OnPoint Dechert LLP

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A Legal Update From Dechert's Employee Benefits and Executive Compensation Group

Department of Labor Clarifies Interpretation of "Related" Under the QPAM Exemption

The U.S. Department of Labor (the "DOL") recently issued an information letter, dated November 9, 2012 (the "Information Letter"), in which it confirms that, for all purposes of determining what parties are "related" to a qualified professional asset manager ("QPAM") under prohibited transaction class exemption 84-14 (the "QPAM Exemption"), only direct ownership interests, and not indirect ownership, should be considered. The "QPAM Exemption is an exemption that allows certain investment managers that are QPAMs to enter into transactions that might otherwise be "prohibited transactions" under the Employee Retirement Income Security Act of 1974 ("ERISA"), if specified conditions are satisfied. One of those conditions is that the other party to the transaction not be "related" to the QPAM.

In Advisory Opinion 2011-06A, dated February 4, 2011, the DOL opined that two particular entities were not "related" for purposes of the QPAM Exemption despite the fact that there was some common ownership of the two entities. Advisory Opinion 2011-06A was helpful to investment managers in that it clarified that the QPAM Exemption is potentially available notwithstanding certain types of affiliation between the QPAM and the transaction counterparty. However, uncertainty arose with respect to the application of the "related" parties condition of the QPAM Exemption because in Advisory Opinion 2011-06A, in analyzing whether a particular party was "related" to another for purposes of the QPAM Exemption, the DOL recited that the party in question did not own, directly or indirectly, a sufficient interest in the other party.

By way of background, Section 406(a) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") prohibits certain transactions (such as sales, exchanges, extensions of credit, and provision of services) between a plan and persons who have certain relationships with the plan, called "parties in interest" (corresponding tax rules provide for similar prohibitions). The term "party in interest" is defined in Section 3(14) of ERISA and includes, in part, fiduciaries to the plan, persons who provide services to the plan, and 10 % or more shareholders and partners of such persons. The DOL has issued a number of class exemptions that permit persons to engage in transactions that otherwise would be prohibited under Section 406(a) of ERISA if certain conditions are satisfied. One of those class exemptions is the QPAM Exemption. In addition, Section 406(b) of ERISA prohibits fiduciaries from engaging in certain transactions that involve conflicts of interest and self-dealing. The DOL indicated in a regulation that for purposes of the prohibitions in Section 406(b) of ERISA a person in whom a fiduciary has an interest that might affect its best judgment and therefore present a prohibited conflict of interest if the fiduciary were to engage in a transaction with that person includes a person that is a party in interest by reason of being a 10% or more shareholder of a fiduciary or service provider.

In Advisory Opinion 2011-06A, the DOL addressed the situation in which Mitsubishi Bank, a wholly-owned subsidiary of Mitsubishi UFJ, owned a greater than 10% but less than 20% interest in Aberdeen PLC, the parent of Aberdeen Asset Management ("AAM"). The questions presented were whether certain broker-dealers owned by Mitsubishi UFJ ("Mitsubishi Brokers") but not owned directly by Mitsubishi Bank (they were brother-sister corporations) (1) would be an indirect 10% owner of AAM under Section 3(14)(H) of ERISA

such that a transaction between an ERISA plan client of AAM and a Mitsubishi Broker would be a per se violation of Section 406(b) of ERISA, and (2) would be "related" to AAM for purposes of the QPAM Exemption (with the result that the exemption would not cover and exempt transactions with the Mitsubishi Brokers).

In Advisory Opinion 2011-06A the DOL stated that a Mitsubishi Broker would not be a party in interest to plans advised by AAM by reason of being an indirect shareholder of AAM. Rather, the DOL takes the position that only entities in a vertical chain of ownership with a person who provides services to a plan can become parties in interest to that plan by reason of being an indirect shareholder of the service provider.

As noted above, the QPAM Exemption does not exempt transactions with the QPAM itself or with anyone "related" to the QPAM. The relevant portion of the term "related" includes where a person controlling or controlled by the party in interest (i) owns a 20% or more interest in the QPAM, or (ii) owns a greater than 10% but less than 20% interest in the QPAM and exercises control over the management or policies of the QPAM by virtue of such interest. The DOL had previously indicated, and reiterated in Advisory Opinion 2011-06A, that the definition of "related" focuses only on ownership in the QPAM itself or in the party in interest itself, but not on ownership in their affiliates (that is, entities under common control). Because the definition of "related" does not extend to ownership in the QPAM's parent (or other affiliates), the DOL concluded that the fact that a corporation under common control with a Mitsubishi Broker owns an interest in AAM's parent does not make the Mitsubishi Broker "related" to AAM for purposes of the QPAM Exemption. Under this analysis, even a greater than 20% interest in the QPAM being held by an entity under common control with a particular party in interest should not cause the party in interest to be "related" to the QPAM (though it could raise questions whether a violation of ERISA Section 406(b) might occur).

Unfortunately, as noted above, in its recitation of AAM's factual representations the DOL made reference to a party's direct or indirect ownership interest. This caused some in the employee benefits community to be concerned that they could rely on the DOL's position in Advisory Opinion 2011-06A only where both direct and indirect ownership within a controlled group is under the 20% level.

The DOL has now issued the Information Letter, which resolves this uncertainty. The Information Letter, which was issued to Dechert LLP, confirms that the reasoning of Advisory Opinion 2011-06A indeed applies to situations in which there is indirect common ownership, so that even if one party has an interest in another party of 20% or more but that interest is only indirect (that is, the parties are under common control but neither controls or is controlled by the other) the parties should not be related for purposes of the QPAM Exemption.

For more information, please contact the attorneys listed below, or any Dechert attorney with whom you regularly work.

This update was authored by:

Susan M. Camillo
Partner
Boston
Send an email
T: +1 617 728 7125

Andrew L. Oringer
Partner
New York
Send an email
T: +1 212 698 3571

For a list of Dechert's Employee Benefits and Executive Compensation lawyers, please click here.

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