

## New ERISA Plan-Asset Rule For Investment Funds

Pension legislation that cleared Congress earlier today and is expected to be signed into law makes an important change in the ERISA compliance rules for investment funds.

Under the rules in effect prior to the Pension Protection Act of 2006, investment by an ERISA plan in an investment partnership or other fund meant that the fund - unless it qualified as a "venture capital operating company" or fell within one of several other narrowly drawn exceptions - had to comply with ERISA's fiduciary-duty, prohibited transaction and certain other rules unless "benefit plan investors" owned less than 25% of each class of equity interests in the fund (disregarding interests owned by managers, advisors and affiliates). Importantly, the definition of "benefit plan investor" included not only plans subject to ERISA but also foreign plans, plans maintained by state or local governments, and church plans. This inclusive definition meant that an investment fund with significant participation by non-U.S., governmental or church plans might find itself subject to ERISA even though investment by actual ERISA plans was very modest.

Under the Act, the only investors that qualify as "benefit plan investors" and therefore count toward the 25% test are (i) plans actually subject to ERISA, (ii) plans subject to the Internal Revenue Code's prohibited transaction rules (e.g., IRAs), and (iii) entities whose underlying assets include "plan assets" by reason of a plan's investment in that entity. Although the legislative drafting is not clear, a separate change appears to be designed to provide that investment by an entity described in (iii) will count as a "benefit plan investor" investment only in part, based on the proportion of "benefit plan investor" investment to total investments in that entity. (For example, if an entity with two equal 50% investors - one ERISA plan and one non-plan investor - were to invest \$1 million in another fund, only \$500,000 of the \$1 million would count in applying the 25% test to the investee fund.)

The changes to the 25% test made by the Act apply "to transactions occurring after the date of the enactment of this Act" - *i.e.*, after the date the President signs the legislation into law. It is not yet clear how this effective-date provision will be applied in the case of existing funds. In any case, the change in the 25% test will have an immediate impact on how funds with limited ERISA-plan participation determine whether and to what extent they have "plan assets" and thus must comply with ERISA's often burdensome and restrictive rules.

The Act contains a number of other changes of importance to particular investment funds and investment managers. We expect to provide additional summary information in the near future.

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