

# Seward & Kissel LLP

August 25, 2005

Memorandum to Our Investment Management Clients and Friends

## **Final Amendment to the Department of Labor's Qualified Professional Asset Manager ("QPAM") Exemption**

As you may be aware, on Tuesday, August 23, the U.S. Department of Labor ("DOL") published a final amendment to Prohibited Transaction Exemption 84-14, relating to QPAMs. The final amendment ("Amended Exemption") is generally effective immediately, but contains certain transition rules to help asset managers come into compliance with the new rules. Selected features of the Amended Exemption are discussed below.

### Increased Asset Thresholds

Of particular interest to certain investment advisers are the Amended Exemption's increased thresholds for a registered investment adviser to qualify as a QPAM. Under the old rules, an adviser was required to manage over \$50 million in client assets and to have partners' or shareholders' equity of over \$750,000. The Amended Exemption increases these thresholds to over \$85 million in client assets and over \$1 million in partners' or shareholders' equity.

The new thresholds are to become effective the last day of the first fiscal year of the adviser beginning on or after August 23, 2005, both for managers that currently qualify as QPAMs and for those that seek so to qualify in the future. An example given by the DOL states that a calendar year adviser meeting the earlier thresholds may continue to act as a QPAM until December 30, 2006. On December 31, 2006, and thereafter, the adviser must have total client assets under management of over \$85 million, and must show partners' or shareholders' equity of over \$1 million in its most recent balance sheet prepared within the immediately preceding two years.

### Liberalized Definition of Affiliate – New 10% Rule

The DOL has changed the definition of affiliate for purposes of the rule that denies exemptive relief if a party in interest or its affiliate can appoint or terminate the QPAM as asset manager or negotiate its management agreement on behalf of the plan.

- ◆ 10% Rule: Notwithstanding any affiliation, if a plan or group of plans own less than 10% of a hedge fund's assets, the exemption will be available for transactions with the person that had the authority to appoint or terminate the QPAM or any of that person's affiliates.
- ◆ A partner in a party in interest must have a ten percent or more interest to be an affiliate, increased from five percent or more.
- ◆ The rule making a named fiduciary of a plan and an employer whose employees are covered by the plan affiliates of each other now applies only if:
  - ◆ the named fiduciary has this role with respect to the plan assets involved, and
  - ◆ the employer or its affiliate can appoint the named fiduciary or negotiate its employment agreement.

- ◆ Authority to manage plan assets no longer makes an employee of a party in interest an affiliate of the party in interest unless the authority extends to the plan assets involved.
- ◆ Non-highly compensated employees of the plan sponsor are no longer affiliates of the plan sponsor (unless they have authority to manage the plan assets involved).

#### Liberalized Relationship Test

The DOL has increased the ownership threshold that requires a party in interest to be considered “related” to a QPAM. If a party in interest is related to a QPAM, exemptive relief is generally unavailable. The old rules generally provided that if a party in interest (or a person controlling or controlled by the party in interest) owned a five percent or more interest in the QPAM, the party in interest was related to the QPAM. The same was true if the QPAM (or a person controlling or controlled by the QPAM) owned a five percent or more interest in the party in interest.

The Amended Exemption liberalizes these rules and provides that a party in interest is related to a QPAM if the party in interest owns ten percent or more of the QPAM or if the QPAM owns ten percent or more of the party in interest. For persons controlling or controlled by a party in interest or QPAM, the automatic threshold has been raised to twenty percent or more. Nevertheless, if a person controlling or controlled by a party in interest owns more than ten but less than twenty percent of a QPAM and exercises control over the QPAM because of its ownership, the party in interest is related to the QPAM. Likewise, where a person controlling or controlled by a QPAM owns more than ten but less than twenty percent of a party in interest and exercises control over the party in interest because of its ownership, the party in interest is related to the QPAM. The DOL warns that regardless of the percentage of ownership, if a QPAM engages in a transaction with a party that actually controls it, there may be a violation of ERISA § 406(b), which is not covered by the Amended Exemption.

#### Other Features

The Amended Exemption also:

- ◆ Drops the one year look-back rule that previously barred a party in interest from exemptive relief if it had exercised the power to appoint a QPAM or negotiate the terms of its management agreement with respect to the plan during the prior year.
- ◆ Permits a party in interest to have power to appoint the QPAM as manager of assets of the plan other than the assets involved in the transaction.
- ◆ Grants limited retroactive and transitional relief to financial institutions that have relied on the QPAM exemption to manage assets of their own plans. In a separate proposed amendment to PTE 84-14, also published on August 23, the DOL set forth rules that would apply to future asset management of financial institutions’ in-house plans.

---

If you have any questions about this memo, please feel free to call John Ryan at (212) 574-1679, Paul Jacobson at (212) 574-1339, or Sharon Vaino at (212) 574-1277.