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# **WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON**

**“What Happens to the QPAM Exemption When  
Your Institute is a Convicted Felon”**

**Presentation to Fiduciary & Investment Risk Management  
Association**

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# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON

## OVERVIEW OF PRESENTATION

- I. Current State of Financial Institution's QPAM Exemption to ERISA Prohibited Transactions
- II. Background on QPAM Exemption
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  - Fiduciary Duties
  - Prohibited Transactions
- III. Qualification – QPAM Prohibited Transaction Exemption
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  - QPAM PTCE 84-14 Requirements
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  - Non US Assets
- IV. Conclusion - If QPAM Convicted of Activities that Violate Financial Trust

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON

## I. Current State of Financial Institution's DOL QPAM Exemption to ERISA Prohibited Transactions

- In December, 2016 Five banks – Deutsche Bank AG, Barclays Capital, Inc., UBSAG, Citigroup Inc. and JPMorgan Chase & Co. asked:
  - Department of Law (DOL) for clarity in waivers being considered for banks to allow them to continue managing retirement assets despite criminal sanctions.
  - Each bank had units that were convicted of financial crimes, such as market manipulation.
  - Banks seeking temporary exemptions from DOL while pursuing longer term exemptions.
- What's at stake?
  - Qualified Professional Asset Manager (QPAM) exemption from Employee Retirement Income Security Act (ERISA)'s prohibited transaction rules to allow the banks to manage pension and other retirement assets.



## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON

- DOL adds new condition to obtaining QPAM Exemption.
  - DOL prohibited transaction Notice 2016-13.
  - Only individuals that did not participate in criminal conduct can serve in QPAM capacity.
  - DOL defines “participate” broadly.
    - \* Participate includes “the knowing or tacit approval of the misconduct underlying the convictions regarding each bank.”
    - \* Banks concerned “tacit” undefined and ambiguous and would result in disparities and problems not in best interest of plans.
  - DOL Notice reference 'This Record'
    - Not clear if DOL means record before DOL or record before Department of Justice when bank reached plea agreement in conviction

## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON

- (DOL) considered granting waiver to five major banks to allow them to continue to manage multitrillions of dollars in U.S. 401(k) plan and retirement funds in spite of financial crimes.
  - Deutsche Bank AG - Previously, DOL tentatively denied QPAM exemption but later granted temporary exemption.
  - Citigroup Inc. - One year temporary exemption.
  - UBS Asset Management - Previously, DOL tentatively denied QPAM exemption, later granted temporary exemption.
  - JP Morgan Chase & Co. - Requests 5 year exemption despite conviction of bank for conspiracy to fix the price of or eliminate competition in purchase or sale of the Euro/U.S. dollar currency price exchanged in the Foreign Spot Market.
  - Barclays Capital Inc. - granted temporary one year exemption.

## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- DOL Exemptions
  - Temporary one year exemptions (start from date of criminal sentence).
  - DOL grants waiver typically when bank division handling pension assets is insulated from division engaged in criminal activity.
  - Five year exemptions subject to strict conditions.
  - Temporary exemption sought to protect ERISA-covered plans and IRA.
  - Over past five years, DOL granted nine QPAM waivers - most to Deutsche Bank
- Royal Bank of Scotland Group – DOL denied waiver (PTE) to allow it to manage 401(k) assets after parent company pleaded guilty to foreign-exchange collusion and unit admitted to interest rate manipulation.

## **WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED**

- Credit Suisse AG
  - In 2014 plead guilty in US District Court for Eastern District of Virginia to one count of conspiracy to aid in preparation and presentation of false income tax returns.
  - 1984 applied for a PTE waiver despite violations.
  - Credit Suisse Case – Bank dealings with client related to \$375 million loan which was structured to move funds through Cayman's Islands and evaded and subvert US banking laws.
- Congressional Representatives, Elizabeth Warren (MA) and Maxine Waters (CA) stressed importance that DOL utilize disqualification authority request hearing as DOL granted 23 applications for PTE since 1987.
  - “If DOL simply waives the disqualification provisions on a seemingly automatic basis, it undermines the incentive to obey the law.”



# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Previously, DOL granted Credit Suisse (which manages \$15.6 billion for tax exempt clients) QPAM exemptions after rigorous evaluation.
  - \* Typically QPAM last 10 years
  - \* Credit Suisse – QPAM 10 years for those managers working for entities in which it owns direct or indirect stake of 50% or more. But 5 years for wholly owned Credit Suisse affiliation which will need to seek new PTE after 5 years.
- December 2016, DOL grants temporary exemption to Deutsche Bank, Citigroup, Barclays Capital, JP Morgan Chase and UBS to protect rights of plan participants and beneficiaries.

## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- DOL requires conditions set in one year exemption including:
  - \* Must inform participants within six months all ERISA covered plans and IRAs receiving discretionary fiduciary services of terms of one year exemption agreement.
  - \* Must have independent auditor.
  - \* Develop training program regarding management of all relevant defined benefit QPAM assets.
  - \* Portfolio Management.
  - \* Trading Requirements.
  - \* Legal
  - \* Compliance and internal audit at least annually.
- DOL added new condition to obtain the waiver:
  - \* Requires only individuals that did not participate in the criminal conduct can serve in a QPAM capacity.
  - \* DOL defines “Participate” broadly”.

## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- “Knowing or tacit approval of the misconduct underlying the convictions” regarding the bank.
- Banks concerned too broad “tacit” approval undefined and ambiguous could be problematic.
- DOL cracked down on exemptions
  - \* Financial firms rely on class exemption from DOL to serve as qualifying professional asset manager for retirement plan clients.
  - \* If firm’s affiliates or parent are convicted of criminal charges, firm must seek individual exemption to continue to manage assets.
  - \* Previously, DOL tentatively denied QPAM exemption to three large asset managers from:
    - Deutsche Bank AG (\$11.5 billion in US institutional exempt assets, \$8.2 billion in QPAM assets).
    - UBS Global Asset Management (\$53.3 billion institutional exempt assets).
    - Royal Bank of Scotland Group.

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- \* Parent companies were convicted of manipulating benchmark interest rates and other charges.

## II. Background on QPAM Exemption

### A. Employment Retirement Income Security Act (“ERISA”)

- Employee Benefit Plans subject to ERISA and related trusts) includes: Pension plans, 401(k) plans and Taft – Hartley (multiemployer) plans but not:
  - Governmental plans or public retirement systems or
  - Non-US plans and pension systems
  - Church plans unless special election for ERISA to apply. (But see Class Action Litigation challenging Church plan exemptions from ERISA for certain types of plans)
- IRAs not subject to ERISA but subject to IRC Section 4975. (See DOL Fiduciary Rule).

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# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

## B. Fiduciary Duties

- Manager of ERISA plan assets is a Fiduciary and must comply with ERISA's Fiduciary Standards.
  - Exclusive Benefit
  - Prudence
  - Diversification
  - Plan Documents
  - Bonding Requirements

## C. Prohibited Transactions

- Rules provided in ERISA Sections 406-408 and IRC Section 4975.
  - Prohibited Transaction Rules broad with conditional exemptions.
  - Subject to initially 15% penalty tax on amount involved.



# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Party-in-Interest Transaction (includes Fiduciary and party providing services to plan ERISA plan fiduciary acting on behalf of plan or IRA must be careful not violate ERISA Section 406) Prohibited Transactions provision.
- Self-Dealing transaction.
- Employer Securities
- IRAs:
  - IRC Section 4975 applies, and
  - New Fiduciary Rule Delayed
    - \* Seller's Exception
    - \* Best Interest Contract Exemption
    - \* Pension Protection Act Exemption for Investment Advice
- Correcting Prohibited Transactions
  - ERISA provides 14 days to correct certain transactions.
  - DOL has adopted Voluntary Fiduciary Correction Program

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

## III. Qualification for QPAM Prohibited Transaction Exemptions

- Types of Prohibited Transactions
  - Individual Exemption
  - Class Exemption
  - Statutory Exemption
- QPAM Overview
  - QPAM is a class exemption (PTCE 84-14)
  - Qualified Professional Asset Manager
  - PTCE 84-14 is main class exemption relied on by investment managers and advisers regarding benefit plan or IRA
  - PTCE 84-14 doesn't remove all investment restrictions, but QPAM reduces the number of restrictions
  - With QPAM, ERISA Section 406A transactions which would be prohibited allowed
    - \* Loans and Extension of Credit
    - \* Leases
    - \* Services between plan and party in interest

## WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Under QPAM Exemption
  - Investment manager of plan assets may enter into trades with broker dealers who are service providers to benefit plan
- QPAM does not relieve Fiduciary Duties
- QPAM Exemption Qualification Requirements PTCE 84-14
  - Requirement to become QPAM must be a bank, savings and loan or insurance company with equity capital or net worth in excess of \$1 million or a registered investment advisor with assets under discretionary management in excess of \$85 million and equity in excess of \$1 million
  - The Asset Manager must acknowledge in writing to the client that it is acting as a Fiduciary

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# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Other party must not be a QPAM related to QPAM or the fiduciary who appointed QPAM or decided to invest in fund
- QPAM must arrange the specifics of transaction and decide to enter the transaction on behalf of the plan
- QPAM MAY NOT HAVE BEEN CONVICTED OF CERTAIN ACTIVITIES THAT RELATE TO FINANCIAL TRUST
- QPAM required to comply with annual audit with respect to investment activities to maintain QPAM status
- QPAM Transactions exemption allowed under PTCE 84-14:
  - Plan assets entering transactions may not be more than 20% of all assets managed by QPAM
  - Transaction terms and conditions must satisfy arm's length transactions and be favorable at this level

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# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- At time of transaction, the opposing party nor affiliate party must not have power to appoint or terminate QPAM as manager of plan assets in the transaction or have any ability to negotiate the QPAM's management agreement on behalf of the plan
- QPAM must arrange the specifics of transaction and decide to enter the transaction on behalf of the plan



# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Non QPAM Alternatives
  - Other status – based ERISA Exemptions
    - i. PTE 90-1 insurance company separate accounts
    - ii. PTE 91-38 bank collective investment funds
    - iii. PTE 95-60 insurance company general funds
    - iv. PTE 96-23 in-house asset manager
  - Service Provider Exemption stated in:  
ERISA Section 408(b) 17 and IRC 4975 (d)(20)
    - i. Party in interest must not be a fiduciary and does not render investment advice for assets
    - ii. Party in interest is a party solely as provides services to plan by reason of affiliation with service provider
    - iii. Plan pays no more than adequate consideration

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - FELON

- Non U.S. Assets
  - ERISA 404(b) requires managers of plan assets to not maintain “indicia of ownership” of plan assets outside of U.S. subject to limited exception
  - Exceptions permitting indicia of ownership of non U.S. securities and non-U.S. currencies to be held outside the U.S.

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

## IV. Conclusion

If QPAM Convicted of Activities that Violate Financial Trust

- DOL Requirements to Preserve QPAM Exemption
  - DOL requires all participants of ERISA retirement plans and IRAs be informed within six months of QPAM situation
  - Independent auditor must be retained
  - Compliance and Internal Audit must be conducted at least annually
  - Bank must develop training program for managing all QPAM assets
  - Bank must comply with DOL/QPAM requirements
  - Trading must comply with DOL requirements
  - Requires legal involvement and overview of QPAM request and implementation
  - Only individuals that did not participate in criminal conduct can serve in a QPAM capacity

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# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Consider viability of Alternative Exemptions
  - Review to see if alternative exemptions applicable and viable to bank's situation
- Maintain QPAM assets in insulated unit to mitigate potential loss of exemption

# WHAT HAPPENS TO THE QPAM EXEMPTION WHEN YOUR INSTITUTE IS A CONVICTED FELON - CONTINUED

- Questions?

Thank you