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July 2010

ERISA QPAM Exemption Amended to Cover QPAM In-House Plans

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On July 6, 2010, the Department of Labor (the "DOL") adopted an amendment to ERISA prohibited transaction exemption 84-14 (the "QPAM Exemption") that will expand the coverage of the exemption to include the in-house pension and other employee benefit plans maintained by investment managers for their own employees. DOL proposed the amendment on August 23, 2005, having observed that some financial institutions believed incorrectly that investment managers could rely on the QPAM Exemption to avoid prohibited transactions in the management of their own plans. The recently adopted amendment to the QPAM Exemption replaces a temporary transitional exemption that DOL had issued previously, effective November 3, 2010.[1]

General Conditions of the Amended QPAM Exemption

Under the amended exemption, a QPAM may manage an investment fund containing assets of an employee benefit plan sponsored by the QPAM and rely on the QPAM Exemption to avoid prohibited transactions that might occur in the management of such assets if: (i) the QPAM adopts written policies and procedures that are designed to assure compliance with the conditions of the amended exemption; (ii) the QPAM engages an independent auditor to conduct an annual exemption audit; and (iii) any other applicable requirements already provided in the QPAM Exemption are satisfied.

Written Policies and Procedures

The amended exemption requires the QPAM to adopt written policies and procedures describing the steps that the QPAM will take to assure compliance with the requirements of the exemption applicable to the management of the assets of plans sponsored by the QPAM. These requirements include:

- The QPAM continues to act as a QPAM under the requirements of the QPAM Exemption;
- The QPAM has discretionary authority or control with respect to the plan assets involved in the transaction; and
- The QPAM negotiates the terms of the transaction and decides whether to enter the transaction.
- If the transaction relies on Part I of the QPAM Exemption, which is applicable to general transactions between the plan or fund managed by the QPAM and parties in interest with respect to such plans, then the written policies and procedures must also include requirements that:

- the party in interest (i) does not have disqualifying power over the QPAM (i.e., the power to terminate the QPAM or to negotiate the terms of the QPAM's management agreement), and (ii) is neither the QPAM itself nor a party related to the QPAM;
- no more than 20 percent of the total client assets managed by the QPAM consist of assets of the in-house plan plus any assets of other plans established or maintained by the QPAM and its affiliates; and
- the transaction is not exempt pursuant to prohibited transaction exemptions 2006-16 (securities lending), 83-1 (acquisitions by plans of interest in mortgage pools) or 82-87 (certain mortgage financing arrangements).

▪ If the parties rely on the QPAM Exemption for transactions involving the leasing of office or commercial space by the QPAM or an affiliate in a building in which the plan has an ownership interest (i.e., Part III of the QPAM Exemption), then the written policies and procedures must also include requirements that:

- the lease does not exceed the greater of 7500 square feet or one percent of the rentable space in the building; and
- the QPAM and any person possessing disqualifying powers over QPAM does not earn a commission or fee with respect to such transaction.

Independent Auditor and Annual Exemption Audit

Under the amended exemption, the QPAM is required to select an independent auditor to conduct an annual exemption audit for the management of in-house plan assets by the QPAM. Each independent auditor must have sufficient technical training or experience and proficiency with ERISA's fiduciary responsibility provisions. DOL has stated this requirement is not intended to limit independent auditors solely to accounting or auditing firms, and that a firm which already provides services for the QPAM or plan will still be considered "independent" if it does not derive more than a *de minimis* amount of its compensation from the QPAM, the plan or their affiliates. Consequently, a QPAM may choose an independent auditor from an array of options (i.e., a law firm, an accounting firm, a consulting firm, etc.), and may use a firm with which it has an existing relationship.

The amended exemption requires that the independent auditor conduct an annual audit of the QPAM to determine whether the QPAM has complied with its written policies and procedures discussed above. Such an audit requires the independent auditor to test a representative sample of the plan's transactions involving the QPAM's in-house plan. DOL has stated that the size and scope of the representative sample will depend on the facts and circumstances surrounding the independent auditor's findings (i.e., the sample size should increase if the auditor finds patterns of non-compliance). This audit requirement is derived from an analogous independent audit requirement imposed by the INHAM Exemption (discussed below). In our experience serving as an independent auditor for purposes of the INHAM Exemption, investment managers relying on the exemption have been able to establish compliance procedures that are consistent with the exemption's requirements without imposing an excessive compliance burden.

In addition, within six months following the end of each year in which the QPAM is seeking to rely on the QPAM Exemption for transactions involving its in-house plan, the independent auditor must render an opinion regarding the QPAM's overall level of compliance and issue a report describing the steps and procedures it took during the course of its audit. DOL has indicated that each report should clearly identify any transaction that fails to comply with the QPAM's written policies or procedures or the QPAM Exemption and identify any steps taken by the QPAM to remedy such compliance failure.

Comparison to the INHAM Exemption

There is significant overlap between the amended QPAM Exemption and the exemption applicable to the management of plan assets by an in-house asset management affiliate of a plan sponsor (prohibited transaction exemption 96-23 (the "INHAM Exemption")). Consequently, certain investment managers that rely on the INHAM Exemption may also be able to rely on the amended QPAM Exemption and vice versa. However, despite the overlap there are two key differences between the amended QPAM Exemption and the INHAM Exemption. First, banks, savings and loan associations, insurance companies and registered investment advisers may rely on the amended QPAM Exemption, while only SEC-registered investment advisers that are wholly-owned subsidiaries of a plan sponsor may rely on the INHAM Exemption. Second, a QPAM relying on the amended QPAM Exemption in connection with the management of its own plan is subject to the 20% limit on the management of in-house plan assets, while the INHAM Exemption contains no analogous limitation. Consequently, the amended QPAM Exemption will only be available for plan sponsors that actively engaged in the asset management business for unaffiliated clients.

Effective Date

The amended exemption will take effect beginning in November 3, 2010. Until that date financial institutions may continue to rely on the transitional relief granted by DOL on August 23, 2005.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] In the case of a QPAM's in-house plan, the transitional exemption had relaxed the requirement that a financial institution that serves as a QPAM be a fiduciary that is independent of and unrelated to the employer sponsoring the plan.