U.S. legislative change should bring further assets into Ireland

AARON OVERY reviews a U.S. legislative change and a regulatory opinion important to European domiciled funds with ambitions to target investment from U.S. ERISA plan investors. This development should enable greater use of the CCF and bring further assets to Ireland to be managed, both by multinationals and investment managers.

Aaron Overy

The 'holy grail' for the chief investment officer of a large multinational corporation with pension plans spread across the world is a single investment offering for global plans. This cross-border pooling structure offers tremendous governance and scale benefits for the home office and efficiencies and diversification opportunities for pension plans.

> **'This cross-border pooling structure offers tremendous governance and scale benefits for the home office and efficiencies and diversification opportunities for pension plans.'**

Ireland's contribution, the common contractual fund ('CCF') was created in 2003 and originally designed as a UCITS structure, but was subsequently amended to provide for the establishment of a non UCITS CCF. The inherent flexibility therein making it more attractive to a wider range of country pension plans. That attractiveness was muted however for U.S. investors as they waited for clarifications from the U.S. Department of Labor, the pension regulator in the United States, around the U.S. Employee Retirement Income Security Act (ERISA) and how U.S. plans could participate in pooled funds.

How do the ERISA rules apply to my fund?

The laws governing U.S. pension plans and the funds in which these plans invest are complex. Investment firms considering distributing funds to these plans must have a clear understanding of the ERISA implications.

If 25 per cent or more of the interests of the fund you distribute are owned by benefit plan investors your fund will

PENSIONS

likely be deemed to hold ERISA plan assets. As such any person with discretionary authority or control over these assets will be subject to the fiduciary rules under ERISA, which include the duty to act prudently and to diversify investments.

> **'Rather than pool solely the assets of DB plans, the IORP allows pooling of contributions and liabilities (subject to some conditions), allowing a Multinational to provide a single point of pension excellence for their employees from across Europe and beyond.'**

In addition, the fund will be subject to prohibited transaction rules under ERISA and the Internal Revenue Code. The general types of transactions addressed by these rules are those which represent a conflict of interest or self-dealing on the part of fiduciaries for benefit plans. There are statutory exceptions to these prohibited transactions as well as class and private exemptions that are issued from time to time by the U.S. Department of Labor. While this article does not go into the details of the prohibited transaction rules please note that these rules can be extremely difficult to comply with, potentially requiring up-front assistance from legal counsel and ongoing monitoring for every transaction with outside parties.

Another ERISA requirement, the indicia of ownership rule, ensures that the U.S. district courts have jurisdiction over ERISA plan assets, in the case of a dispute. Given the complexity involved, it is important for investment firms to receive advice from an ERISA attorney regarding when and how ERISA rules will apply to their funds before distributing to ERISA plans.

> **'The tax transparency of the CCF is essential to maintain tax neutrality for participants.'**

The Pension Protection Act and the plan asset rules

Under the plan asset rules of ERISA, when 25 per cent of the interests in a fund are owned by benefit plan investors, the fund is considered to be managing ERISA plan assets. The 25 per cent threshold is considered to represent substantial participation by benefit plan investors. Prior to the Pension Protection Act (PPA), benefit plan investors included all benefit plans regardless of whether the plan was subject to ERISA. The definition included traditional U.S. pension and welfare benefit plans, foreign employee benefit plans, U.S. state and local government plans and certain church plans. In August of 2006 the PPA narrowed the definition of benefit plan investors to certain U.S. plans including ERISA plans, IRAs, Keoghs, and §403(b) plans. Also, in master feeder funds a portion of the assets from the feeder fund are included for the purposes of calculating the 25 per cent threshold for the master, if the feeder itself is considered to be managing plan assets.

A simple example should help clarify the impact this change may have on your fund. Assume your fund consists of the investor types listed in the table below. The final two columns in Table 1 provide a comparison of the calculation of the ERISA plan asset 25 per cent threshold before and after the PPA went into effect. Under the old rules a fund may have been hesitant to accept the U.S. ERISA plan's investment of $100 million due to concerns that the fund would be

Table 1: *Fund Investors*	*Assets ($ millions)*	*% of total Fund*	*Pre-PPA Benefit Plan Investors*	*Post-PPA Benefit Plan Investors*
Foreign Benefit Plans	150	15	✔	
U.S. State & Local Gov Plans	150	15	✔	
U.S. ERISA Plan	100	10	✔	✔
Foundations	600	60		
TOTAL	**1,000**	**100**		
ERISA Plan Assets (as a percentage of the total fund)			40%	10%

deemed to hold ERISA plan assets and be subject to the ERISA rules mentioned earlier. The new definition for benefit plan investors under the PPA is helpful. Now the same fund could accept the ERISA plan investment without exceeding the ERISA plan asset threshold of 25 per cent and thus not be subject to the ERISA rules.

There is an important distinction for multinationals interested in launching their own funds, where all investors are affiliated. In these cases, the funds assets are likely to be considered ERISA plan assets at any level of ERISA plan investment greater than nil.

> **'There is an important distinction for multinationals interested in launching their own funds, where all investors are affiliated. In these cases, the fund assets are likely to be considered ERISA plan assets at an level of ERISA plan investment greater than nil'.**

The U.S. Department of Labor Advisory Opinion regarding the indicia of ownership rules for pooled funds

A recent Advisory Opinion issued by the U.S. Department of Labor clarified the indicia of ownership rules applicable to European funds deemed to hold ERISA plan assets. On 8th April 2008, the Department of Labor issued an advisory opinion to Northern Trust. The Department of Labor clarified that the use of offshore vehicles to invest the assets of ERISA plans does not violate the ERISA indicia of ownership requirements relating to the holding of currencies or securities offshore if the assets are administered in the manner described in Northern Trust's request.

The request to the Department of Labor included an explanation of how assets are maintained in Northern Trust's global custody network for certain cross-border pooling clients. The Northern Trust Company or a branch of this U.S. bank will be the local or global custodian for the relevant plan assets. This is an important element in the pooling solution for satisfying the ERISA indicia of ownership rules.

These two developments provide clarity for European investment firms seeking ERISA plan investments and progress the cross-border pooling objectives of multi-national organizations.

The clarification of the above should enable greater use of the CCF and bring further assets to Ireland to be managed, both by multinationals and investment managers.

Pan European pension plans

In addition to asset pooling, multinationals are asking the concomitant question about the use of a cross border IORP (Institution for Occupational Retirement Provision) structure.

Rather than pool solely the assets of DB plans, the IORP allows pooling of contributions and liabilities (subject to some conditions), allowing a multinational to provide a single point of pension excellence for their employees from across Europe and beyond.

Domiciliary competition between Ireland (where the IORP is a Master Trust), Belgium (OFP), Luxembourg (ASSEP) and the Netherlands (API/PPI) brings the usual acronym soup and claims of outstanding success. What can be said is that beneath the verbiage there are baby steps being taken to establish, in the first instance, IORPs for defined contribution plans. Typically for internationally mobile employees (IMEs) and new DC plans. Their greenfield nature is perfect for utilising a pan European pension.

> **'In addition to asset pooling, multinationals are asking the concomitant question about the use of a cross border IORP (Institution for Occupational Retirement Provision) structure.'**

Multinationals pension arrangements are going to be wide and varied. The use of an Irish Master Trust IORP (with DB and/or DC sections) investing via a CCF will sit alongside direct investment in that CCF by plans which do not want to use the IORP to pool assets and processes (ie perhaps U.S. DB Plans). These kinds of structures bring scale and an institutionalisation of investment approach to all members. The tax-transparency of the CCF is essential to maintain tax neutrality for participants.

Aaron Overy is vice president, business development for pooling at Northern Trust.

FINANCE*jobs.ie*

Ireland's financial jobs market

Log on at ***www.financejobs.ie***