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BLOG

The QPAM Exemption: Common Traps for the Unwary

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Investment professionals who manage the assets of certain employee benefit plans are subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), and all the rules under ERISA governing prohibited transactions. One such prohibited transaction arises when an ERISA-governed plan or fund (a plan) engages in a transaction with a party who may be conflicted or has an interest with respect to that plan. However, as with any rule, there are available exceptions such as the QPAM Exemption described below.

The QPAM Exemption

The U.S. Department of Labor's Prohibited Transaction Class Exemption 84-14 (the "QPAM Exemption") permits a plan fiduciary who qualifies as a "qualified professional asset manager" (a QPAM) (generally, a person who (i) is a registered investment adviser, (ii) has at least $85 million in assets under management as of the end of the most recent fiscal year, and (iii) has a minimum of $1 million in owner's equity) to enter into certain transactions with parties that would otherwise be prohibited, without violating ERISA. There are several conditions and requirements for an asset manager to qualify as a QPAM, as well as restrictions on the types of transactions the asset manager may engage. In addition, not all parties are exempt under the QPAM Exemption. Discussed below is a brief refresher on who may be a "party in interest" and two points that come up frequently in practice. Note that the QPAM Exemption is quite detailed and this post does not detail all of the nuances of the requirements.

Parties in Interest

For purposes of the QPAM Exemption a "party in interest" includes, among others:

- (i) any fiduciary (such as any administrator, officer, trustee, or custodian), counsel, or employee of such plan;
- (ii) a person providing services to such plan (such as any independent auditor);
- (iii) an employer or union sponsoring such plan;
- (iv) an "owner" of the employer or union sponsoring such plan;

- (v) a relative of any person described above; and
- (vi) certain affiliates of any person described above.

Parties in Interest with the Power to Appoint or Terminate the QPAM

The QPAM Exemption provides relief for transactions between a QPAM and virtually all parties in interest ***except***:

- if the party in interest, or any of its affiliates, transacting with the QPAM has the power to hire or fire the QPAM or to negotiate the terms of the QPAM's management agreement; or
- if the party in interest is the QPAM itself or a person or entity "related" to the QPAM.

For this purpose, a party in interest and a QPAM are considered "related" if:

- If the party in interest or QPAM owns 10% or more of the other entity;
- A person controlling or controlled by the QPAM owns 20% or more of the party in interest; or
- A person controlling or controlled by the party in interest owns 20% or more of the QPAM.

Fortunately for QPAMs managing plan assets, the QPAM Exemption builds in an exception to the prohibition against transacting with a party in interest who has the power to appoint or terminate the QPAM. In the case of an investment fund in which two or more unrelated plans have an interest, a transaction with a party in interest with respect to a plan who has authority in hiring or firing the QPAM (for example, by having the authority to acquire or redeem interests in the fund), will be permitted if the assets of the plan managed by the QPAM in the investment fund, when combined with the assets of other plans established or maintained by the same employer (or affiliate) or by the same union, and managed in the same investment fund, represent less than **10%** of the total assets of the investment fund.

This means that a fund will generally have to inquire into who has investment authority over a plan investor's assets ***only if*** the plan investor holds a 10% or more interest in the fund.

20% of Total AUM Threshold

Another important percentage to monitor is the percentage of all plans managed for the same client. To qualify under the QPAM Exemption, the transaction must not be entered into with a party in interest with respect to a plan if the assets of the plan in question, when combined with the assets of all other plans of the same employer and its affiliates (or union in the case of a multiemployer plan) that the QPAM manages, represent more than **20%** of the total client assets managed by the QPAM ***at the time of the transaction***. This limitation is designed to ensure that a QPAM is not so beholden to the plan it manages that it lacks independence.

QPAM Best Practices

While this post does not detail all of the specific requirement of the QPAM exemption, there are several best practices for fund managers.

- Determine, on at least an annual basis, that you qualify as a QPAM.
- Identify any clients or circumstances with respect to which the QPAM Exemption is unavailable.
- Require ERISA clients to identify any parties who have (or whose affiliates in the financial services industry have) the power to appoint or terminate you as manager over the ERISA client's assets managed by you or to negotiate the terms of an investment management agreement with you with respect to such assets.

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