LOWENSTEIN SANDLER PC CLIENT ALERT

INVESTMENT MANAGEMENT

COMPLIANCE ISSUES

January 2008

As 2008 begins, it is an appropriate time to remind you of issues about which you should be aware to assure your fund's compliance with applicable law, regulation and best practices. Please contact a member of the Lowenstein Sandler Investment Management Group if you have any questions regarding the information discussed below or if you would like further guidance.

Deferred Compensation Plans Compliance Date Extended

The Treasury Department and the IRS have recently granted an extension of the deadline for nonqualified deferred compensation arrangements to be amended in order to conform to the requirements of Section 409A of the Internal Revenue Code ("Section 409A"). Section 409A establishes certain requirements affecting virtually all nonqualified deferred compensation arrangements. Failure to comply with such requirements would force plan participants to include amounts deferred under the arrangement in income and to pay significant penalty taxes. Under the extension granted by the IRS, fund managers now have until December 31, 2008 to amend their deferred compensation arrangements to comply with Section 409A. In the interim, nonqualified deferred compensation arrangements must be administered in conformity with the requirements of Section 409A and IRS guidance.

Under special IRS transition rules, fund managers will have an opportunity in 2008 to change their deferral payment terms without violating Section 409A. The transition rule will allow a fund manager to change the time of payment of any deferrals that are not payable in 2008 (but deferrals due to be paid in 2008 cannot be deferred and amounts due to be paid after 2008 cannot be accelerated into 2008).

On April 10, 2007, the IRS issued its final regulations concerning Section 409A. These regulations touch upon the following areas that may be of interest:

Initial Deferral Elections. Generally, deferral elections must be made prior to the taxable year in which compensation is earned. However, for newly eligible participants, the initial deferral election may be made within thirty (30) days of eligibility, so long as the amount deferred is earned after such election.

Side Pockets. When investors have no interest in a fund other than in side pockets (i.e., certain investments not yet redeemable due to illiquidity), management fees are often paid only upon the disposition of the investment. This structure could trigger an inadvertent violation of Section 409A, as the fees could be deemed "deferred." Please contact us if you think that this provision may affect you.

Redeferrals. Redeferrals of fees may be made in compliance with Section 409A so long as (i) the redeferral election is made at least one (1) year before the first scheduled payment date in the original deferral election, (ii) the redeferral election does not take effect until at least one (1) year after such redeferral election is made, and (iii) the revised payment date is five (5) years or more from the date the original payment would have been made. As noted above, limited relief from this restriction applies during 2008.

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Offshore Funding Vehicles. Section 409A also prohibits deferred compensation from being secured through offshore funding vehicles such as offshore trusts. Further guidance on this restriction is expected to be provided by the IRS.

In addition, pending legislation in Congress, if enacted, would significantly limit deferral opportunities for fund managers. Also, at least one Democratic party presidential candidate has voiced a desire to eliminate the wage cap on FICA taxes, which would have an enormous effect on deferred compensation, and many Democratic party candidates have indicated that they would approve higher income tax rates. These factors should also be considered in planning for existing and future deferrals.

If you currently defer fees or are contemplating such deferral, please contact us to discuss these issues. Please also contact us to discuss planning opportunities with respect to the special 2008 transition rule described above.

Private Investment Funds

Compliance Policies. As we have noted in prior Investment Management Alerts, the line between registered investment advisers and unregistered advisers has continued to blur, and more and more unregistered managers are adopting best practices and improving their existing compliance policies. Whether or not your firm will be required to register as an investment adviser, you should review your compliance policies periodically to verify that they are adequate and that your firm is adhering to them.

New Issues Certifications. If you purchase "new issues" (defined by NASD Rule 2790 as adopted by FINRA* to mean equity securities issued in an initial public offering) your broker (or, if you are a fund of funds that invests in funds that invest in new issues, the underlying funds) will require that you certify each year as to whether the fund is a "restricted person" within the meaning of the rule. To do so, you must recertify the status of investors in your fund as restricted persons or unrestricted persons. Please contact us if you require documentation to obtain such recertifications from your investors.

Updating Offering Documents. Offering documents should be reviewed from time to time to verify that they contain a current, complete and accurate description of your fund's strategy, management, soft dollar and brokerage practices; that they comply with current law and regulation; and that they reflect current disclosure trends. We would be happy to assist you in reviewing and, if necessary, updating your offering documents to reflect changes in law, regulation and disclosure practices.

Blue Sky and Local Securities Matters. You should continue to inform us of all offers or sales of fund interests. Offers to U.S. persons may trigger filing obligations in a given offeree's state of residence. Offers to foreign persons may require filings in the country of a given offeree's residence.

Privacy Notices. Investment advisers and investment funds must have privacy policies in place. In addition to being distributed at the time of subscription, privacy policies must be distributed at least once per year and more often if there are any changes to the policy. We believe that the best time for the annual distribution of the policy is with your annual financial statements and/or tax reports.

Beneficial Ownership Reporting Requirements. If your fund (including, for this purpose, affiliated investment funds) acquires more than five percent (5%) of a class of equity securities of an issuer registered under the Securities Exchange Act of 1934, as amended (the "1934 Act") (i.e., most publicly-traded companies), you must monitor and comply with the reporting requirements of the Williams Act by filing a Schedule 13D or a Schedule 13G. A Schedule 13D must be amended upon any material change in the facts contained therein, including the acquisition or disposition of securities in an amount equal to one percent (1%) or more of the class being reported. If, on the other hand, you have filed a short-form Schedule 13G, and the information reflected in the schedule is different at December 31 than that previously reported, you are required to amend the schedule by February 14 of the following year. In addition, if the fund (again, including affiliated funds) acquires a greater than ten percent (10%) interest in such a company, there is an obligation

* **The Financial Industry Regulatory Authority ("FINRA").** In July, 2007, the NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange were consolidated into FINRA, which is currently the largest nongovernmental entity regulating securities firms in the United States. The FINRA rule book currently consists of both NASD Rules and certain NYSE Rules.

to file reports of beneficial ownership on Forms 3, 4 and 5, as well as corresponding potential liability for short-swing profits under Section 16 of the 1934 Act. Furthermore, quarterly reports of equity holdings by institutional investment managers are required on Form 13F where certain equity assets under management total One Hundred Million Dollars ($100,000,000) or more. If the fund (together with all affiliated investment funds) reaches this threshold, please let us know, and we will provide information regarding how and when to file Form 13F.

Registered Commodity Pool Operators. If your fund is a commodity pool, you must prepare an annual report for each pool in accordance with the rules of the Commodity Futures Trading Commission ("CFTC") and file such report with the CFTC and the National Futures Association. In addition, unless your fund qualifies for an exception, you must update your disclosure documents periodically, as you may not use any document dated more than nine (9) months prior to the date of its intended use. Furthermore, documents that are materially inaccurate or incomplete must be corrected and the correction must be distributed to pool participants within twenty-one (21) days of discovering the defect.

Investment Company Act Compliance. If your fund is a 3(c)(1) fund—that is, it relies on the exemption from registration as an investment company because it has one hundred (100) or fewer investors—you must continually monitor the number of investors and the attribution rules under the Investment Company Act of 1940, as amended. The attribution rules provide that if an investor that is itself relying upon Section 3(c)(1) or Section 3(c)(7) (for example, a "fund of funds") holds more than ten percent (10%) of the equity interests in the fund, the fund must "look through" this investor and count as the hedge fund's own investors each of the partners or shareholders of the fund investor. Therefore, potential investments greater than ten percent (10%) of the fund's equity made by entities must be analyzed to verify that they will not subject the fund to regulation as an investment company by exceeding the one hundred (100) investor limit. In addition, if an entity not relying on Sections 3(c)(1) or 3(c)(7) invests more than forty percent (40%) of its total assets in the fund, regulators will "look through" such entity for purposes of counting beneficial owners. Furthermore, if an entity is created for the purpose of investing in a 3(c)(1) fund, then the regulators also will "look through" the entity, regardless of its percentage ownership.

ERISA Compliance. If the aggregate amount invested in the fund by benefit plan investors (e.g., employee benefit plans, individual retirement accounts (IRAs) and entities the underlying assets of which include plan assets) were to equal or exceed twenty-five percent (25%) of the aggregate investments in the fund, the fund would be subject to various Employee Retirement Income Security Act of 1974 ("ERISA") requirements. Recent federal legislation has modified the types of plans that are to be counted for the purposes of the twenty-five percent (25%) threshold (i.e., governmental plans, church plans and foreign plans are no longer counted for the purposes of the twenty-five percent (25%) threshold). You should monitor on an ongoing basis the level of investments by benefit plan investors, and to the extent your fund approaches the twenty-five percent (25%) threshold, you should contact us to discuss the application of ERISA rules and the alternatives for compliance.

Registered Investment Advisers

Annual Updating Amendments to Form ADV. Any investment adviser who is registered with the Commission must amend its Form ADV at least annually, within ninety (90) days after the end of the adviser's fiscal year. Your annual updating amendment must update all items on the form. Part 1A, however, must be updated electronically on the SEC's electronic Investment Adviser Registration Depository ("IARD") system and must specify that it is an annual updating amendment. In addition to providing the annual updating amendment, a registered adviser is required to amend (and with respect to Part 1, file) certain parts of its form whenever the information on it becomes inaccurate.

State Filing Requirements. In addition, a given state's laws may require a federally-registered adviser to make notice filings and to pay fees in the state if it has clients or a place of business therein. Laws vary significantly from state to state. For example, New York requires that a federally-registered investment adviser that has more than five clients residing in the state complete a notice filing by adding

New York as a notice filing state on the IARD, and that the adviser submit to the Office of the Attorney General a copy of Part II, Schedule F and any other part of the Form ADV that is not on the IARD. There may also be certain licensing or qualification requirements for representatives of state-registered investment advisors. Please contact us with any state-specific questions.

Compliance Policies and Code of Ethics. Registered investment advisers must adopt and maintain detailed compliance policies and a code of ethics, and appoint a Chief Compliance Officer. If you have not already done so, please contact us immediately so that we may assist you in creating and/or documenting compliance procedures tailored to your business. In addition, compliance policies and procedures must be reviewed by the registered adviser at least annually. The annual review should focus on an evaluation of the effectiveness of the policies and procedures and the need for revisions as a result of any compliance issues that arose during the prior year, any changes in the business activities of the investment adviser and/or any regulatory changes. The first review is required to be conducted within eighteen (18) months after the adoption of the compliance policies. Subsequent reviews must occur on an annual basis. We recommend that this review be conducted relatively early in the year so that it does not conflict with time periods when quarter-end or year-end matters are pressing. Policies that are materially changed as a result of such review should be redistributed to all appropriate personnel. In addition, Schedule F of Form ADV must contain a description of the code of ethics and a statement that the adviser will provide upon request the code of ethics to any current or prospective client.

Annual Delivery of Form ADV. Every year a registered adviser must deliver (or offer in writing to deliver) to each advisory client a written disclosure statement containing the information required by Part II of Form ADV. The written offer to deliver the written disclosure statement may be included in other communications with the client, such as in an annual investor letter.

Custody. In order for registered investment advisers that are general partners or advisers to limited partnerships to avoid sending quarterly statements detailing the fund's investments to all limited partners as a result of the Advisers Act's custody rules, the fund must distribute annually audited financial statements in accordance with GAAP (without any exception to GAAP, including the amortization of offering expenses) to all limited partners within one hundred twenty (120) days after the end of its fiscal year (one hundred eighty (180) days for a fund of funds). Please contact us if you have any question about what your practice should be.

We trust that this alert is a useful reminder of the regulatory issues relevant to your business. Please contact us if you have any questions or require further information.

We appreciate the opportunity to serve you, our clients, and we value your business. We wish you all the best for 2008 and look forward to working with you throughout the year.

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