

# Client Alert

A report  
for clients  
and friends  
of the firm

May 2005

## Department of Labor Expands and Simplifies Voluntary Fiduciary Correction Program

On April 6, 2005, the Employee Benefits Security Administration of the U.S. Department of Labor ("EBSA") published in the Federal Register an expanded and simplified Voluntary Fiduciary Compliance Program ("VFCP"). The VFCP is designed to encourage employers and plan fiduciaries to voluntarily comply with the Employee Retirement Income Security Act of 1974, as amended ("ERISA") by self-correcting certain violations that would ordinarily give rise to civil actions and civil penalties under ERISA. In addition, EBSA has proposed amendments to prohibited transaction exemption 2002-51 ("PTE 2002-51") to accommodate a new transaction contained in the revised VFCP. The revised VFCP is not yet final and therefore may be revised further, however, EBSA has stated that the revised VFCP is effective immediately and will be available during the comment period. The excise tax relief afforded by the amendments to PTE 2002-51, however, is not available until the amendments are adopted in final form.

### Background

The VFCP was originally adopted in March 2002 to encourage voluntary compliance with ERISA and allow those potentially liable for certain specified fiduciary violations under ERISA to voluntarily apply for relief from enforcement actions and certain penalties, provided that the criteria under the VFCP is satisfied and the VFCP's procedures are followed. EBSA has reported that many workers have benefited from the VFCP as a result of the restoration of plan assets and payment of promised benefits.

The VFCP describes: the specific transactions covered; acceptable methods for self-correcting violations; examples of potential violations and corrective actions; and how to apply for relief from Department of Labor enforcement action. Eligible applicants that satisfy the terms and conditions of the VFCP receive a "no-action letter" from EBSA and are not subject to civil monetary penalties. In addition, the original PTE 2002-51 provides excise tax relief for four specific VFCP transactions. While the original VFCP has been successful, EBSA has determined that changes are needed to improve administration of the VFCP.

### Covered Transactions

As revised, the VFCP provides descriptions of the following 18 transactions and their correction methods:

- Delinquent Participant Contributions and Participant Loan Repayments to Pension Plans
- Delinquent Participant Contributions to Insured Welfare Plans
- Delinquent Participant Contributions to Welfare Plan Trusts
- Fair Market Interest Rate Loans with Parties in Interest
- Below-Market Interest Rate Loans with Parties in Interest
- Below-Market Interest Rate Loans with Persons who are not Parties in Interest
- Below-Market Interest Rate Loans Due to Delay in Perfecting Security Interest
- Participant Loan Amount in Excess of Plan Limitations

- Participant Loan Duration in Excess of Plan Limitations
- Purchase of Assets by a Plan from a Party in Interest
- Sale of Assets by a Plan to a Party in Interest
- Sale and Leaseback of Real Property to Sponsoring Employers
- Purchase of Assets from a Person who is not a Party in Interest at other than Fair Market Value
- Sale of Assets to a Person who is not a Party in Interest at other than Fair Market Value
- Holding of an Illiquid Asset Previously Purchased by a Plan
- Benefit Payments Based on Improper Valuation of Plan Assets
- Payment of Duplicate, Excessive or Unnecessary Compensation
- Payment of Dual Compensation to a Plan Fiduciary

The VFCP has been revised to include a correction of a transaction that permits a plan to divest, rather than continuing to hold in its portfolio, a previously purchased asset that is currently classified as illiquid. The new transaction covers circumstances where a plan is holding the illiquid asset and a plan fiduciary has determined that continued holding of the asset is not in the best interest of the plan or the plan's participants, and following reasonable efforts to dispose of the asset, the only available purchaser is a party in interest. The revised VFCP provides relief for both the original acquisition of the asset that was determined to be illiquid, as well as the correction involving the sale to a party in interest. The required correction permits the sale of the illiquid asset to a party in interest, provided that the plan is returned to a financial position that is no worse than if the acquisition had never taken place. Accordingly, a plan must receive the higher of the fair market value of the asset on the date of the correction or its original purchase price, plus incidental costs. PTE 2002-51 has also been amended to provide additional exemptive relief from prohibited transaction sanctions imposed under the Internal Revenue Code.

To facilitate the correction of certain plan loans to participants that result in prohibited transactions through no fault of the participants, the VFCP has been revised to include situations where a plan extends a loan to a participant who is a party in interest based solely on his or

her status as an employee. In addition, the revised VFCP also includes situations where either the amount or duration of the loan exceeds that permitted under the plan provisions. The IRS has indicated that it intends to develop a coordinating correction mechanism for these plan loans under which certain tax consequences may be alleviated.

Finally, consistent with the Department of Labor's prior guidance, the VFCP has been expanded to explicitly include delinquent participant loan repayments as a transaction eligible for correction under the VFCP.

### **Model Application Form**

To encourage the use of the VFCP, EBSA is making available a model application form. While use of the model form is voluntary, EBSA encourages use of the form in order to avoid common application errors that may result in processing delays or rejections. Use of the model form will also enable regional offices to provide a more expedient and consistent review of VFCP applications. The model form provides an outline of the information and supplemental documentation that must be included with the application to help ensure that the application is correct and complete, as well as a mandatory checklist.

### **Reduced Documentation**

The VFCP has been revised to eliminate the requirement that applicants provide certain information relating to the plan's fidelity bond. The revised VFCP also permits many applicants to provide certain summary documentation, rather than detailed information and copies of accounting and payroll information.

### **Simplification of Correction Amount and Online Calendar**

In an effort to address applicant concerns and facilitate corrections, EBSA simplified the definitions of lost earnings and restoration of profits in the revised VFCP. In addition, EBSA is providing an online calculator on its website which may be used to automatically calculate lost earnings and interest, if any, and the interest amount for restoration of profits. While EBSA anticipates that most applicants will use the online calculator, applicants may also perform a manual calculation as described in detail in the revised VFCP.

The VFCP has always required that the amount to be restored to the plan be based on either the losses to the plan resulting from a breach or the profits gained from improper use of plan assets, as required under ERISA. The correction amount generally consists of two components: (1) principal amount—the amount of plan assets that would have been available to the plan if the breach had not occurred; and (2) lost earnings or restoration of profits.

Under the original VFCP, lost earnings were calculated by comparing two hypothetical amounts that a plan might have earned on the principal amount between the date of breach (the loss date) and the date the principal amount is restored to the plan (the recovery date), as well as any interest on such earnings because of payment of lost earnings after the recovery date. In order to simplify this calculation, EBSA has revised the method of calculating lost earnings and interest, if any, to use factors provided under IRS Revenue Procedure 95-17. These factors, which are displayed on EBSA's website, incorporate daily compounding of interest over a set period of time.

In an effort to simplify the calculation of a restoration of profits amount, the VFCP has been revised to provide that the calculation of a restoration of profits amount is only required when the principal amount is used by a fiduciary, plan sponsor or other plan official for a specific purpose such that a profit resulting from the breach is determinable. EBSA anticipates that most applicants will use the lost earnings calculation more frequently than the restoration of profits calculation because, in most cases, the principal amount is commingled with other funds so that a profit from the use of the principal amount cannot definitively be determined. The interest calculation on the restoration of profits amount has also been simplified to use the factors provided under IRS Revenue Procedure 95-17.

### Other Changes

Other changes made to the VFCP include a modification to the scope of the term "under investigation" (which precludes use of the VFCP) to include investigations by other federal agencies, as well as notice of the intent to conduct an investigation. The perjury statement has also been simplified.

If you are interested in taking advantage of the expanded and simplified VFCP, please contact your Proskauer employee benefits attorney so that we may assist you in preparing your application. Click [www.dol.gov/ebsa/compliance\\_assistance.html#section8](http://www.dol.gov/ebsa/compliance_assistance.html#section8) for a link to the EBSA Notice.

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### Client Alert

**The Employee Benefits and Executive Compensation Law Practice Group at Proskauer Rose LLP counsels clients on the full spectrum of benefit and compensation issues, communicating technical and complex legal concepts in an intelligible, pragmatic manner.**

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