The Investment Lawyer
Covering Legal and Regulatory Issues of Asset Management
VOL. 29, NO. 2 • FEBRUARY 2022

Qualified Professional Asset Manager: An Important Tool for ERISA Fiduciaries

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A key prohibited transaction exemption on which registered investment advisers and other discretionary asset managers of plans and accounts covered by the Employee Retirement Income Security Act of 1974, as amended (ERISA) and the Internal Revenue Code of 1986, as amended (Code) rely is the Qualified Professional Asset Manager Exemption (QPAM Exemption) issued by the Department of Labor (Department or DOL).[1] The QPAM Exemption addresses prohibited transactions that occur during some of the most common transactions between a plan and parties that provide services to the plan or have some other relationship to the plan. As such, it is an extremely important exemption. However, compliance with the QPAM Exemption, at times, can be tricky. The purpose of this article is to explain the meaning of the term qualified professional asset manager (QPAM), summarize the key conditions of the QPAM Exemption, identify the prohibited transactions it exempts and those it does not, and address some common issues that arise when using the QPAM Exemption.

Overview of the Prohibited Transaction Provisions

ERISA requires that asset managers comply with the statute's fiduciary duty requirements, for example, the duty of prudence, with regard to plans and entities covered by the fiduciary provisions of Title I of ERISA. Such plans are "employee benefit plans" as defined in Section 3(3) of ERISA that are sponsored by private sector employers (ERISA Plans). Entities subject to the fiduciary duty provisions include partnerships, limited liability companies, collective investment trusts, collective investment funds, single member and pooled insurance company separate accounts, and other entities the assets of which are deemed to be ERISA Plan assets for purposes of ERISA by reason of ERISA Plans investing in such entities (Plan Asset Entities).[2]

ERISA also imposes certain prohibited transaction restrictions that are designed to ensure that asset managers and other fiduciaries in fact exclusively act in the interest of an ERISA Plan and its participants and beneficiaries.[3] As discussed below, comparable prohibited transaction provisions are found in Section 4975 of the Code. ERISA Plans and Plan Asset Entities are also subject to the fiduciary duty provisions and the prohibited transaction provisions in the Code.

Tax-favored savings vehicles described in Section 4975, for example, most individual retirement accounts and health savings accounts (Non-ERISA Plans), are not subject to ERISA's fiduciary duty or prohibited transaction provisions because such accounts are not provided by an employer. However, such accounts are subject to the prohibited transaction provisions in the Code. Additionally, an entity in which Non-ERISA Plans invest their assets may still be deemed a Plan Asset Entity and subject to the prohibited transaction provisions in the Code

despite the fact that no ERISA Plans invested in such entity.

Pursuant to Section 406(a), a fiduciary may not cause an ERISA Plan or a Plan Asset Entity to engage in the following transactions:[4]

- A direct or indirect sale or exchange of property between the ERISA Plan (or Plan Asset Entity) and a party in interest;[5]
- A direct or indirect lending of money or other extension of credit between the ERISA Plan (or Plan Asset Entity) and a party in interest;[6]
- A direct or indirect furnishing of goods, services, or facilities between the ERISA Plan (or Plan Asset Entity) and a party in interest;[7]
- A direct or indirect transfer to, or for the use by or for the benefit of, a party in interest of plan assets;[8] and
- A purchase of employer securities or employer property.[9]

A "party in interest" is defined broadly to include, among others, another fiduciary, a plan or individual retirement account (IRA) service provider and their affiliates, an employer whose employees participate in the plan and their affiliates, and IRA owners and beneficiaries.[10] The Code generally mirrors the prohibited transactions of ERISA. However, the Code uses the term "disqualified person" rather than "party in interest." The term "disqualified person" is defined slightly differently from the term "party in interest."[11]

ERISA contains additional prohibited transaction restrictions that prohibit fiduciaries from engaging in transactions in the face of a conflict.[12] More specifically, ERISA prohibits a fiduciary from engaging in the following transactions:

- Dealing with assets of the ERISA Plan (or Plan Asset Entity) in his or her own interest or his or her own account (or in the interest of a person in which the fiduciary has an interest), that is, no self-dealing;[13]
- Acting in any transaction involving the ERISA Plan (or Plan Asset Entity) on behalf of a party whose interests are adverse to the interests of the ERISA Plan (or Plan Asset Entity) or the ERISA Plan's (or Plan Asset Entity's) participants and beneficiaries, that is, no conflicts of interest;[14] and
- Receiving any consideration for his or her own personal account from any party dealing with the ERISA Plan (or Plan Asset Entity) in connection with a transaction involving plan assets, that is, no kick-backs.[15]

The Code mirrors the aforementioned restrictions as they relate to self-dealing and kick-backs.[16]

For purposes of this article, we cite the ERISA prohibited transaction provisions, but unless otherwise noted, the reader should assume that there is a corresponding provision under the Code. As discussed, the Code's prohibited transaction provisions apply to ERISA Plans, Non-ERISA Plans, and Plan Asset Entities. The prohibited transaction provisions in Section 406(a) of ERISA are commonly known as *per se* prohibited transactions. In other words, the intent of the fiduciary who engages in the transaction is not at all relevant. Therefore, in the absence of compliance with a prohibited transaction exemption, a non-exempt prohibited transaction occurs. The law is less clear on whether an act contrary to the terms of Section 406(b) is a per se violation of such provisions. However, regardless of the intent requirement under Section 406(b), asset managers should try to avoid engaging in such transactions. Failure to comply with the ERISA prohibited transaction provisions or failure to meet the conditions of an applicable prohibited transaction exemption, like the QPAM Exemption, will result in fiduciary breaches, while violation of the Code's prohibited transaction provisions without meeting the conditions of an exemption may result in the assessment of excises taxes.[17]

Importantly, an asset manager could unknowingly cause an ERISA Plan, Non-ERISA Plan, or Plan Asset Entity to engage in a per se prohibited

transaction simply by receiving services or entering into other transactions in the normal course of business. For example, an ERISA Plan utilizes the custodial services of Bank A for the ERISA Plan. Bank A has a broker-dealer affiliate (Broker Dealer). The ERISA Plan fiduciary hires Manager X to manage a portion of the ERISA Plan's assets. Manager X, which is not affiliated with Bank A or Broker Dealer, executes trades through Broker Dealer. Such transaction would result in a prohibited transaction under Section 406(a) because Broker Dealer is a party in interest to the ERISA Plan by reason of its affiliation with Bank A, which is a party in interest to the ERISA Plan by reason of being a service provider, that is, custodian, to the ERISA Plan. This is a very basic example. In the case of an investment fund that has dozens of ERISA Plan investors and the assets of the investment fund are deemed to include the assets of the ERISA Plan investors, making it a Plan Asset Entity, it would be very difficult for the manager of the investment fund to identify every party in interest to each and every ERISA Plan investor.

Prohibited Transactions Exempted by the QPAM Exemption

In the event that a transaction will be prohibited under Section 406(a) or 406(b), asset managers should seek to comply with a prohibited transaction exemption like the QPAM Exemption. Asset managers will find that the broad exemptive relief provided by the exemption, particularly Part I, will address many of the common party in interest transactions under Section 406(a) that will arise in managing assets including those that occur in the above example. However, the QPAM Exemption only provides exemptive relief under very limited circumstances with regard to the prohibited transactions provisions under Section 406(b).

More specifically, Part I of the QPAM Exemption is a class exemption, which permits a QPAM that exercises discretion over the management of investments in an investment fund to engage in certain transactions with most parties in interest to ERISA Plan investors, Non-ERISA Plan investors, and Plan Asset Entity investors in the investment fund without violating ERISA or the Code.[18] However, Part I of the QPAM Exemption does not provide exemptive relief from the prohibited transaction restrictions of ERISA Section 406(b).[19] Parts II, III, and IV of the QPAM Exemption provide very limited relief in this regard. The QPAM Exemption broadly defines an "investment fund" to include "single customer and pooled separate accounts maintained by an insurance company, individual trusts and common, collective or group trusts maintained by a bank, and any other account or fund to the extent that the disposition of its assets (whether or not in the custody of the QPAM) is subject to the discretionary authority of the QPAM."[20]

Asset Manager Must Be a QPAM

At the core of the QPAM Exemption is the requirement that the asset manager be a "qualified professional asset manager," that is, a QPAM. To that end, the asset manager must satisfy certain conditions based on financial institution type and certain capitalization and assets under management thresholds.[21] Generally, an entity with the power and respective legal authorization to manage, acquire, and dispose of assets of an ERISA Plan (or Plan Asset Entity) must confirm annually, upon review of its annual financial statement and reported assets under management, its status as either:

- A bank, as defined in Section 202(a)(2) of the Investment Advisers Act of 1940, as amended (Advisers Act), that has the power to manage, acquire or dispose of assets of an ERISA Plan (or Plan Asset Entity) and with equity capital in excess of $1 million;[22]
- A savings and loan association that has applied for and been granted by an applicable state or federal regulator trust powers to manage, acquire or dispose of assets of an ERISA Plan (or Plan Asset Entity) and with equity capital or net

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worth in excess of $1 million as of the last day of its most recent fiscal year;[23]

- An insurance company that is qualified under the laws of more than one state to manage, acquire or dispose of the assets of an ERISA Plan (or Plan Asset Entity) with a net worth in excess of $1 million;[24] or
- A registered investment adviser under the Advisers Act with net capital and shareholders' equity of at least $1 million and has total assets attributable to clients under its management and control in excess of $85 million as of the last day of the adviser's most recent fiscal year.[25] In the case of an adviser that cannot meet the $1 million shareholders' equity requirement, the adviser can still be a QPAM if certain affiliates of the adviser who are financial institutions that otherwise meet the QPAM definition or if certain affiliates that meet the shareholders' equity requirements in the exemption unconditionally guarantee the payment of all liabilities incurred by the adviser, including for breaches of Section 404 or 406 of ERISA.[26]

Regardless of whether an asset manager is a bank, savings and loan association, insurance company, or registered investment adviser, such manager must acknowledge in writing that it is a fiduciary with respect to each ERISA Plan investor, Non-ERISA Plan investor, and Plan Asset Entity investor in the investment fund managed by the QPAM.[27] Note that the definition of QPAM specifically requires that a bank, savings and loan association and insurance company have the power to manage, acquire and dispose of the assets of an ERISA Plan (or Plan Asset Entity) because not all of these financial institutions (or their affiliates) have such powers.

Conditions of the QPAM Exemption

Under Part I of the QPAM Exemption, the prohibited transaction restrictions and the accompanying taxes imposed by the Code, will not apply in the event of an otherwise prohibited transaction under Section 406(a) between the ERISA Plan investor, Non-ERISA Plan investor, or Plan Asset Entity investor (Plan Investor) and a party in interest to the Plan Investor so long as the following conditions are met by the Plan Investor and the QPAM.

Power of Appointment

At the time of the transaction, the party in interest with whom the Plan Investor engages in a transaction neither has the ability (or has exercised discretionary authority) to appoint or terminate the QPAM as the manager of any Plan Investor's assets, nor the ability to negotiate the terms of the management agreement on behalf of the Plan Investor with the QPAM.[28] However, this condition will be deemed satisfied if there are two or more unrelated Plan Investors invested in the investment fund so long as the assets of the Plan Investor that has the party in interest relationship, when aggregated with the assets of any other Plan Investors affiliated with such Plan Investor, represent less than 10% of the assets in the investment fund.[29] Importantly, in the case of a commingled fund, a party in interest's power to purchase, sell or redeem its interests in the fund is tantamount to a decision to appoint or terminate the QPAM.[30]

This provision establishes that the Plan Investor and the QPAM only get the benefit of the exemptive relief if the counterparty to the transaction, that is, the party in interest, has no power to exert influence over the QPAM's investment decisions with respect to managing the assets of a Plan Investor. Therefore, the DOL requires that the party in interest not have the ability to hire and fire the QPAM. Notably, this restriction only applies to the assets of the Plan Investor involved in the transaction with the party in interest. Therefore, the party in interest can have the ability to hire and fire the QPAM with regard to assets of the Plan Investor that are not part of the

transaction for which relief is sought. Furthermore, the DOL acknowledges that a party in interest will have less influence over a QPAM if the Plan Investor and its affiliates are relatively small investors in the investment fund, that is, less than 10 percent regardless of the party in interest's power of appointment with respect to the QPAM. Therefore, in a commingled fund that meets the investor size requirement, the ability of a party in interest (or its affiliate) to purchase, sell or redeem interests does not affect the satisfaction of this condition.

Prohibited Transactions Covered by Other Exemptions

The QPAM may not rely on the QPAM Exemption in respect of prohibited transactions that arise in connection with certain types of investment transactions, as those investment transactions are covered by other exemptions. These transactions include (1) prohibited transactions that arise in connection with a QPAM's securities lending practices, which are addressed through compliance with DOL Prohibited Transaction Exemption 81-6, (2) prohibited transactions that arise in connection with a QPAM's purchase of interests in mortgage pools, which are addressed through compliance with Prohibited Transaction Exemption 83-1, and (3) transactions that arise when a QPAM enters into certain mortgage financial arrangements, which are covered by Prohibited Transaction Exemption 82-87.[31]

QPAM Discretionary Authority and Control

The QPAM must negotiate on behalf of the investment fund the terms of the transaction for which exemptive relief is sought. Such terms may also be negotiated by another party under the authority and general direction of the QPAM. Alternatively, in the case of a real estate investment fund, a property manager may negotiate the terms of the transaction so long as the QPAM retains full fiduciary responsibility with respect to the transaction and the property manager acts in accordance with written guidelines established and administered by the QPAM. In no case, however, may the property manager enter into the transaction if there is "an agreement, arrangement or understanding designed to benefit a party in interest."[32]

The party in interest prohibited transaction provisions under Section 406(a) are designed to provide protections to Plan Investors that are in addition to the more general fiduciary duty provisions. As such, virtually any transaction in which a Plan Investor may enter into with a party that has a direct or indirect relationship to a Plan Investor, that is, party in interest, is prohibited except in the absence of an exemption. The premise behind the QPAM Exemption is that the insertion of an appropriately qualified professional investment manager between the Plan Investor and the party in interest should adequately protect the Plan Investor so long as such QPAM is independent of the party in interest and has full discretionary authority over the assets involved in the transaction with the party in interest. Therefore, the Department has stated that the plan fiduciary that hires the QPAM cannot have final veto power over the investment decision made by the QPAM.[33] Otherwise, the QPAM may be influenced to enter into a transaction that is not in the interest of the Plan Investor. The exemption, however, provides some more latitude when a property manager enters an agreement with a party in interest in connection with the investment fund so long as the QPAM has sufficient oversight and authority.

Unrelated Party

The party in interest with which the investment fund transacts can neither be the QPAM nor related to the QPAM.[34] A party in interest is "related" to the QPAM if as of the last day of its most recent calendar quarter: (1) the QPAM owns 10 percent or more of the party in interest; (2) a person controlling or controlled by the QPAM owns 20 percent or more of the party in interest; (3) the party in interest owns 10 percent or more of the QPAM; or (4) a person

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controlling or controlled by the party in interest owns 20 percent or more of the QPAM.[35]

Additionally, a party in interest is related to the QPAM if (1) a person controlling, or controlled by, the party in interest has an ownership interest that is less than 20 percent but greater than 10 percent in the QPAM and such person exercises control over the management or policies of the QPAM by reason of its ownership interest or (2) a person controlling, or controlled by, the QPAM has an ownership interest that is less than 20 percent but greater than 10% in the party in interest and such person exercises control over the management or policies of the party in interest by reason of its ownership interest.[36]

Consistent with other conditions of the exemption, this requirement is designed to ensure the independence of the QPAM's decision-making with respect to the party in interest. Practically speaking, this means that QPAMs should be aware that the QPAM and its affiliates must rely upon other prohibited transaction exemptions for transactions that lack independent decision-making. Also, an affiliate relationship between the QPAM and a party in interest often results in prohibited transactions under Section 406(b), which for the most part are not covered by the QPAM Exemption.

20 Percent Assets under Management Limitation

At the time of a party in interest transaction that would otherwise violate Section 406(a), the assets of a Plan Investor managed by the QPAM (when aggregated with the assets of other affiliated Plan Investors) must be equal to or less than 20 percent of the QPAM's total assets under management.[37] The Department intends that this requirement help prevent the QPAM from being unduly influenced by a particularly large investor.[38] Importantly, the limit applies to the QPAM's book of business, not just to the investment fund the assets of which are involved in the transaction. This is the case even if management is spread across multiple advisers established as separate legal entities across a controlled group of corporations that are separately managed and separately accountable for their own operating profits or losses.[39]

Arm's Length Terms

At the time of the party in interest transaction (and any renewals or modifications thereafter), the terms of the transaction must be at least as favorable to the Plan Investor as terms generally available in arm's length transactions between unrelated parties.[40] Because the QPAM is intended to be a professional investment management organization with a certain level of size and sophistication that is independent and not affiliated with the party in interest, the assumption should be that the terms of the transaction would be negotiated between the QPAM and party in interest at arm's length. The Department makes that clear by including it as a condition of the QPAM Exemption.

Certain Felony Convictions

Within 10 years immediately preceding the transaction, the QPAM, certain affiliates of the QPAM and certain owners of the QPAM cannot have been convicted or released from imprisonment as a result of certain enumerated crimes, including, but not limited to, felonies arising out of the conduct of the business of an investment adviser.[41] The Department included this anti-criminal condition in order to ensure that the Plan Investors are adequately protected and, to that end, the Department applied the condition to not just the QPAM, but also affiliates and certain owners of the QPAM. As explained below, this condition has raised issues for some asset managers' ability to rely on the QPAM Exemption.

Common Issues to Consider When Relying upon the QPAM Exemption

In considering how an asset manager will deal with prohibited transaction issues when managing Plan Investors' assets and whether it will comply with the QPAM Exemption to address such prohibited

transactions, the asset manager should consider the following common issues that arise in complying with the QPAM Exemption and what other options may be available.

Limited 406(b) Relief

As discussed earlier in this article, Section 406(a) of ERISA prohibits certain transactions between a Plan Investor and a party in interest and Section 406(b) of ERISA prohibits fiduciaries from using their authority to enter into transactions that might benefit itself or parties in which they have an interest, for example, the fiduciaries' affiliates. So long as its conditions are met, Part I of the QPAM Exemption exempts the prohibited transactions under Section 406(a). However, except in the very limited circumstances described below, the QPAM Exemption does not exempt prohibited transactions under Section 406(b). Therefore, asset managers, even if they are QPAMs, will be required to comply with another exemption to address the Section 406(b) prohibited transactions or take other action to eliminate the conflict.

Part II(a) of the Exemption provides exemptive relief from the prohibited transactions under Sections 406(a) and 406(b)(1) of ERISA, that is, the prohibition on self-dealing, when the QPAM engages in certain transactions with a party in interest and the party in interest is an employer (or an affiliate of an employer) whose employees are covered by an employee benefit plan that is a Plan Investor in the investment fund. As discussed earlier, Part I is not available under these circumstances.[42] Part II applies to the sale, leasing or servicing of goods and the furnishing of services to the investment fund by such party in interest. There are a number of conditions for exemptive relief, including the requirement that "the amount attributable in any taxable year of the party in interest to transactions engaged in with an investment fund pursuant to Section II(a) of this exemption does not exceed one (1) percent of the gross receipts derived from all sources for the prior taxable year of the party in interest."

Part II(b) of the QPAM Exemption also exempts prohibited transactions resulting from the leasing of commercial or office space by an investment fund maintained by a QPAM to a party in interest with respect to an employee benefit plan investor in the fund if, among other things, such party in interest is an employer whose employees are covered by such Plan Investor or certain affiliates of such employer. There are a number of conditions for exemptive relief, including a limit on the portion of the rentable space of the property that may be rented to the investment fund.

Part III exempts from Sections 406(a), 406(b)(1), and 406(b)(2) of ERISA the leasing of commercial or office space by a QPAM-managed investment fund to the QPAM, by an affiliate of the QPAM as described in Sections 3(14)(G), (H), and (I) of ERISA or by a person who cannot rely on Part I of the exemption because such person has a power of appointment that is not permitted under Part I(a).[43] Part III provides for a number of conditions for exemptive relief, including the requirement that the amount of space covered by the lease does not exceed the greater of 7,500 square feet or one (1) percent of the rentable space of the office building, integrated office park, or of the commercial center in which the investment fund has the investment.[44] Finally, Part IV of the QPAM Exemption exempts from Sections 406(a), 406(b)(1), and 406(b)(2) of ERISA the furnishing of services and facilities by a place of public accommodation owned by a QPAM-managed investment fund to a party in interest of a Plan Investor so long as such facilities and services are furnished on a comparable basis to the general public.[45]

Clearly, the exemptive relief under Section 406(b) of ERISA is very narrow. Such limited relief is important for asset managers who intend to rely on the QPAM Exemption to understand. As discussed, the use of affiliates to provide services to the investment fund may prohibit the use of QPAM exemptive relief for Section 406(a) of ERISA party in interest transaction provisions with respect to the

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transactions involving such affiliates. However, even if the QPAM Exemption is available to address the Section 406(a) prohibited transactions, the exemption more often than not will be unavailable to exempt any Section 406(b) transactions. The QPAM will have to look to another exemption or eliminate the conflict.

"Plan Asset" Funds

Asset managers should be concerned with the prohibited transaction provisions with regard to each and every transaction that the asset manager causes the investment fund to enter if the assets of the investment fund are deemed assets of the Plan Investor for purposes of ERISA and the Code.[46] Part I of the QPAM Exemption will allow an asset manager that is a QPAM to enter into most transactions with parties in interest to the Plan Investors that invest in the fund so long as the party in interest is neither the QPAM nor an affiliate of the QPAM. Therefore, the QPAM Exemption allows the QPAM to avoid identifying each and every party in interest (other than the QPAM's affiliates) to the Plan Investors in the fund so long as the other conditions of the exemption are met. Of course, the QPAM must be concerned about affiliate transactions and violations of the fiduciary prohibited transaction provisions under Section 406(b), which in large part are not exempted by the QPAM Exemption.

On the other hand, if the assets of the investment fund are not plan assets, the prohibited transaction provision issues become much less of a concern. For example, there is no transfer of Plan Investors' assets to a party in interest pursuant to Section 406(a)(1)(A), no loan or extension of credit of Plan Investors' assets to a party in interest pursuant to Section 406(a)(1)(B), and no use of Plan Investors' assets by a party in interest pursuant to Section 406(a)(1)(D) when the assets of the investment fund are not deemed plans assets. Additionally, the asset manager's exercise of discretion over the investment fund's assets is not an exercise of discretion over plan assets, which means the prohibited transaction provisions under Section 406(b) are not implicated. The assets of the investment fund are not plan assets for purposes of ERISA and the Code if the Plan Investors' equity participation in the investment fund is not significant or the investment fund is an operating company, including a venture capital operating company or real estate operating company, as set forth in the Department's plan asset regulation.[47]

Based on the foregoing, an asset manager should consider whether it wants the assets of an investment fund to be deemed plan assets as that decision will have a substantial impact on how the asset manager will operate the fund. For those assets managers that are interested in managing the assets of a "plan asset" fund, compliance with the QPAM Exemption likely is the best way to comply with the prohibited transaction provisions under Section 406(a), that is, the party in interest prohibited transactions. However, the QPAM Exemption has its limits as explained elsewhere in this article. Structuring the fund and its operations in a manner that allows for compliance with ERISA is the key and compliance with the QPAM Exemption is just one part of that process. Furthermore, an asset manager will often start from the position that it will establish the fund as a non-plan asset fund, but will then rely on the QPAM Exemption in the event that the assets of the fund become plans assets. This certainly is a possible approach, but in reality, compliance with the QPAM Exemption and other ERISA requirements after the fund begins its operations may be very difficult.

Ability of an Asset Manager to Be a QPAM

The definition of "qualified professional asset manager" as set forth in the QPAM Exemption may preclude certain asset managers from relying on the QPAM Exemption because the asset managers will not meet the requirements of the definition. This issue tends to arise with regard to certain investment advisers.

As discussed, an investment adviser must be registered under the Advisers Act, have at least $85 million of assets under management, and have net

capital and shareholders' equity of at least $1 million. These latter two requirements are difficult to meet for startup investment advisers, which was the intent of the Department when it added this requirement to the QPAM definition. The Department is of the view that such net capital and shareholders' equity requirements are necessary to protect investors. Additionally, at times, even managers with $2 or $3 billion of assets under management cannot meet the net capital and shareholders' equity requirements due to the ownership structure of the firm. Some investment advisers may not have the opportunity to or may be unwilling to ask an affiliate to contractually assume the liabilities of the adviser in lieu of the adviser meeting the net capital and shareholders' equity requirements as permitted under the QPAM definition.

Also, the QPAM definition may pose challenges for investment funds that do not have ties to the United States. Such funds often are managed by an investment adviser registered under the laws of a country other than the United States. However, that adviser cannot be a QPAM unless it is registered under the Advisers Act. Therefore, if the fund intended to allow its assets to be deemed plan assets for purposes of ERISA and the Code, the fund would have to hire an adviser registered under the Advisers Act to exercise discretion with regard to management of the fund's assets in order to rely on the QPAM Exemption.

QPAM for a Day

Oftentimes, plan fiduciaries will look to hire a registered investment adviser or another type of financial services company, such as a bank trustee, to review and approve a proposed transaction between the plan and another party, which is a party in interest as defined under ERISA. The primary reason for hiring the adviser or other financial institution to review and approve the transaction is to limit the plan fiduciary's exposure to prohibited transactions under Section 406(b) because the DOL has stated that a Section 406(b) prohibited transaction does not occur if a fiduciary does not use its discretion or authority to cause the transaction. However, the fiduciary also wants the financial institution to be a QPAM particularly if the counter-party to the transaction is a party in interest to the plan and thus the transaction could result in prohibited transactions under Section 406(a). This concept is colloquially known as "QPAM for a day."

As discussed, the QPAM Exemption is available only for those transactions that the QPAM negotiates and authorizes on behalf of an investment fund. The Department has expressed a view that the QPAM Exemption is not available in the event of mere approval by the QPAM of a transaction that has already been negotiated by another plan fiduciary.[48] As such, in the Department's view, the QPAM Exemption will not be available unless the financial institution has sufficient discretion. Whether such discretion is sufficient is based on the particular facts and circumstances of the situation.

Criminal Convictions

As discussed, a condition of the QPAM Exemption is that neither the QPAM, its affiliates, nor certain owners of the QPAM can be convicted of certain crimes. Determining whether a QPAM can meet this condition can be challenging, particularly for large multi-national financial institutions. Additionally, if a financial institution that is otherwise a QPAM intends to purchase another financial institution and the target company or its affiliate has a criminal conviction, the purchase of the financial institution could impact the ability of the purchaser to rely on the QPAM Exemption. The DOL has granted numerous individual exemptions to asset managers who would otherwise serve as a QPAM but for this anti-criminal condition. A number of those exemptions have been issued in connection with an affiliate's foreign criminal conviction unrelated to the QPAM's activities.[49] In a November 2020 Department of Labor Office of the Solicitor of Labor's opinion letter, the DOL opined that an affiliate's foreign criminal convictions would

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not disqualify an asset manager from satisfying the anti-criminal condition and serving as a QPAM. However, the Solicitor retracted this opinion in March of 2021.[50]

Other Exemptions

An asset manager may conclude that it wants to comply with statutory or class exemptions other than the QPAM Exemption because it better suits its business model or offers broader exemptive relief such as relief from prohibited transactions under Section 406(b). Additionally, an asset manager, particularly certain investment advisers, may not meet the definition of a "qualified professional asset manager" and thus must look to other exemptions. Finally, even if an asset manager is a QPAM, it may need to rely on other exemptions or take other actions to address prohibited transactions because the QPAM Exemption is not available to exempt one or more transactions involving the investment fund.

As discussed, certain banks and insurance companies may be QPAMs and thus may rely upon the QPAM Exemption. However, banks may also look to statutory and class exemptions that specifically apply to banks. Section 408(b)(8) of ERISA provides broad exemptive relief for investments by Plan Investors in bank-maintained collective investment trusts, while Section 408(b)(4) provides for exemptive relief in connection with bank deposits and Section 408(b)(6) provides exemptive relief in connection with a bank's provisions of ancillary services. The Department has also issued Prohibited Transaction Exemption 91-38, which also provides exemptive relief for prohibited transactions that arise in connection with certain bank collective investment funds that may not be covered under Section 408(b)(8).[51] Similarly, Section 408(b)(8) of ERISA also exempts prohibited transactions that arise in connection with pooled insurance company separate accounts, while Prohibited Transaction Exemption 90-1 provides exemptive relief for certain prohibited transactions that arise in connection with insurance company separate accounts. Banks and insurance companies will often look to these exemptions rather than the QPAM Exemption.

Registered investment advisers, on the other hand, are more likely to rely on the QPAM Exemption. However, as discussed, some registered investment advisers will not be a "qualified professional asset manager" because they do not meet the United States registration requirements or do not meet the net capital and shareholders' equity requirements. In such circumstances, the investment adviser should look for other exemptions. One such exemption is the service provider exemption under Section 408(b)(17) of ERISA, which was added to ERISA with the enactment of the Pension Protection Act of 2006. Advisers will find that this exemption can be applied in many situations that the QPAM Exemption would otherwise be applied. However, as discussed earlier, the QPAM Exemption provides very limited relief for transactions with affiliates and for transactions that violate Section 406(b). In those cases, the adviser may have to take steps to eliminate the conflict.

Conclusion

In conclusion, the QPAM Exemption provides broad exemptive relief from the party in interest prohibited transaction provisions found in Section 406(a) of ERISA and identical provisions found in Section 4975 of the Code. Therefore, discretionary asset managers who fit within the definition of a "qualified professional asset manager" should consider meeting the conditions of the exemption as it will allow them to more easily conduct their day-to-day investment management activities. This is particularly true for registered investment advisers. Banks and insurance companies, who may otherwise be a QPAM, may find broad exemptive relief under other statutory exemptions found in ERISA or other class exemptions issued by the DOL. Asset managers who intend to rely on the QPAM Exemption should review the exemption and their policies and procedures to ensure that they can meet all of the conditions of the QPAM Exemption. To the extent that the exemption is not available, asset managers

should look to other exemptions or other strategies to deal with conflicts of interest as required by ERISA and the Code.

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NOTES

1 Amendment to Prohibited Transaction Exemption (PTE) 84-14 for Plan Assets Transactions Determined by Independent Qualified Professional Assets Managers, 75 Fed. Reg. 38837 (Jul. 6, 2010).
2 ERISA § 3(42); 29 C.F.R. § 2510.3-101.
3 ERISA § 406(a).
4 ERISA § 406(a).
5 ERISA § 406(a)(1)(A).
6 ERISA § 406(a)(1)(B).
7 ERISA § 406(a)(1)(C).
8 ERISA § 406(a)(1)(D).
9 ERISA § 406(a)(1)(E).
10 ERISA § 3(14).
11 I.R.C. § 4975(c)(1).
12 ERISA § 406(b).
13 ERISA § 406(b)(1).
14 ERISA § 406(b)(2).
15 ERISA § 406(b)(3).
16 I.R.C. § 4975(c)(1).
17 I.R.C. § 4975(a).
18 75 Fed. Reg. at 38841; PTE 84-14, Part I.
19 75 Fed. Reg. at 38841; PTE 84-14, Part I.
20 75 Fed. Reg. at 38843; PTE 84-14, Part VI(b).
21 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a).
22 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a)(1).
23 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a)(2).
24 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a)(3).
25 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a)(4).
26 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a)(4).
27 75 Fed. Reg. at 38843; PTE 84-14, Part VI(a).
28 75 Fed. Reg. at 38841; PTE 84-14, Part I(a).
29 75 Fed. Reg. at 38841; PTE 84-14, Part I(a).
30 Amendment to Prohibited Transaction Exemption (PTE) 84–14 for Plan Asset Transactions Determined by Independent Qualified Professional Asset Managers, 70 Fed. Reg. 49305, 49306 (Aug. 23, 2005).
31 70 Fed. Reg. at 49305, 49306; PTE 84-14, Part I(b).
32 75 Fed. Reg. at 38842; PTE 84-14, Part I(c).
33 70 Fed. Reg. at 49312.
34 70 Fed. Reg. at 49309; PTE 84-14, Part I(d).
35 70 Fed. Reg. at 49312; PTE 84-14, Part VI(h).
36 70 Fed. Reg. at 49312; PTE 84-14, Part VI(h).
37 70 Fed. Reg. at 49310; PTE 84-14, Part I(e).
38 70 Fed. Reg. at 49309.
39 Class Exemption for Plan Asset Transactions Determined by Independent Qualified Professional Asset Managers, 40 Fed. Reg. 9494, 9500 (Mar. 13 1984).
40 70 Fed. Reg. at 49310; PTE 84-14, Part I(f).
41 70 Fed. Reg. at 49310; PTE 84-14, Part I(g).
42 75 Fed. Reg. at 38842; PTE 84-14, Part II.
43 75 Fed. Reg. at 38842; PTE 84-14, Part III.
44 PTE 84-14, Part III(a) – (d).
45 75 Fed. Reg. at 38843; PTE 84-14, Part IV.
46 *See* 29 C.F.R § 29 C.F.R. § 2510.3-101, *as modified by* ERISA § 3(42).
47 29 C.F.R § 2510.3-101(a)(2).
48 Proposed Exemptions; McLane Company, Inc. Profit Sharing Plan and Trust (the Plan), 62 Fed. Reg. 27625 (May 20, 1997) ("The preamble to the proposed class exemption, 47 FR 56945 at 56947 (December 21, 1982), explains that the Department is prepared to grant broad exemptive relief only where an independent asset manager has, and in fact exercises, discretionary authority to cause an investment fund to enter into a transaction which is otherwise prohibited. Party in interest transactions that are negotiated by, *e.g.*, an employer which sponsors a plan, and are then presented to a QPAM for approval would not qualify for the class exemption as proposed. It is the view of the Department that the retention of a QPAM solely to approve a specific transaction presented for its consideration by a plan sponsor at the time of its engagement is inconsistent with the underlying intent of the exemption, *i.e.*, the transfer of plan assets to an independent,

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discretionary manager free from the undue influence of the sponsor. Such a transaction also raises issues under Section I(c) of the exemption which requires that the transaction not be a part of an agreement, arrangement or understanding designed to benefit a party in interest.")

[49] The DOL explicitly expressed its view in a recent individual exemption that this condition extended to foreign criminal convictions as well as US criminal convictions. PTE 2019-01, Exemption Involving UBS Assets Management (Americas) Inc.; UBS Realty Investors LLC; UBS Hedge Fund Solutions LLC; UBS O'Connor LLC; and Certain Future Affiliates m UBS's Asset Management and Global Wealth Management U.S. Divisions, 84 Fed. Reg. 6163, 6164, 6165 (Feb. 26, 2019).

[50] Department of Labor's Office of the Solicitor of Labor's Letter to Securities Industry and Financial Markets Association (November 3, 2020) (As of March 23, 2021, this letter has been withdrawn.)

[51] 56 Fed. Reg. 31966 (July 12, 1991), as corrected at 56 Fed. Reg. 59299 (Nov. 25, 1991).

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