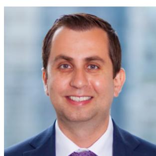
PENSION SERIES

POOL HOPPING: ERISA-REGULATED DEFINED BENEFIT PLANS MAY HAVE MORE PRIVATE INVESTING FLEXIBILITY THAN THEY REALIZE



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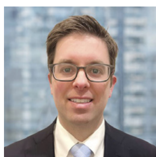

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This paper discusses the qualified professional asset manager (QPAM) exemption, an established, ERISA-approved exemption related to private investing programs. This exemption is currently under regulatory review by the US Department of Labor (DOL). Plans wishing to undertake a QPAM transaction should consult with their ERISA counsel.

Many plan sponsors that have a private investment (PI) allocation, or are considering one, are wary of time horizons. They may have concerns that the longer-term lock-ups required for PI preclude them from strategies such as a pension risk transfer, plan termination, or asset de-risking. They may also worry that selling their PI portfolio on the secondary market as a potential liquidity workaround might cause them to incur meaningful losses. While these concerns may be valid in some instances, they are often misconstrued. In fact, most plan sponsors have untapped illiquidity premium potential.[1] In addition, many plan sponsors can keep their PI portfolios in place for longer than they might imagine. This is because an exemption exists that allows all ERISA-governed defined benefit (DB)[2] plans to transfer their PI programs to a separate investment pool—such as a sponsor-affiliated endowment—without liquidating them or sacrificing returns through secondary market transactions. Thus, an opportunity exists for sponsors without PI portfolios to begin to consider how PI might help them achieve their broader investment goals. Furthermore, those with an existing PI program can move all or part of their allocation to another asset pool via a direct dollar-for-dollar transfer without taking a haircut on the valuation.

Although this exemption has been available for years, it has not been used extensively. With an increasing number of plans seeking to settle benefit obligations in the near term, this exemption offers a way for some plans to realize the potential return-generating benefits of a PI allocation without impeding de-risking activities. For plans at or near fully funded, the exemption allows for continued use of PI to enhance risk-adjusted returns.[3]

1 See Alex Sawabini and Michael Dunleavy, "Overestimating Liquidity Needs Can Undercut the Return Potential of US Pension Plans," Cambridge Associates LLC, November 2021.

2 This may include church plans and other plans defined by IRC 414(e), but applicability depends on specific state provisions.

3 Please see Ming Yan and Kelly Jansen, "Right-Sizing Private Investments for the Evolving Pension," Cambridge Associates LLC, September 2022.

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HOW DOES A QPAM EXEMPTION WORK?

A QPAM can facilitate the transfer of private assets under DOL exemption 84-14, where a separate QPAM acts as a fiduciary for each pool of assets (e.g., two unrelated QPAMs). Most asset owners already use a QPAM for discretionary or non-discretionary management of one or multiple asset pools. Employing a separate QPAM for one of the pools allows for the transfer of assets between the pools without running afoul of ERISA-prohibited transaction regulations.

The main area of concern with these sales is the fair market value of the private assets, which is negotiated between the separate QPAMs. Although this transfer can occur between any two pools of assets, it is most practical for a plan sponsor with multiple pools that are under the ownership of the sponsor. Here, the PI assets can be transferred out of the pension plan and into another pool of capital in a more streamlined manner.

In most cases, approval by an external entity is not necessary. Outside of the generally reasonable fees for this service to the QPAM and the time required to agree upon a price of the assets to be transferred, the sale can occur within a few months at a price that is sensible to both the purchaser and seller.

WHAT PLANS QUALIFY FOR THE EXEMPTION?

While the QPAM exemption is available to all organizations with an ERISA-governed DB plan, it is more practical for institutions with multiple pools of investment assets, given visibility within each pool. Assuming there is an adjacent capital pool—such as an endowment—that can add to its PI program, assets can be transferred dollar for dollar to the DB plan as long as the adjacent pool maintains sufficient liquidity for a cash transaction. For this reason, institutions such as universities, healthcare organizations, or other 501(c)(3) organizations—which often manage multiple large investment pools—are prime candidates for the QPAM exemption. Although corporations also qualify, additional approval from the DOL is required for the PI program to be transferred to a corporate balance sheet.

Transfer opportunities for non-related DB plan sponsors with private programs also exist. It is possible to find an unrelated party that is looking to obtain all or part of the PI program in question. If the right buyer can be found, a private transfer may be the best option.

CONCLUSION

Plan sponsors seeking enhanced risk-adjusted returns can achieve those returns through a PI program, knowing that if they ever have a liquidity need—such as a plan termination, pension risk transfer, or increasing fixed income assets—a QPAM facilitated transfer may be available. Determining whether to sell a private program to another pool is a decision a plan sponsor needs to make based upon their short-, mid-, and long-term pension plan goals. ■

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