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U.S. ERISA VCOC Exemption and REOC Exemption

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VCOC Exemption and REOC Exemption

- VCOC is a “venture capital operating company.”
- REOC is a “real estate operating company.”
- A VCOC and a REOC are not considered to hold plan assets.[1]

[1] See U.S. ERISA Significant Participation Rules for a list of holdings that do not constitute plan assets.

VCOC Exemption and REOC Exemption

- The term “operating company” includes both a VCOC and a REOC.
- An operating company is an entity that is primarily engaged, either directly or through a majority-owned subsidiary, in the production or sale of a product or service other than the production of capital.
- Where the entity relies on either the VCOC or the REOC exception to the Plan Assets Regulation, the Benefit Plan Investor should require the entity to use its “best efforts” to qualify as a VCOC or REOC.

VCOC Exemption and REOC Exemption

- An entity is a VCOC for the period beginning on its "initial valuation date" and ending on the last day of its first "annual valuation period" (if the entity was not a VCOC immediately before the determination) or for the 12-month period following the expiration of an "annual valuation period" (if the entity was a VCOC immediately before the determination) if:
  - It has at least 50% of its assets (valued at cost) invested in operating companies (other than a VCOC) which provide it with "management rights" in those companies ("50% requirement"); and[1]
  - The VCOC exercises the management rights during each 12-month period with respect to at least one operating company.
- This definition prevents a VCOC from operating as a "fund of funds" and investing in other VCOCs.[2]
- However, a VCOC can invest in a REOC because a REOC is considered an operating company.

[1] "Derivative investments" (not discussed in these slides) will also satisfy the 50% requirement.

[2] See fund of funds example in Significant Participation Rules, Example 3, Slide 5.

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VCOC Exemption and REOC Exemption

- A VCOC may continue to qualify as a REOC during its "distribution period" even if it does not meet the 50% requirement and facts to exercise its management rights.

- Valuation Date

  – An "initial valuation date" is the first date on which an entity makes an investment that is not a short-term investment of funds pending long-term commitment.

  – An entity must qualify as a VCOC on its initial valuation date or it can never qualify as a VCOC. This means that the 50% requirement must be satisfied on the initial valuation date.

  – An "annual valuation period" is an annually recurring period of not more than 90 days that begins no later than the anniversary of an entity's initial valuation date. An annual valuation period, once established, may not be changed except for good cause.

  – The 50% requirement must be satisfied on at least one day during each annual valuation period.

VCOC Exemption and REOC Exemption

“Management rights’” means contractual rights directly between the investor and an operating company to substantially participate in, or substantially influence the conduct of, the management of the operating company. This is a facts and circumstances analysis.

- Examples of Management Rights
  - The right to appoint a director to an operating company board.
  - The right to examine books and records of the operating company and the right to consult or advise management.
  - Covenants granting greater rights than are typically found in covenants in debt instruments.

VCOC Exemption and REOC Exemption

- An entity is a REOC for the period beginning on its "initial valuation date" and ending on the last day of its first "annual valuation period" " (if the entity was not a REOC immediately before the determination) or for the 12-month period following the expiration of an annual valuation period (if the entity was a REOC immediately before the determination) if:
  - It has at least 50% of its assets (valued at cost) invested in real estate which is managed or developed and with respect to which such company has the right to substantially participate directly in the management or development activities; and
  - The REOC is engaged in such management or development activities during each 12-month period.

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VCOC Exemption and REOC Exemption

- The REOC rules generally operate in the same manner as the VCOC rules. However, it appears that a REOC must engage in real estate management or development activities with respect to all of its qualifying investments, as opposed to just one portfolio company as in the case of the VCOC.