

Morgan Lewis

Katten
Katten Muchin Rosenman LLP

WEST
LEGALworks

perspective

ERISA for Money Managers: A Practical Workshop

Hedge Funds

Edward J. Rayner, Katten Muchin Rosenman LLP

Craig A. Bitman, Morgan Lewis

Gerald T. Lins, ING Investment Management

Retirement Assets in US

- \$14.6 Trillion in US Retirement Assets (9/30/07)
 - \$5.9 Trillion in Private Pension Plans
 - \$3.3 Trillion in State & Local Pension Plans
 - \$1.2 Trillion in Federal Pension Plans
 - \$4.2 Trillion in IRAs (12/31/06)
 - Source: Federal Reserve Flow of Funds Accounts, 3rd Quarter 2007 (doesn't include \$2.5 Trillion held at life insurance companies)
- According to Greenwich Associates 2006 Research Study:
 - Corporate Pension Assets increased from 0.8% of Assets in 2002 to 1.7% of Assets in 2005
 - 34% of Corporate Pension Plans intend to “significantly jump start their hedge fund investments.”
- US Pension Investors Are Generally Slow to Invest And Slow to Redeem

Plan Asset Exceptions

- Publicly-Offered Securities
- Registered Investment Companies
- Operating Companies
 - Venture Capital Operating Companies
 - Real Estate Operating Companies
- Participation by Benefit Plan Investors (BPIs)
Not Significant
- No ERISA/4975 Plans

BPI Investment Not Significant

- <25% Of Each Class Of Equity Held by BPIs
 - Equity interests held by non-BPI with discretionary authority or control with respect to the assets of the entity are not treated as outstanding (“Controlling Persons”)
- Insurance company general accounts
 - Partial BPI based upon percentage of Plan Assets in general account

Benefit Plan Investors

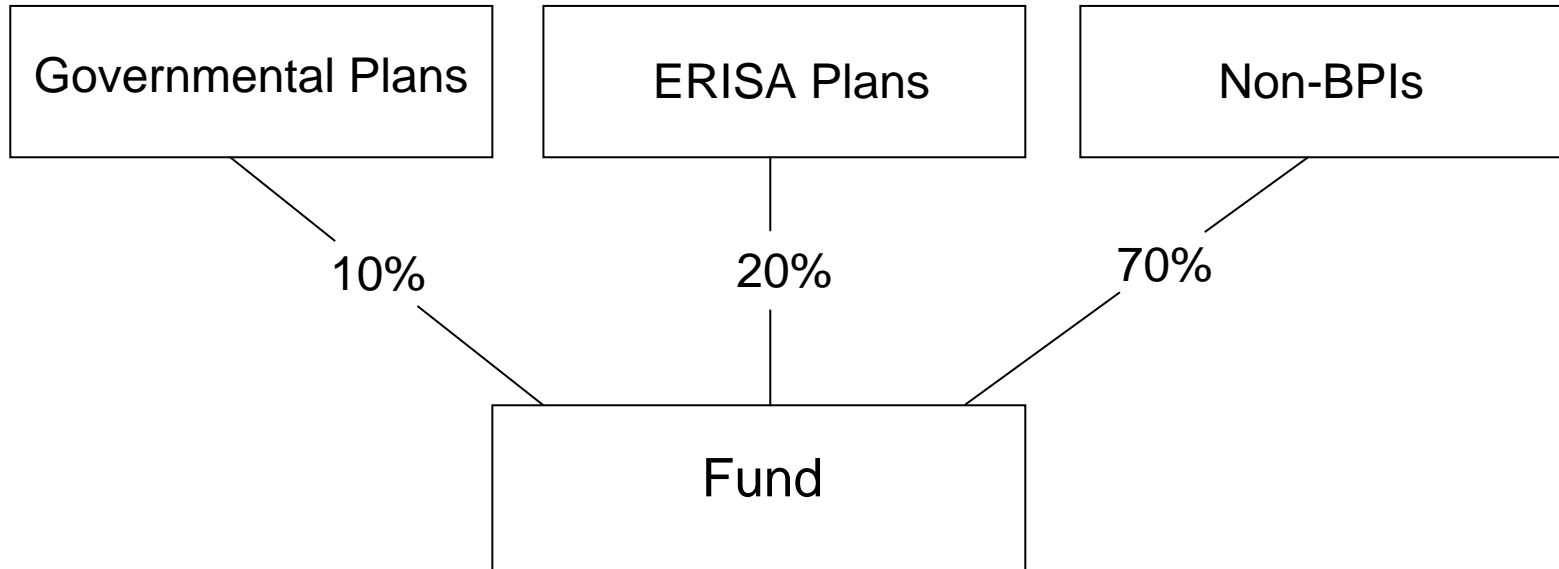
- Prior To PPA

- Employee Benefit Plans (whether or not subject to ERISA)
 - Includes plans not subject to ERISA
 - *Governmental Plans*
 - *Foreign Plans*
 - *Church Plans*
- Plans Subject to 4975 of the Code
 - IRAs, Qualified Plans, Archer MSAs, Health Savings Accounts and Section 530 Plans
- Entities deemed to hold “plan assets” by reason of a plan’s investment in such entity

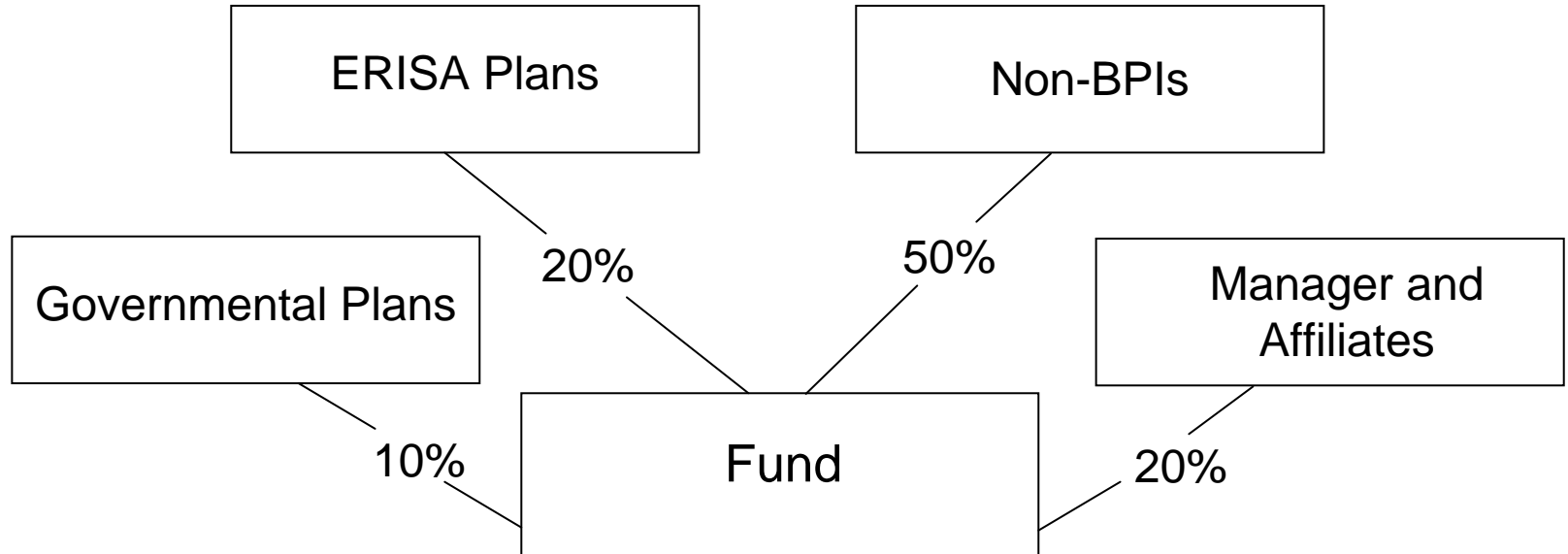
Benefit Plan Investors

- <25% Of Each Class Of Equity Held by Benefit Plan Investors
 - *Benefit Plan Investors includes*
 - Employee Benefit Plans Subject to Fiduciary Rules of ERISA
 - Plans subject to Code Section 4975
 - Entities deemed to hold “plan assets” by reason of a plan’s investment in the entity
 - *Benefit Plan Investor does not include*
 - Foreign Plans
 - Government Plans
 - Certain Church Plans
- An entity exceeding the 25% threshold is a “benefit plan investor” only to the extent of the percentage of its own equity interest held by benefit plan investors

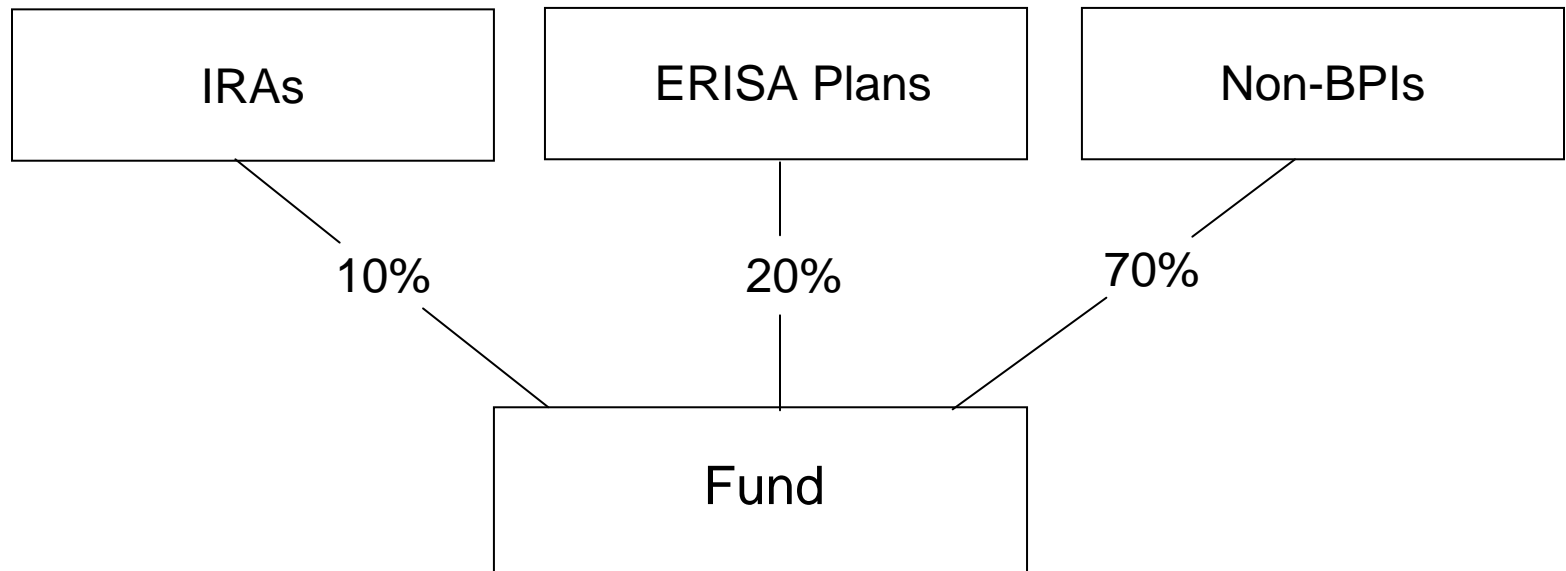
BPIs - Example 1



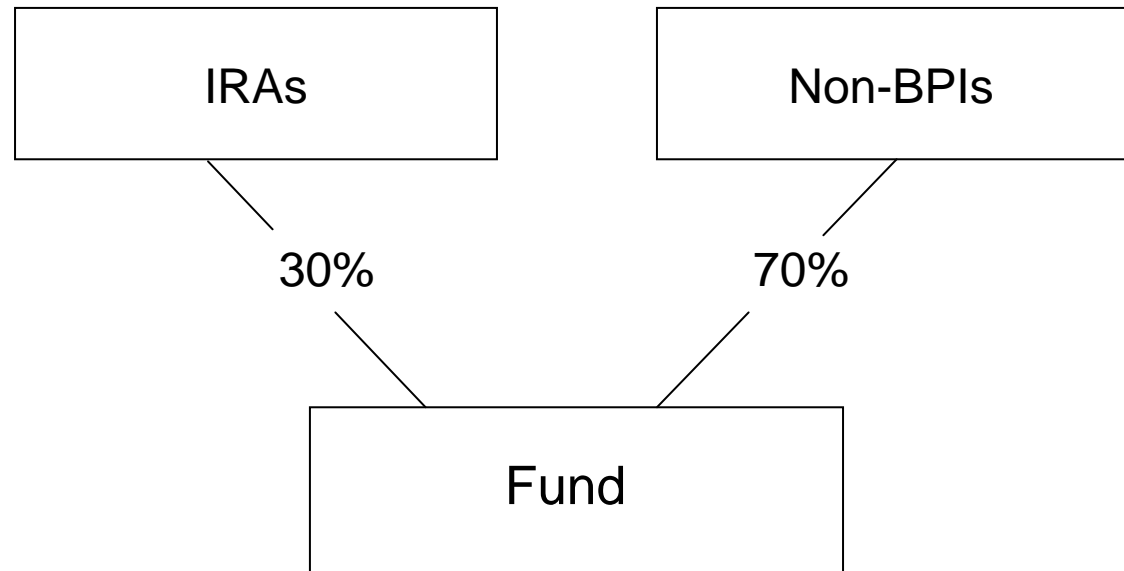
BPIs - Example 2



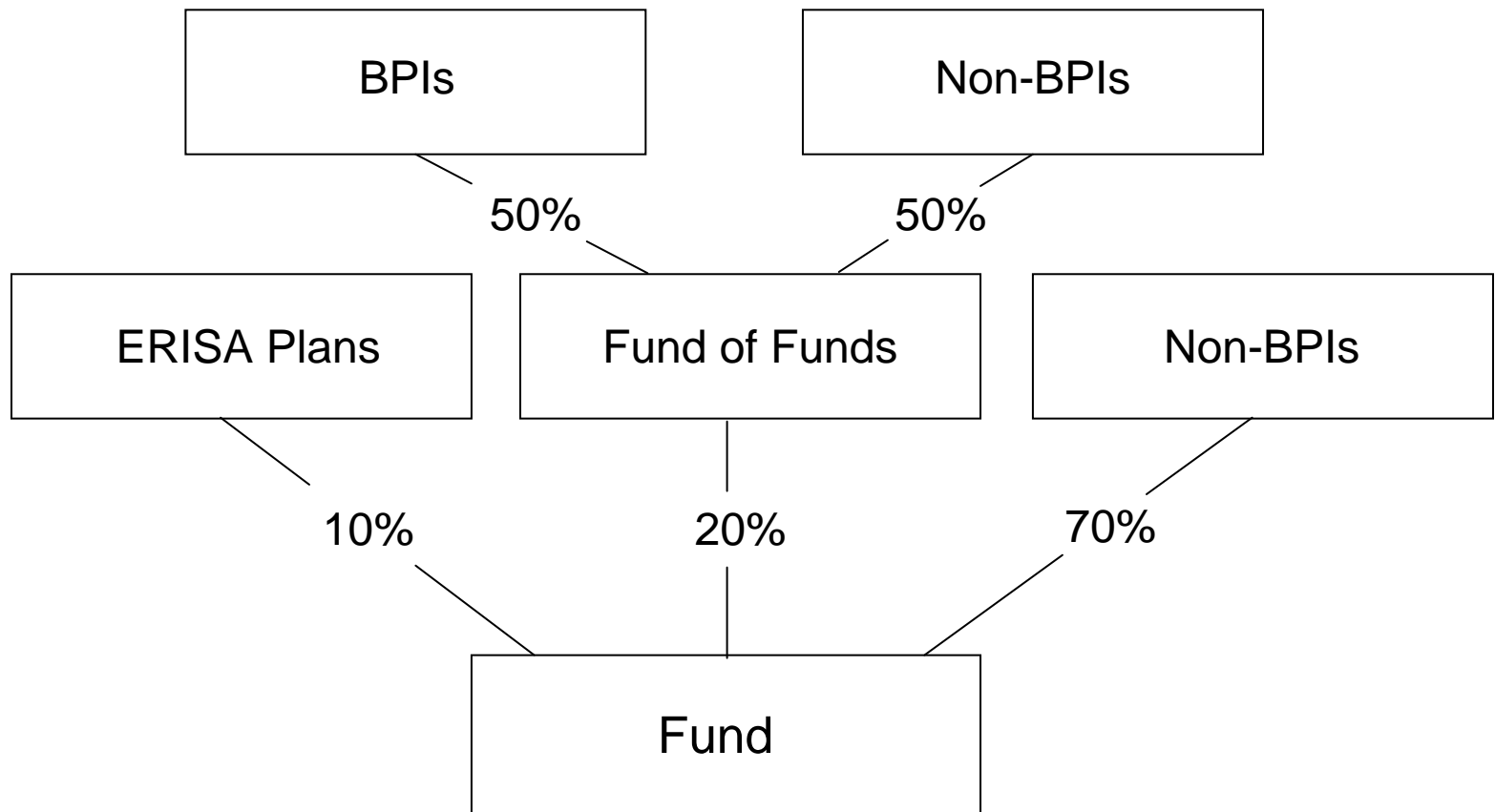
BPIs – Example 3



BPIs - Example 4



BPIs - Example 5



ERISA Fiduciary Obligations

- Exclusive Benefit Rule
- Prudent Person Standard
- Diversification
- Hold Plan Assets in Trust
- Avoid Prohibited Transactions
- ERISA Fiduciaries are personally liable for any breaches of their fiduciary obligations

Prohibited Transactions Exemptions

- Common Hedge Fund Operation Exemptions
 - Qualified Professional Asset Manager Exemption (QPAM)/PTCE 84-14
 - Prohibited Transaction Class Exemption (PTCE) 75-1
 - Service Provider Exemption (PPA)
- Exemption For Fees
 - 408(b)(2)/(c)(2) Exemption

408(b)(2)/(c)(2) Exemption

- Necessary Service
 - Appropriate & Helpful in carrying out purpose of plan
- Reasonable Contract or Arrangement
 - Must Permit Termination by Plan
 - *On Reasonably Short Notice*
 - *Without Penalty*
 - DOL Advisory Opinions suggest 60 or 90 days
- Reasonable Compensation

Performance Fees

- Could be Self-Dealing PT
- Advisory Opinions Provide no-PT if
 - Fee arrangement approved by independent fiduciary
 - Investing Plans each have \$50M in assets
 - Performance based on realized and unrealized gains
 - Most investments have readily available price quotations
 - Other investments appraised by independent appraiser selected by plans and acting on behalf of plans
 - Performance measured over pre-established time period

Other ERISA Issues

- Delegation
 - Investment decisions can only be delegated to “investment manager”
 - Investment Manager must be bank, insurance company or RIA
- Bonding
 - Lesser of 10% of plan assets or \$500,000 per plan (after 12/31/07, \$1 million, if plan holds employer securities)
 - Not required for broker-dealers subject to certain fidelity bond requirements
- Reporting
- Indicia of Ownership within jurisdiction of US District Courts

Contact Information

Edward J. Rayner
Partner
Katten Muchin Rosenman LLP
575 Madison Avenue
New York, NY 10022
(212) 940-8515
Ed.rayner@kattenlaw.com

Craig A. Bitman
Partner
Morgan Lewis & Bockius LLP
101 Park Avenue
New York, NY 10178
Phone (212) 309-7190
cbitman@morganlewis.com

Gerald T. Lins
General Counsel
ING Investment Management
230 Park Avenue
New York, NY 10169
Gerald.Lins@inginvestment.com