

DOL Continues to Expand and Improve the Voluntary Fiduciary Correction Program

The Department of Labor ("DOL") adopted the Voluntary Fiduciary Correction ("VFC") Program on a permanent basis in March of 2002. The VFC Program is designed to encourage employers and fiduciaries of employee benefit plans to voluntarily comply with the Employee Retirement Income Security Act of 1974 ("ERISA"), and allows those potentially liable for certain fiduciary violations to voluntarily apply for relief from enforcement actions by the DOL, provided that they meet the VFC Program's criteria and follow its procedures for correcting the violations.

Eligible persons who apply under the VFC Program and satisfy its procedures receive a "no-action letter" from the DOL and are not subject to enforcement actions and penalties. In 2002, the VFC Program was expanded to include a class exemption (PTCE 2002-51), which provided relief from the excise taxes imposed under Section 4975 of the Internal Revenue Code of 1986 ("Code") for four specific transactions which violate ERISA and could be corrected under the VFC Program.

In April of 2005, the DOL proposed to revise to the VFC Program and PTCE 2002-51 (the "2005 Proposals"). The DOL has now adopted final changes to the VFC Program, based on the 2005 Proposals, with some additions and modifications, and has finalized and expanded the proposed revision to PTCE 2002-51, all effective as of May 19, 2006.

Changes to VFC Program

The finalized changes to the VFC Program, including revisions introduced in the 2005 Proposals, are generally the following:

- The VFC Program now provides relief from the imposition of potential civil pen-

alties under Section 502 of ERISA, under which the DOL may assess a civil penalty on prohibited transactions with respect to welfare plans and nonqualified pension plans.

- The VFC Program now includes a correction under which a plan may divest, rather than continue to hold in its portfolio, a previously purchased asset which is determined to be illiquid. Continuing to hold the illiquid asset may be an ERISA violation, because the asset may have been purchased in a non-exempt prohibited transaction or as a result of an imprudent decision, or because it may be imprudent for the plan to hold the asset.

The Program describes four types of transactions in which the asset was purchased, including a transaction in which the asset is acquired from a party in interest in a purchase to which a statutory or administrative exemption applied. Each transaction eventually results in the plan holding an illiquid asset, for which the applicant must determine that correction is necessary.

- The VFC Program now makes correction available for several types of transactions involving plan loans to participants, namely, (1) the situation in which the loan exceeds the Code's limitation on a loan's amount or duration, or violates the Code's level amortization requirement, which limitation or requirement has been incorporated into the plan, or (2) a default on a participant loan, caused by the failure to withhold contributions from the participant's pay and make a timely loan

payment, in violation of the plan's terms. The statutory exemption from the prohibited transaction provisions for participant loans in ERISA requires that the loans be made in accordance with the plan's terms. A violation of ERISA, requiring correction, would therefore occur if the Code's loan limitations or requirements are incorporated into the plan and then are exceeded or violated, or if the plan's terms are otherwise violated.

- The VFC Program now requires only that an applicant correct participant loan ERISA violations under the Internal Revenue Service's Employee Plans Compliance Resolution System, and then submit a copy of the resulting EPCRS compliance statement, along with proof of payment of any required amounts, to the DOL.
- The VFC Program has been clarified so that ERISA violations involving the use of plan assets to pay expenses, which should have been paid by the plan sponsor either because they related to settlor functions or the plan documents require it, may be corrected under the VFC Program.
- The definition of "Under Investigation" in the VFC Program has been narrowed to focus on situations in which an investigation, either ongoing or for which notice has been given, involves the plan or an act or transaction involving the plan. For example, a plan would be "Under Investigation" if it is undergoing an Employee Plans Examination by the Internal Revenue Service.

For non-criminal investigations and examinations of a plan, or of the applicant or plan sponsor in connection with an act or transaction directly related to the plan, by the Pension Benefit Guaranty Corporation, any state attorney general or any state insurance commissioner, the DOL is instituting an optional disclosure provision. Potential applicants who choose to disclose such an investigation may apply under the VFC Program, while potential applicants who opt for non-disclosure cannot apply because they are considered to be "Under Investigation."

- The VFC Program has been clarified so that specific transactions which are identified by

the DOL in a written notice to a plan fiduciary, and which the DOL has referred to the Internal Revenue Service, may not be corrected under the Program.

- The VFC Program will now allow correction of a plan's *purchase* of an asset from, or *sale* of an asset to, a party in interest by reversing the transaction (e.g., in the case of a *purchase*, selling the asset back to the party in interest, or to a non-party in interest) or by retaining the asset and settling the correction amount in cash, provided that an independent fiduciary determines that the plan will realize a greater benefit from the cash settlement than from reversing the transaction.
- The VFC Program will use the Code Section 6621 interest rate when calculating "Lost Earnings."
- When correcting the delinquent remittance of participant contributions or loan repayments to 401(k) plans, or any delinquent remittance of participant contributions to an insured welfare plan or to a welfare plan trust, the VFC Program will now permit applicants to provide summary documentation (instead of full substantiation) when correcting breaches that involved (1) an amount below \$50,000, or (2) an amount exceeding \$50,000 that was remitted within 180 calendar days after receipt by the employer.
- The VFC Program will offer an Online Calculator to make calculations required by the VFC program. Further, the VFC Program has been clarified so that applicants using the Online Calculator need to submit only a copy of the final page(s) that results from using the "Print Viewable Results" function. This function is used after inputting all data elements and completing all calculations using the Online Calculator.
- The notice from the DOL announcing the finalized revisions to the VFC Program includes a sample no-action letter, an example showing the calculation of "Lost Earnings," a model application form, and a list of regional DOL offices.

Changes to PTCE 2002-51

As indicated above, the revised VFC Program allows corrections when an asset purchased by a plan is later determined to be illiquid. In this regard, the revised VFC Program both (1) allows correction of the plan's original acquisition of this asset, and (2) permits correction by the sale of this asset in a transaction that would violate the prohibited transaction rules of Title I of ERISA and Section 4975 of the Code. Similarly, PTCE 2002-51 has been amended to provide relief from the excise taxes imposed by Section 4975 of the Code for an acquisition in (1) and a sale in (2).

Similar to the changes made to the VFC Program, PTCE 2002-51 has been revised to provide excise tax relief for the use of plan assets to pay expenses of a service provider pertaining to the establishment, design or termination of the plan, when such activities are undertaken by the plan sponsor in its settlor capacity, *provided* that such payment by the plan was not prohibited by the plan's governing documents.

To simplify correction procedures for any failure to timely remit participant contributions and loan repayments to a 401(k) plan, PTCE 2002-51 has been further revised so that an applicant under the VFC Program need not notify interested persons of the application to correct this failure if:

- The excise tax due under Section 4975 of the Code for the failure does not exceed \$100
- The excise tax that otherwise would be due is contributed to the plan and allocated among the plan's participants as if it were earnings
- The applicant has satisfied all other applicable conditions of PTCE 2002-51 and the VFC Program

If the conditions for the relief under PTCE 2002-51 are met, the applicant is not required to file a Form 5330 with the IRS to report any excise tax.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employeebenefits.

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