

Department of Labor Finalizes Conditions for Financial Institutions to Serve as QPAMs to Their In-House Plans

July 15, 2010

In early July 2010, the Department of Labor (DOL) adopted amendments to the class exemption for qualified professional asset managers (QPAMs) to permit them to obtain exemptive relief for transactions for their in-house plans. The amendments are effective after November 3, 2010.

Description of Amendments

In adopting amendments to the QPAM exemption, Prohibited Transaction Class Exemption (PTE) 84-14 in August 2005, DOL revised the exemption language to require that a QPAM be independent of the employer with respect to the plan whose assets the QPAM is managing. DOL's proposal of this change generated a strong reaction from financial services firms, which told DOL that they had believed, based on advice of counsel, that they could serve as QPAMs for their own plans. In response, DOL proposed new conditions to apply to financial institutions acting as investment managers for their in-house plans, and also provided limited transitional relief pending the finalization of the new conditions.

Those conditions have now been adopted. A new Part V, "Specific Exemption Involving QPAM-Sponsored Plans," imposes the following additional conditions on a transaction involving the assets of a plan sponsored by the QPAM or an affiliate of the QPAM:

- (1) The QPAM must adopt written policies and procedures that are designed to assure compliance with the conditions of the exemption. The written policies and procedures must describe certain specified "objective requirements" of the exemption and must specify the steps adopted by the QPAM to assure compliance with each of these requirements.
- (2) An independent auditor, who has appropriate technical training or experience and proficiency with ERISA's fiduciary responsibility provisions and so represents in writing, must conduct an "exemption audit" (as defined in the definitions section) on an annual basis. Following completion of the exemption audit, the auditor is to issue a written report to the plan presenting its specific findings regarding the level of compliance with:
 - (a) The policies and procedures adopted by the QPAM
 - (b) The objective requirements of the exemption

The written report also must contain the auditor's overall opinion regarding whether the QPAM's program complied with:

- (a) The policies and procedures adopted by the QPAM
- (b) The objective requirements of the exemption

The exemption audit and the written report must be completed within six months following the end of the year to which the audit relates.

This "exemption audit" condition is based on the analogous condition in Prohibited Transaction Class Exemption 96-23, which covers asset managers for in-house plans (in-house asset managers, or INHAMs). That exemption had been designed specifically for in-house management groups of large corporations. As that exemption requires an INHAM to be a registered investment adviser that is a wholly owned subsidiary of the employer, it would not be available to financial institutions that are banks or insurance companies.

Several comments on the proposal requested that the "exemption audit" requirement be eliminated, due to its being unnecessary given existing regulatory oversight and internal audit requirements. DOL responded that PTE 84-14 had been based on the essential premise that the transactions being covered are the sole responsibility of an independent, discretionary manager. By contrast, where the QPAM is related to the plan sponsor, the plan sponsor is retaining investment discretion, so that the QPAM is no longer independent. The exemption audit condition addresses this lack of QPAM independence, DOL said, by ensuring that the conditions of the exemption have been met, a matter not addressed by existing regulatory oversight. DOL also noted that internal audits do not meet this need because they do not address the potential for the exercise of undue influence that may arise in the absence of an independent investment manager.

Other comments asked DOL to modify the exemption audit requirement to reduce cost burdens by reducing the frequency of the audits (for example, every five years instead of annually), possibly subject to interim reviews being done in-house instead of by an independent firm. DOL responded that performance of the exemption audit on a less-than-annual basis would weaken an important plan protection against the QPAM's lack of independence, and that if cost is a problem, the financial services entity need not serve as a QPAM for its own plan. Therefore, DOL did not modify the exemption audit condition.

DOL also received comments on the "diverse clientele" test under the exemption, which excludes from relief those plans whose assets, when combined with the assets of plans of the same or affiliated employers or employee organizations, represent more than 20% of total client assets managed by the QPAM. DOL said that the presence of independent business provides an important protection, and therefore declined to eliminate this test. DOL also declined a request to lower the percentage under this test to 10%. Another commenter noted that the INHAM exemption does not contain a diverse clientele test, and criticized imposing this condition on banks and insurance companies that do not meet the definition of an INHAM and therefore do not qualify for the INHAM exemption. DOL said that it is not foreclosing future consideration of additional exemptive relief in the INHAM exemption for financial institutions that do not meet the diverse clientele test and do not currently qualify as INHAMs.

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