SEWARD & KISSEL LLP

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MEMORANDUM TO CLIENTS

SUMMARY OF RULES CONTAINED IN NEW FINAL TREASURY REGULATIONS ON DEFERRED COMPENSATION ARRANGEMENTS OF INVESTMENT FUND MANAGERS

I. Introduction

Section 409A of the Internal Revenue Code ("Section 409A") was enacted in October 2004 and contains provisions relating to the taxation of nonqualified deferred compensation plans, agreements and similar arrangements ("Deferred Compensation Plans"). Section 409A applies to the Deferred Compensation Plans entered into by investment managers ("Managers") of offshore investment funds ("Offshore Funds") with respect to the management fees and/or incentive fees payable to the Managers by the Offshore Funds (collectively, the "Fees"). Section 409A also applies to the Deferred Compensation Plans entered into between Managers and their employees (and, possibly, the equity owners of the Managers). In October 2005, the Treasury Department issued a comprehensive set of proposed regulations providing guidance on certain of the rules contained in Code Section 409A (the "Proposed Regulations").

The long-awaited final Treasury regulations under Section 409A (the "Final Regulations") were issued on April 10, 2007 and provide guidance on certain of the rules contained in Section 409A, including the types of plans and arrangements that are covered by Section 409A, the operational requirements for deferral elections and the timing of deferred compensation payments made under Section 409A. The effective date for the Final Regulations is January 1, 2008. While the Final Regulations modify the rules contained in the Proposed Regulations concerning a number of issues regarding various types of Deferred Compensation Plans, the Final Regulations generally follow the rules contained in the Proposed Regulations with respect to the Deferred Compensation Plans entered into between Managers and Offshore Funds.

Section II of this memorandum summarizes the key aspects of the Final Regulations impacting the Deferred Compensation Plans entered into between Managers and Offshore Funds. We will distribute a more detailed memorandum summarizing and analyzing the Final Regulations shortly.

II. Summary of the Key Aspects of the Final Regulations Affecting Managers

The following are several key points of the Final Regulations relating to the typical Deferred Compensation Plans between Managers and Offshore Funds:

1. **Compliance with Section 409A Rules.** Under the Final Regulations, the deadline for documentary compliance with the rules contained in Section 409A is December 31, 2007. This means that if a Deferred Compensation Plan is operated in good faith compliance with the provisions of Section 409A, a Manager and Offshore Fund have until December 31, 2007 to modify their existing Deferred Compensation Plan to comply with the provisions of Section 409A. So long as a Manager's Deferred Compensation Plan is technically compliant with Section 409A as of January 1, 2008, there is no need for a Manager to make any retroactive amendments to such Plan. The transitional rules contained in the Proposed Regulations and in guidance issued by the Internal Revenue Service continue to apply for all periods prior to January 1, 2008.

2. **Timing of Deferral Elections.** Section 409A generally requires that a deferral election be made no later than December 31 of the year preceding the year in which the relevant services are rendered or such other time as provided in Treasury Regulations. The Final Regulations in effect provide that a Manager of an Offshore Fund which has a fiscal year ending on a date other than December 31 can defer those incentive fees payable at the end of the fiscal year of the Offshore Fund provided that the Manager's deferral election is made prior to the commencement of the Offshore Fund's fiscal year. However, it appears that a Manager must make a deferral election by December 31 of the year preceding the commencement of the Offshore Fund's fiscal year in order to effectively defer (i) any incentive fees payable to the Manager with respect to the redemption of shares of the Offshore Fund prior to the last day of such fiscal year; (ii) any incentive fees payable to the Manager with respect to shares of the Offshore Fund issued during such fiscal year; and (iii) any management fees payable to the Manager with respect to such fiscal year.

3. **Redeferral Election.** If certain requirements are met, Section 409A effectively provides that a Manager may elect to extend an earlier specified deferral period with respect to a previously deferred Fee. The Final Regulations do not impose any limitation on the number of times that a Manager can elect to extend previously made deferral elections. However, if a Deferred Compensation Plan is first amended so as to permit a Manager to extend the deferral period for Fees that were earned prior to December 31, 2004 we believe such an amendment would be viewed as a "material modification" of the pre-2005 arrangements and subject all aspects of those arrangements to the rules of Section 409A.

4. **Back-to-Back Deferral Elections.** Section 409A restricts the type of events that are permitted to trigger accelerated payment of deferred Fees to a Manager. (For example, payment upon "separation from service," death or disability of a service provider is permitted.) Under the Final Regulations, "back-to-back" deferral arrangements between a Manager and its employees and between the Manager and the Offshore Funds (i.e., arrangements whereby payments of all or portion of a Manager's Fee deferrals with the Offshore Fund are accelerated upon an employee ceasing to provide services to the Manager) are expressly permitted for post-2004 Fee deferrals provided that the deferred compensation arrangement

between the Manager's and employees complies with Section 409A. Therefore, to take advantage of the "back-to-back" rule, Managers should have written deferral arrangements with its equity owners and/or employees that comply with Section 409A.

Under the Proposed Regulations, it was unclear whether the "back-to-back" rules discussed above with respect to a Deferred Compensation Plan entered into between Manager and its employees would also be applicable to the equity owners of those Managers treated as partnerships for federal income tax purposes. We note that the Final Regulations, as in the case of the Proposed Regulations, reserve for future guidance any special rules relating to the applicability of Section 409A to the deferral of compensation by partners who provide services to partnerships but provide that, with certain limited exceptions, partnerships may treat such internal arrangements as not being subject to Section 409A. However, the Final Regulations add some additional language to the "back-to-back" rules which we believe supports applying the same "back-to-back" rules to both partners who provide services to a partnership which enters into a Deferred Compensation Plan. Therefore, even though arrangements among partners generally are not subject to Section 409A under current law, our view is that a Manager treated as a partnership for federal income tax purposes should be able to avail itself of the "back-to-back" rule contained in the Final Regulations with respect to a departing equity owner of the Manager provided that the deferral arrangement among the equity owners of the Manager complies with Section 409A.

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