PROSKAUER ROSE LLP®

Client Alert

A report for clients and friends of the firm

September 2005

U.S. Department of Labor Finalizes and Proposes Amendments to the Qualified Professional Asset Manager Exemption and Provides Transitional Relief

Recently, the U.S. Department of Labor (the "DOL") finalized an amendment to Prohibited Transaction Class Exemption 84-14 ("PTCE 84-14") relating to "qualified professional asset managers" or "QPAMs." Under this exemption, if a plan's assets are managed by a QPAM and certain other conditions are met, parties in interest to the plan are permitted to engage in certain transactions with the plan that would otherwise be prohibited. The DOL's new guidance will generally facilitate compliance with the exemption's requirements.

Also, although the DOL "clarified" its intent under the original exemption that the QPAM be independent of an employer with respect to the plans whose assets are managed by the QPAM, the DOL acknowledged that financial service entities have been acting as QPAMs for their own in-house plans under the rubric of PTCE 84-14. The new guidance explicitly provides transitional relief to permit this until a proposed amendment to PTCE 84-14 is finalized that would add certain conditions for the exemption to apply to this case.

Background

Section 406(a)(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), generally prohibits employee benefit plans from engaging in transactions with parties in interest. Under PTCE 84-14, an exemption was granted for substantially all transactions that would otherwise be prohibited by Section 406(a)(1) of ERISA where the plan assets are managed by a QPAM and certain other conditions are met. However, some of the conditions that the DOL required for this exemption to apply were burdensome, and this made compliance difficult. The DOL has amended the rules to generally make compliance with the conditions of the exemption less burdensome.

Final Amendment to PTCE 84-14

The DOL's final amendment to PTCE 84-14 is generally effective August 23, 2005. It includes changes relating to:

- *Power of Appointment and Lookback Rules*. The old rules made the exemption unavailable for purposes of a transaction with a party in interest if the party in interest or its affiliate was authorized to appoint or terminate the QPAM as a manager of any of the plan's assets or to negotiate the terms of the management agreement with the QPAM. The exemption was also not available if the party in interest had exercised these powers in the immediately preceding one year (the "Lookback Rule").

  The final amendment removes the Lookback Rule. Also, the final amendment specifies that the powers of appointment and negotiation limitations relate only to the power to appoint the QPAM as manager of the assets involved in the transaction, as opposed to any of the plan's assets.

- *Commingled Investment Funds*. The new rules provide that the class exemption is available to a plan investing in a commingled investment fund, even if a party in interest has the power to appoint or terminate the QPAM (*e.g.*, by acquiring or redeeming units of the fund) or to negotiate the terms of the management agreement, as long as the plan's interest in the fund represents less than 10% of the investment fund's total assets.

- *Definition of Affiliate*. The QPAM exemption does not apply if an "affiliate" of a party in interest was authorized to appoint or terminate the QPAM or to negotiate the terms of the management agreement with the QPAM. Under the old rules, five percent or more partners and non-highly compensated employees could be considered affiliates. Pursuant to the new guidance, the term "affiliate" includes enterprises in which the party in interest is a 10 percent or more partner or a highly compensated employee as defined under Section 4975(e)(2)(H) of the Internal Revenue Code (if the employer of such employee is the plan sponsor).

- *Definition of QPAM*. The definition of "QPAM" under PTCE 84-14 includes a registered investment adviser that meets certain minimum dollar limits relating to assets under management and shareholders' or partners' equity. Effective as of the last day of the first fiscal year of the QPAM beginning on or after August 23, 2005, the final amendment raises these dollar limits from $50 million to $85 million with respect to assets under management, and from $750,000 to $1 million with respect to shareholders' or partners' equity. The final amendment clarifies that the assets under management limit, but not the shareholders' or partners' equity limit, must be met as of the last day of the most recent fiscal year. These increased limits will make it harder for some smaller entities to qualify as QPAMs.

- *Definition of Related*. For the exemption to apply, the party in interest dealing with the investment fund may not be the QPAM nor a person "related" to the QPAM. Under the old rules, a party in interest and a QPAM would be related if either entity (or parties controlling or controlled by either entity) owned a five percent or more interest in the other entity. The final amendment:

  - Increases the limit to 10 percent generally.

  - Increases the limit to 20 percent in the case of a party controlling or controlled by either a party in interest or a QPAM.

  - Provides that a party controlling or controlled by either entity (*i.e.*, a QPAM or a party in interest) may still be "related" to the other entity if that party owns between 10 and 20 percent of the other entity and exercises control over the management or policies of the other entity by reason of its ownership interest.

  - Specifies that determinations of whether the QPAM is related to a party in interest are made as of the last day of the most recent calendar quarter.

  - Does not require shares held in a fiduciary capacity to be considered when applying the percentage limitations.

Proposed Amendment to PTCE 84-14 and Transitional Relief

In the preamble to the final amendment, the DOL notes that financial service entities have acted in good faith in applying the QPAM exemption to serve as QPAMs for their own in-house plans. Although in the DOL's view the QPAM exemption does not authorize the use of an "in-house" QPAM, the DOL has decided to provide transitional relief. The new guidance explicitly permits financial service entities to serve as QPAMs for their own in-house plans pursuant to the QPAM exemption through the date on which the DOL issues a final amendment on this issue.

In the meantime, the DOL has issued a proposed amendment that would apply the QPAM exemption to a financial services entity serving as a QPAM for its own in-house plan if certain requirements are met, including the adoption of written policies and procedures that are designed to assure compliance with the conditions of the exemption. Also, the proposed rules require an independent auditor to conduct an exemption audit on an annual basis that results in a written report regarding the level of compliance with such policies and procedures.

The proposed amendment will not be effective until it is finalized.

NEW YORK • LOS ANGELES • WASHINGTON

BOSTON • BOCA RATON • NEWARK

NEW ORLEANS • PARIS

Proskauer's Employee Benefits and Executive Compensation Law Practice Group includes over 50 attorneys with significant and diverse tax, executive compensation and employee benefits law experience. The following individuals serve as contact persons with respect to this Client Alert and would welcome any questions you might have:

Jacob I. Friedman
212.969.3805 – jfriedman@proskauer.com

Ira G. Bogner
212.969.3947 – ibogner@proskauer.com

Avraham Gorin
212.969.3328 – agorin@proskauer.com

Proskauer Rose is an international law firm that handles a full spectrum of legal issues worldwide.