



Pension Legislation to Make Important Changes for Hedge Funds

On Friday, August 4, 2006, the President announced that he plans to sign the Pension Protection Act of 2006, which was recently passed by Congress. Although a primary focus of the legislation is pension funding and related matters, the legislation will make important changes to ERISA's "plan assets" rules that will allow hedge funds and other investment funds to more readily tap the pension plan market.

Under ERISA regulations, if "benefit plan investors" own 25% or more of any class of equity interest in a hedge fund or other investment fund, the fund's underlying assets are treated as "plan assets" subject to ERISA's fiduciary duty, prohibited transaction, and other rules. Currently, the term benefit plan investor is defined to include not only plans subject to ERISA and/or the Internal Revenue Code's prohibited transaction rules, but also plans not subject to such rules, including non-U.S. plans and governmental plans ("non-ERISA Plans"). The Pension Protection Act narrows the definition of benefit plan investor, so that it will only include plans subject to ERISA and/or the Internal Revenue Code's prohibited transaction rules. This liberalization will allow hedge funds and other investment funds to tap an unlimited amount of non-ERISA Plan assets without concern about compliance with the 25% rule, and also allow greater access to ERISA and other covered plans by including only such plans in the 25% calculation.

The legislation also resolves a "look-through" issue of particular importance to "fund of funds" by amending ERISA to provide that an entity is considered to hold plan assets only to the extent of the percentage of its equity interests held by benefit plan investors. ERISA regulations currently can be interpreted to require that, if an entity is treated as holding any ERISA plan assets, the entire amount of any investment made by the entity is treated as plan assets for purposes of the 25% rule, even though less than all of the entity's assets are attributable to benefit plan investors. Under the new legislation, only a proportionate amount will be treated as plan assets.

The above provisions are effective with respect to transactions occurring after the date of enactment.

AUGUST 2006

Washington, DC
+1 202.942.5000

New York
+1 212.715.1000

London
+44 (0)20 7786 6100

Brussels
+32 (0)2 517 6600

Los Angeles
+1 213.243.4000

San Francisco
+1 415.356.3000

Northern Virginia
+1 703.720.7000

Denver
+1 303.863.1000

This summary is intended to be a general summary of the law and does not constitute legal advice. You should consult with competent counsel to determine applicable legal requirements in a specific fact situation.

arnoldporter.com

We hope that you find this brief summary helpful. If you would like more information, or assistance in addressing or commenting on the issues raised in this advisory, please feel free to contact:

Ed Bintz

+1 202.942.5045

Edward.Bintz@aporter.com

Doug Pelley

+1 202.942.5423

Douglas.Pelley@aporter.com