Proskauer

Investment Advisers to ERISA Plans and Plan Asset Funds Will Be Subject to New Disclosure Obligations Effective July 1, 2012

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The U.S. Department of Labor's ("DOL") final regulations (the "Final Regulations") under Section 408(b)(2) of ERISA (the "necessary services exemption") will go into effect on July 1, 2012 (the text of the Final Regulations may be accessed here). Under the Final Regulations, investment advisers to ERISA-covered pension plans and private investment funds deemed to hold the "plan assets" of ERISA-covered pension plans must disclose certain information regarding the services they provide and the compensation they receive to such ERISA plans. A private investment fund generally will be deemed to hold plan assets under ERISA if (i) "benefit plan investors" (e.g., employee benefit plans and other retirement accounts subject to ERISA or Section 4975 of the Internal Revenue Code) hold 25% or more of the value of any class of equity interest in the fund (generally excluding for these purposes commitments held by the fund's sponsor and investment adviser and their affiliates), and (ii) the fund does not qualify for the venture capital operating company (VCOC) exception or any other available exception under the ERISA plan assets regulation.

Investment advisers to ERISA-covered pension plans (either directly or as investors in funds deemed to hold plan assets) rely on the necessary services exemption under ERISA to provide investment related services to ERISA-covered pension plans for compensation without engaging in a "prohibited transaction" under ERISA and the Internal Revenue Code. Failure to comply with the Final Regulations could lead to a non-exempt prohibited transaction, the penalties for which can include the imposition of excise taxes and a refund of compensation.

Following is a brief summary of the material provisions of the Final Regulations that apply to investment advisers to funds deemed to hold plan assets. For a more detailed summary of the Final Regulations and the key changes from the interim final regulations, please see our earlier client alert.

Final Regulations Apply to "Covered Service Providers" to "Covered Plans"

The Final Regulations generally define "covered plans" as ERISA-covered pension plans, both defined contribution and defined benefit plans. Covered plans do not include individual retirement accounts (IRAs), governmental pension plans or any other plans or accounts that are exempt from coverage under ERISA.

The Final Regulations define "covered service providers" generally as any service provider that enters into a contract or arrangement with a covered plan and reasonably expects to receive $1,000 or more in "compensation" (direct or indirect) in connection with certain services provided to that covered plan. Such services include the following (among others): (i) services provided as an ERISA fiduciary, either directly to a covered plan or to an investment fund deemed to be holding plan assets, and (ii) services provided directly to a covered plan by a registered investment adviser. The Final Regulations define the term "compensation" to include anything of monetary value, including money, gifts, awards and trips (but does not include non-monetary compensation valued at $250 or less, in the aggregate, during the term of the contract or arrangement). Accordingly, investment advisers typically will qualify as covered service providers whenever they or an affiliate charge or receive account, incentive or management fees or carried interest for providing investment management services either directly to an ERISA–covered pension plan or to an investment fund that is deemed to hold plan assets.

Required Disclosures

The Final Regulations require investment advisers that are covered service providers to make the requisite disclosures to "responsible plan fiduciaries," which are the fiduciaries with authority to cause their covered plan investors to enter into, extend or renew an investment advisory contract (including a fund's limited partnership agreement). Required disclosures include, among other items:

- a description of the services to be provided;
- a description of the direct and indirect compensation to be received and the manner in which it will be received; and
- a statement as to whether the covered service provider reasonably expects to provide services as an ERISA fiduciary or a registered investment adviser.

In addition to the general disclosures described above, an adviser to a private investment fund deemed to hold plan assets must disclose the following investment-related information:

- the fund's annual operating expenses (e.g., expense ratio) if the fund's return is not fixedand any ongoing expenses in addition to annual operating expenses (such as wrap fees, mortality and expense fees); and
- any compensation that will be charged directly against the investment (such as account fees, commissions, sales loads and other sales charges, redemption fees, surrender charges and exchange fees) and that is not included in the fund's annual operating expenses.

Covered service providers also must update previously disclosed information (other than certain investment related information, such as the annual operating and ongoing expenses with respect to plan asset funds described directly above) as soon as practicable, but not later than 60 days from the date on which the covered service provider learns of the change. If such disclosure is precluded due to extraordinary circumstances beyond an investment adviser's control, then disclosure must be made as soon as practicable. Changes to the above-referenced investment-related information must only be disclosed at least annually.

Lastly, covered service providers are also required to furnish, upon the written request of a covered plan, any other information relating to the compensation it received that is required for the covered plan to comply with the reporting and disclosure requirements of ERISA (e.g., Form 5500 reporting).

Disclosure Timing

The Final Regulations require that the disclosures be made reasonably in advance of the date that the investment advisory contract or limited partnership agreement is entered into, extended or renewed. With respect to investment contracts and limited partnership agreements already in existence, such disclosures must be made no later than the July 1, 2012 effective date of the Final Regulations. Many investment advisers to ERISA-covered pension plans and private investment funds will have already received requests from their ERISA investors to provide this disclosure.

In addition, there are special disclosure timing rules in certain situations, including when non-plan asset funds become plan asset funds. When a covered plan invests in a fund that is not deemed to hold plan assets at the time of its investment, but later *is* deemed to hold plan assets, then the required disclosures must be made as soon as practicable thereafter, but not later than 30 days from the date that the covered service provider knows that its fund is deemed to hold plan assets.

Disclosure Format

The Final Regulations do not require the disclosures to be made in any particular manner or format. However, the DOL did include a "sample guide" as an appendix to the Final Regulations, which the DOL encourages, but does not require, covered service providers to use (the sample guide may be accessed here by scrolling to the bottom of the Final Regulations).

Certain information required by the Final Regulations already may be included in materials typically provided to prospective investors (such as a private placement memorandum) or within the contract or arrangement itself (such as the investment advisory contract or a fund's limited partnership agreement) or within periodic financial reports provided to clients. However, covered service providers should not simply assume that the required disclosures have already been provided.

Response for Advisers that are not Covered Service Providers

Investment advisers to private investment funds that are not deemed to hold plan assets are not required to provide disclosures under the Final Regulations (unless and until such funds ever become plan asset funds or the investment adviser or the fund has agreed to provide this information, for example, through a side letter provision). Nonetheless, ERISA-covered pension plans investing in non-plan asset funds may request the adviser to provide disclosure anyway, for example, as part of a mass request sent to all of the plan's service providers. In such a case, the adviser should consider communicating directly with the investor regarding such information request.

Concluding Summary

Effective as of July 1, 2012, investment advisers that are covered service providers under the Final Regulations because they provide investment management services to covered plans (either by providing such services directly to an ERISA-covered pension plan or to a fund that is deemed to hold plan assets) will be required to disclose to such covered plans information regarding the services they provide and the compensation they receive. Many ERISA-covered plans have already distributed requests to their investment advisers and other service providers for these disclosures (but note, these disclosures are required even if not requested).

Failure to provide the required disclosures in a timely manner could result in significant penalties assessed against both the adviser and the affected plans, so compliance with the Final Regulations is essential from both the perspective of the ERISA-covered plan and the investment adviser. In addition, if the requisite disclosures are not provided, the covered plan may, in certain cases, be required to notify the DOL of the failure and to terminate the contract or arrangement with the covered service provider.

The above discussion is a summary only of certain material aspects of the Final Regulations that are most likely to apply to investment advisers to private investment funds in which ERISA-covered plans invest. The Final Regulations mandate additional disclosures to which other service providers to ERISA-covered plans may be subject. If you have any questions regarding the Final Regulations or this client alert, please feel free to contact any of the Proskauer attorneys listed in this alert.

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