

**U.S. Department of Labor**

Pension and Welfare Benefits Administration  
Washington, D.C. 20210



DEC 4 1996

96-26A  
ERISA SEC. 401(b)

Mr. Jacob I. Friedman  
Proskauer Rose Goetz & Mendelsohn  
1585 Broadway  
New York, NY 10036

Dear Mr. Friedman:

This is in response to your request for an advisory opinion concerning the "plan assets" regulation (29 C.F.R. §2510.3-101, 51 Fed. Reg. 41262, November 13, 1986) issued by the Department of Labor (the Department) under the Employee Retirement Income Security Act of 1974 (ERISA). Specifically, you request guidance with respect to the determination of "venture capital operating company" (VCOC) status under the plan assets regulation.

You state that you represent a number of employee pension benefit plans (Plans), within the meaning of section 3(2)(A) of ERISA, which periodically contemplate making investments in an entity that may be considered to be a VCOC under the plan assets regulation. You ask whether an entity may retroactively satisfy the "50 percent test" in regulation section 2510.3-101(d)(1)(i) as of the date of its first long term investment, even if that investment does not qualify as a venture capital investment under the terms of the regulation, as long as the "50 percent test" is satisfied at some later time before the last day of a ninety day period beginning on the date of the anniversary of the first investment. Your proposal would create up to a 15 month relation back period during which the entity would be treated as having satisfied the terms of the regulation, even though it had not yet done so.

Regulation section 29 C.F.R. 2510.3-101 describes the circumstances under which a plan's investment in another entity causes that entity's underlying assets to include "plan assets." In general, the regulation provides that, in the case of a plan's investment in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940, its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless the entity is an operating company or equity participation in the entity by benefit plan investors is not significant.

The term "operating company" is generally defined in regulation section 29 C.F.R. 2510.3-101(c) to mean an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. The operating company exclusion also applies to entities which are separately defined as VCOCs.

Regulation section 29 C.F.R. 2510.3-101(d)(1) provides, in pertinent part, that an entity is a VCOC for the period beginning on an "initial valuation date" and ending on the last day of the first "annual valuation period" if, (1) on such initial valuation date at least 50 percent of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are invested in venture capital investments; and (2) during such period, the entity, in the ordinary course of its business, actually exercises "management rights" with respect to one or more of the operating companies in which it invests. Section 29 C.F.R. 2510.3-101(d)(5)(i) defines "initial valuation date" as the first date on which an entity makes an investment that is not a short-term investment of funds

pending long-term commitment.<sup>1</sup> Section 29 C.F.R. 2510.3-101(d)(5)(ii) defines "annual valuation period" as a preestablished annual period, not exceeding 90 days in duration, which begins no later than the anniversary of an entity's initial valuation date.

You suggest that section 2510.3-101(d)(1) sets forth alternate tests so that an entity that is not an existing VCOC may choose to satisfy the "50 percent" test either "[o]n such initial valuation date" or "at any time within such annual valuation period." It is the Department's view, however that these two phrases must be read in the context of the two separate situations discussed in the immediately preceding paragraph. When read in this context, it is clear that the phrase "on such valuation date" refers to the case of an entity that is not a venture capital operating company immediately before the determination, and that the phrase "at any time within such annual valuation period" refers to the case of an entity that is a venture capital operating company immediately before the determination. Thus, as entity that is not already a VCOC must satisfy the "50 percent test" on the initial valuation date.

The preamble to the final regulation provides direct support for this construction. It states: "[A] venture capital operating company must meet the 50 percent standard when it first makes long-term investments. Thereafter, a company is treated as a venture capital operating company if on any day during an annual 'valuation period' it complies with the 50 percent test." 51 Fed. Reg. 41262, 41272 (Nov. 13, 1986). In other words, only after the entity has originally met the "50 percent test" on the "initial valuation date," does the VCOC establish an "annual valuation period" during which it must annually comply with the "50 percent test."

The Department has previously addressed the issue of whether an entity must satisfy the 50 percent test before it may be considered a VCOC. In Advisory Opinion 89-15 (August 3, 1989), the Department considered the status of initial capital contributions by employee benefit plans to a newly formed venture capital company that proposed to invest in short-term money market investments pending long-term venture capital commitments. The Department concluded that the VCOC exception did not apply to the venture capital company during the period preceding its first qualifying venture capital investment when the 50 percent test had not been satisfied. The Department reasoned that it would be inconsistent with the plan assets regulation to extend the application of the VCOC exception before the company had undertaken the types of activities required to qualify as a VCOC.

This is an advisory opinion under ERISA Procedure 76-1. It is subject to the provisions of the procedure, including section 10, relating to the effect of advisory opinions.

Sincerely,

Bette J. Briggs  
Chief, Division of Fiduciary Interpretations  
Office of Regulations and Interpretations

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<sup>1</sup> As noted in the preamble, section 29 C.F.R. 2510.3-101(d)(5)(i)(A) contains a special transition rule, which provides that, "[i]n the case of an existing venture capital or real estate company, the initial valuation date is any date designated by the company within the 12 month period ending on the effective date of the regulation."