Memorandum to Our Clients and Friends

Re: New ERISA Section 408(b)(2) Regulation **February 22, 2012**

A new Department of Labor ("DOL") regulation (the "Regulation") will take effect on July 1, 2012 that will require investment managers ("Managers") of "plan assets" subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") to make specific disclosures in connection with the fees they receive for their investment management services. This alert addresses how the Regulation will affect: (i) Managers of private investment funds that are subject to Title I of ERISA because participation by "benefit plan investors" in one or more of their funds is "significant" (such funds herein referred to as "Plan Asset Funds") and (ii) Managers of separate accounts created on behalf of a plan subject to Title I of ERISA (such accounts herein referred to as "Plan Asset Accounts" and together with Plan Asset Funds, "Plan Asset Vehicles"). Unlike the Schedule C disclosure rules, the Regulation does **not** require Managers of non-plan asset funds (e.g., funds below the 25% threshold) to provide their ERISA investors with any additional disclosures. Therefore, if you are not managing any ERISA plan assets, the new Regulation does not require any additional action on your part.

Background:

The payment of unreasonable fees by a Plan Asset Vehicle to its Manager is a prohibited transaction under Section 406(a)(1)(C) and (D) of ERISA.[1] In most cases, the Manager and the investing plans rely on Section 408(b)(2) to exempt the payment of reasonable fees from the prohibitions of Section 406 and the excise taxes imposed by Section 4975 of the Code. The DOL had previously offered little in the way of guidance for determining what was reasonable, other than to prohibit unreasonable or punitive termination provisions. The new Regulations require that in order to be reasonable, Managers must disclose all direct and indirect compensation they will receive in providing investment management services to a plan prior to the plan's investing in a Plan Asset Fund or establishing a Plan Asset Account.

The New Regulation:

The Regulation provides that no contract or arrangement between a "covered plan" and a "covered service provider" will be reasonable within the meaning of Section 408(b)(2) unless certain disclosures are made by the covered service provider to the covered plan.

Covered Plans and Covered Service Providers:

- A "covered plan" is any "employee pension benefit plan" or "pension plan" sponsored by a U.S. employer.
    - It does not include:

[1] All references herein to "Sections" are references to Sections of ERISA, unless otherwise indicated.

  - Simplified employee pensions (SEPs)
  - Simple retirement accounts
  - Individual retirement accounts or individual retirement annuities
  - 403(b) plans
  - Governmental, foreign or non-electing Church plans

- The term "covered service providers" includes service providers that reasonably expect $1000 or more in compensation and provide services (i) directly as an ERISA fiduciary to a Plan Asset Account or (ii) indirectly as an ERISA fiduciary to a Plan Asset Vehicle in which a covered plan has a direct equity investment. The Regulation excludes a Plan Asset Vehicle's non-fiduciary service providers from this definition, relieving service providers such as administrators, prime brokers and accountants from a reporting obligation with respect to services they provide to a Plan Asset Vehicle.
  - Managers of private investment funds that have significant participation (over 25% by class) by "benefit plan investors" but do not accept any investments by ERISA plans (i.e., IRA-only funds) are not subject to the disclosure mandated by the Regulations.
  - In the case of an ERISA fund of funds, the underlying portfolio funds that are Plan Asset Funds are not required to provide disclosures to ERISA fund of funds investors, and ERISA funds of funds do not have to disclose the indirect compensation paid by their portfolio funds to their Managers, even if those portfolio funds are Plan Asset Funds.

Disclosure Requirements:

The following disclosures must be made, in writing, "reasonably in advance" of the decision to invest in a Plan Asset Vehicle. There is no specific format required for the disclosure, although the DOL has provided a suggested model guide to direct "responsible plan fiduciaries"[2] to the documents where the required disclosures can be found. Attached as Appendix A to this memorandum is a Disclosure Guide based on the DOL model that Managers may find useful in reviewing the existing fee disclosures for their Plan Asset Vehicles. The final section of this Alert ("Action Steps") provides our recommendations to comply with the new Regulations.

Status: The Manager (and/or its affiliates[3], if applicable) must make a statement indicating that it will (or reasonably expects to) provide services to the Plan Asset Vehicle as an ERISA fiduciary.

Services Provided: The Manager must provide a description of the services that it will provide to the Plan Asset Vehicle. The DOL indicated that the level of detail required of this disclosure will

[2] The "responsible plan fiduciary" is the fiduciary with the authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement in question.

[3] An "affiliate" for the purpose of the Regulation is a person or entity that controls, is controlled by, or is under common control with, the Manager, or is an officer, director, or employee of, or partner in, such person or entity.

"vary depending on the needs of the responsible plan fiduciary." Thus, it is ultimately up to the responsible plan fiduciary to decide if the information it receives is sufficient for the purposes of the Regulation.

Compensation: The Manager must provide a description of all compensation – direct or indirect – that it receives. The definition of "compensation" includes anything of monetary value, including management fees, incentive allocations, soft dollars, redemption fees, gifts, awards and trips, but does not include non-monetary compensation valued at $250 or less, in the aggregate, expected to be received during the term of the contract or arrangement. The amount of the compensation can be expressed as a fixed amount, as a formula, as a percentage of the investing plan's assets or, if it cannot be reasonably described in such terms, then by any reasonable method. The is no requirement to disclose the actual dollar amounts of any compensation.

Direct compensation (fees paid by a plan or plan sponsor) disclosure will only be applicable to the Manager of a Plan Asset Account, and will typically be described in the investment management agreement with the plan.

Indirect compensation (fees paid by third parties or by a reduction to a plan's investment) disclosure applies to Managers of all Plan Asset Vehicles. With respect to the Manager of a Plan Asset Fund, the Manager typically receives only indirect compensation from the fund's plan investors in the form of fees that are charged against the investing plan's interest. A Manager's Plan Asset Funds and Plan Asset Accounts may also receive indirect compensation in the form of soft dollars, redemption fees, or gifts and entertainment received from service providers to the Plan Asset Vehicle.

Indirect compensation disclosures must include identification of: the services provided, the payor of the compensation and a description of the arrangement between the payor and the Manager under which the indirect compensation is payable. For indirect management and incentive fees, the payor of the indirect compensation is generally the Plan Asset Fund, but in a "master-feeder" structure with a Plan Asset "feeder fund" it would also include payments made at the master fund level to the Manager or its affiliates, regardless of the plan asset status of the master fund. With respect to soft dollars, redemption fees, gifts and other similar compensation, the Manager will need to identify each service provider from whom it reasonably expects to receive such compensation.

The Manager must also disclose any compensation paid among the Manager and its affiliates and subcontractors[4] in connection with services performed for the Plan Asset Vehicle if

[4] A "subcontractor" for the purpose of this memorandum is any person or entity (or affiliate of such person or entity) that is not an affiliate of the Manager and that, pursuant to a contract or arrangement with the Manager or its affiliate, reasonably expects to receive at least $1000 in compensation for performing one or more services as a fiduciary to Plan Asset Vehicle. Because service providers to a Plan Asset Vehicle perform such services pursuant to a contract with the vehicle rather than with the covered plan, most Plan Asset Vehicle service providers should not be considered subcontractors.

the compensation is set on a transaction basis, such as placement agent fees, finder's fees or other commissions ("Transaction Based Fees"). The Manager must identify the services to be provided, the amount of the compensation, the identity of the payors and recipients, and their status as affiliates or subcontractors. Even if this compensation is already disclosed as direct compensation (and thus eligible to be aggregated with other direct compensation), the Regulation requires the additional information.

Miscellaneous: The disclosure must include any termination payments **payable to the Manager**, its affiliates or subcontractors, and in the case of a Manager of a Plan Asset Fund, the following information:

- A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer or withdrawal from the Plan Asset Fund – e.g., finders fees, redemption fees, surrender charges and exchange fees.
- A description of the Plan Asset Fund's annual operating expenses. The Regulation provides the expense ratio of a fund as a specific example.
- A description of any ongoing expenses in addition to annual operating expenses.

Timing of Disclosure: The Manager must make the initial disclosure to a plan investor "reasonably in advance" of the date the investment is made. In the case of a fund that is not a Plan Asset Fund at the time a plan invests but subsequently becomes a Plan Asset Fund, the required disclosure must be made to plan investors as soon as practicable but not later than 30 days from the date the Manager knows that the fund is a Plan Asset Fund. Any changes in the information required to be disclosed must be disclosed to plan investors not later than 60 days from the date the Manager is informed of such change, unless precluded by extraordinary circumstances, in which case the disclosure must be made as soon as practicable.

The Regulation also provides that, upon the written request of a plan fiduciary or administrator, a Manager of a Plan Asset Vehicle must furnish "any other information relating to the compensation received in connection with the Plan Asset Vehicle that is required for the plan investor to comply with the reporting requirements of any part of Title I of ERISA and the regulations, forms and schedules thereunder" for example, the Form 5500. This request must be honored reasonably in advance of the date the requesting plan states that it must comply with the applicable reporting or disclosure requirement, unless precluded by extraordinary circumstances, in which case the disclosure must be made as soon as practicable.

Disclosure Errors: Errors or omissions in the required disclosure do not preclude reliance on the exemption provided the Manager acted in good faith and with reasonable diligence with respect to the error or omission and discloses the error to its plan investors as soon as practicable but not later than 30 days from the date the Manager knows of the error or omission.

Compliance Failures: If a Manager fails to provide the required disclosures to a plan investor within 90 days of a written request for such disclosure, the plan investor can avail itself of a class exemption granted in the Regulation (and obtain relief for itself from its obligation to make the plan whole for any losses) by providing notice to the Department of Labor of the Manager's non-compliance. The Manager will still be liable for any excise taxes associated with the prohibited transaction.

Action Steps:

Many of disclosures required by Regulation typically are made by Managers (i) in a fund's offering materials or in the investment management agreement between the Manager and the plan, (ii) in periodic reports to investors and/or (iii) in the Manager's Form ADV. We suggest that Managers begin by reviewing their existing documents to confirm which of the required disclosures have, in fact, been made. To assist you in this, we have attached, as Appendix A, a Guide to 408(b)(2) Fee Disclosures based on a model suggested by the DOL (the "Disclosure Guide"). Once you have completed your review, the second step would be to update existing documentation and/or disclosures to comply with the Regulation. Finally, we recommend that before July 1, 2012, you provide the completed Disclosure Guide and any supplemental disclosures to the ERISA plan investors in your Plan Asset Vehicles to assist them in meeting their obligations under the Regulation.

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If you have any questions regarding this memorandum, please contact S. John Ryan at (212) 574-1679, Michael O'Brien at (212) 574-1505, Irina Kerzhner at (212) 574-1257 or Frank Mitchell at (212) 574-1368.

Appendix A - Guide to 408(b)(2) Fee Disclosures

ABC Investment Manager (ABC)

Guide to Services and Compensation

Prepared for the XYZ Fund

The following is a guide to important information that you should consider in connection with the services to be provided by ABC to the XYZ Fund.

Should you have any questions concerning this guide or the information provided to you concerning our services or compensation please do not hesitate to contact [NAME] at [CONTACT INFO].

Required Information	Location(s)
Description of the services that ABC will provide to the Fund.	Private Offering Memoranda page [ ]
A statement that the services will provided as an ERISA Fiduciary.	Private Offering Memoranda page [ ]
Management fee ABC will receive from the Fund.	Private Offering Memoranda page [ ]
Incentive allocations ABC will receive from the Fund.	Private Offering Memoranda page [ ]
Compensation that will be paid among ABC and related parties.	Private Offering Memoranda page [ ]
Compensation ABC will receive if redeeming from the fund within the lock-up period.	Private Offering Memoranda page [ ]
Total annual operating expenses.	Private Offering Memoranda page [ ] Annual Financial Statement prepared by [Auditor] [Estimate if a new fund]
Soft dollars.	Private Offering Memoranda page [ ] Form ADV page [ ] Annual Schedule C Letter List of executing brokers: [BROKERS]
Gifts and entertainment.	Private Offering Memoranda page [ ] Form ADV page [ ] Annual Schedule C letter Gift and Entertainment Policy