment decision-making authority

with respect to transactions negotiated by a QPAM, or otherwise have approval or veto power over such transactions

- The 20% limit in the QPAM Exemption on the assets of a single plan (and plans of the same employer or its affiliates) which can be managed by the QPAM be eliminated or increased

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