

NEW PENSION ACT MAKES IMPORTANT CHANGES AFFECTING
INVESTMENT FUNDS WITH BENEFIT PLAN INVESTORS AND
THOSE WHO TRADE WITH THEM

The House and Senate have both passed the Pension Protection Act of 2006 (the "*Pension Act*"), and President Bush has announced that he intends to sign it on August 17, 2006. The Pension Act contains many changes to the pension laws, primarily involving funding of defined benefit pension plans, but also contains provisions which are very important for investment funds and those who trade with them.

Under current law, if an employee benefit plan subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended ("*ERISA*") or comparable provisions of Section 4975 of the Internal Revenue Code of 1986, as amended (the "*Code*") (which apply to individual retirement accounts) invests in an entity, the assets of that entity may be considered assets of such plan if (1) interests in such entity are not publicly traded and the entity is not a registered mutual fund, (2) the entity is not an operating company, and (3) equity participation in the entity by "benefit plan investors" is significant.

Equity participation in an entity by "benefit plan investors" is considered significant if such investors hold 25% or more of any class of interests in the entity, exclusive of interests held by the manager or investment advisor of the entity or their affiliates. Under current Department of Labor regulations, "benefit plan investors" includes not only plans subject to ERISA or Section 4975 of the Code, but also any other employee benefit plans, whether or not subject to ERISA or Section 4975 of the Code. This includes governmental plans and foreign plans, which are generally not subject to these provisions but often invest in investment funds. "Benefit plan investors" also includes any entity whose assets are considered to be plan assets under the foregoing rules. Thus, under these regulations, it is possible for the assets of an investment fund to be considered plan assets even though plans subject to ERISA have only a very small investment in the fund. In addition, if a fund's assets are deemed plan assets by reason of only a 25% investment in the fund by benefit plan investors, all of the fund's assets are considered plan assets for purposes of applying the 25% test to an entity the fund itself invests in.

The Pension Act makes two important changes to these rules, both to become effective as of the day following the date the President signs the Pension Act.

First, "benefit plan investors" will be limited to plans subject to ERISA or Section 4975 of the Code. Accordingly, governmental plans and foreign plans will no longer be considered benefit plan investors. This may allow investment funds which have been over the 25% limit to now be under such limit, and may allow others which have limited investment by benefit plans to avoid reaching this limit to allow additional investment by benefit plans.

Second, if an entity's assets include plan assets because it is over the 25% limit, for purposes of applying the 25% test to entities it invests in, it will only be considered plan assets for the percentage of its interests held by benefit plan investors, *e.g.*, an entity with 25% of its interests held by benefit plan investors, will itself be considered as only 25% plan assets, rather than 100% as under current law, when the test is applied to an entity it invests in.

The Pension Act also adds a number of statutory prohibited transaction exemptions to both ERISA and the Code, also effective as of the date after the date on which the President signs the Pension Act. The most interesting of these exemptions is one which will generally permit sales between plans and parties in interest, as long as the party in interest (or its affiliate), did not cause the plan to enter into the sale or provide the plan with investment advice with respect to the sale. This exemption is only available if the sale was at "adequate consideration," which is to be fair market value; in the case of property for which there is not a generally recognizable market this will have to be determined by fiduciaries in good faith under regulations to be issued by the Secretary of Labor. Once such regulations are issued, this may eliminate much concern about inadvertent prohibited transactions.

If you have any questions concerning the provisions of the Pension Act, please contact Ken Werner, (212) 530-1961, kwerner@rkollp.com.