COMMENTS ON THE VOLUNTARY FIDUCIARY CORRECTION PROGRAM

The following comments represent the individual views of the members of the Employee Benefits Committee of the Section of Taxation of the American Bar Association who were involved in their preparation, and do not represent the position of the Committee, the Section or the American Bar Association.

These comments were prepared and coordinated by Donald J. Myers. He was assisted by Michael B. Richman, Robert Musick and Sharon W. Vaino. The comments were reviewed by Diane J. Fuchs, Chair of the Committee on Employee Benefits, Thomas R. Hoecker and Seth H. Tievsky of the Committee on Employee Benefits. The comments were reviewed by Roberta Watson of the Section’s Committee on Government Submissions and by Stuart M. Lewis, Council Director for the Committee on Employee Benefits.

Although the members of the Committee who participated in preparing these comments have clients who may be affected by the program or may advise clients with respect to using the program, no such member (or firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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Executive Summary

The adoption of the Voluntary Fiduciary Correction Program (the “Program”) by the Department of Labor (the “Department”) is a positive step that should promote compliance with the ERISA fiduciary rules, avoiding potentially costly investigative and enforcement actions as well as statutory penalties. However, a number of aspects of the Program in its current form will limit or discourage its use. The fact that parties correcting prohibited transactions under the Program will continue to be subject to excise taxes will discourage them from using the Program, so that the Department should work with the IRS to remove this impediment. Another problem is that the Program does not permit pre-filing negotiations as to the amount of relief owed or eligibility to use the Program, creating uncertainty that will deter use of the Program. There should be ways to permit at least limited pre-filing discussions, as is currently done under IRS voluntary correction programs for qualified plans. The notice requirement may present a serious deterrent to using the Program, and should be eliminated or at least modified to reduce the burdens involved. In addition, the Department should look to expand over time the types of transactions covered by the Program over the very limited set of transactions currently eligible for relief. Finally, the Department should clarify the Form 5500 implications of making a filing under the Program, the potential uses of Program information and the ability to supplement or amend a Program application.
Introduction

Set forth below are the comments of individual members of the Section of Taxation on the Voluntary Fiduciary Correction Program (the “Program”) issued by the Department of Labor (the “Department”) on March 15, 2000 (65 Fed. Reg. 14164).

We welcome the adoption of the Program, which should serve to promote compliance with the ERISA fiduciary rules by encouraging voluntary and timely correction of certain fiduciary breaches. It will enable parties to assure that they have resolved those types of fiduciary breaches to the satisfaction of the Department, avoiding potentially costly investigative and enforcement actions as well as statutory penalties. In particular, we appreciate the issuance of guidance on the Department’s views as to what constitutes “correction” of a breach of fiduciary duty under Title I of ERISA, which will provide added certainty in future dealings with the Department, including matters outside the bounds of the Program itself.

However, there are aspects of the Program in its current form that will limit or discourage its use. Our comments address those aspects of the Program.

1. **Prohibited Transaction Excise Taxes**

**Background:** The Department has requested comments on possible areas of coordination with the IRS that would facilitate voluntary correction of fiduciary breaches. One area in which coordination would be appropriate is that of prohibited transaction excise taxes under section 4975 of the Internal Revenue Code of 1986, as amended (the “Code”). The first-tier excise tax in section 4975(a), imposed on the disqualified person with respect to the prohibited transaction, is equal to 15% of the amount involved in the transaction for each year until the transaction is corrected. The excise tax is administered by the Internal Revenue Service (the “IRS”).

The form of the no action letter to be issued under the Program, in Appendix A to the Program document, states that prohibited transaction matters will be referred to the IRS. The accompanying release further states that full correction under the Program will not preclude the IRS from exercising any rights it may have with respect to the transaction. Consequently, it appears that the disclosure of any prohibited transaction in a Program application will result in
the IRS imposing prohibited transaction excise taxes on the parties who engaged in the transaction with the plan.

**Comment:** The fact that an application to correct a prohibited transaction will automatically lead to excise tax liability will discourage potential applicants from using the Program.

**Recommendation:** We urge the Department to work with the IRS to remove this impediment to using the Program. The simplest solution would be for the IRS to agree to abate or otherwise waive excise taxes for applicants who submit an application that is accepted under the Program, perhaps subject to a requirement that the application be filed within a certain period of the original transaction.

If the statutory authority for such a waiver is lacking, another approach would be to issue a class exemption modeled on PTE 96-63, the class exemption that was part of the “pension payback” program and served as a precursor to the Program. PTE 96-63 provided relief from all of the prohibited transaction provisions of section 406 of ERISA and section 4975 of the Code, except section 406(b)(3) and section 4975(c)(1)(F). Similarly, a class exemption could provide the same section 406 and section 4975 relief for transactions covered by applications submitted and accepted under the Program.

2. **Negotiation**

**Background:** As described in the Program release, one of the objectives of the Program is to allow applicants to make complete and fully acceptable corrections without discussion or negotiation with the Department. If the Department were to negotiate the relief owed, the release states that the Department would be obligated to assess a civil penalty under section 502(l) of ERISA. This civil penalty is imposed on any breach of fiduciary responsibility or other fiduciary violation, or knowing participation in such a fiduciary breach of violation, with respect to the amount recovered pursuant to any settlement agreement with the Department, or ordered by a court in a judicial proceeding instituted by the Department. This penalty, in the amount of 20% of the amount recovered, is reduced by any penalty or tax imposed under section 4975 of the Code or section 502(i) of ERISA. In addition, it may be waived or reduced if the Department
determines that the fiduciary or other person acted reasonably and in good faith, or that the person will not otherwise be able to restore all losses to the plan without severe financial hardship.

**Comment**: The inability to even enter into discussions with the Department prior to filing a Program application will deter use of the Program. It will force parties to take their chances in determining what is an acceptable correction method, and whether the transaction involves what the Department would consider to be potential criminal violations that could result in a criminal referral of the matter. Under this standard, any uncertainties faced by the applicant could not be resolved prior to filing an application, so that the applicant would risk the application being rejected and the possibility of subsequent enforcement action (now that the Department would be on notice of the breach).

Similar issues arose under the IRS voluntary correction programs for qualified plans. As those programs evolved, the IRS became more flexible in permitting pre-filing negotiations and even anonymous pre-submissions. These steps helped to encourage use of the programs, and also saved time and money by resolving issues in advance rather than requiring the IRS staff to respond to defective applications.

**Recommendation**: It should be possible to provide some mechanism for limited pre-filing discussions, as under the IRS programs, without requiring the Department to assess section 502(l) penalties. The Department should reexamine the issue of whether voluntary correction under the Program should in fact be considered a “settlement agreement” with the Department, particularly where any discussions regarding correction are limited to interpreting and applying the Program’s correction standards in advance of an actual submission. In addition, section 502(l)(3) gives the Department discretion to waive or reduce the penalty if the fiduciary or other person acted reasonably and in good faith. The Department should consider whether voluntarily correcting a fiduciary breach pursuant to the Program can be treated as acting reasonably and in good faith for purposes of section 502(l)(3). The Department should be able to conclude under one of these approaches that pre-filing discussions will not trigger penalty assessments, thereby facilitating use of the Program. In addition, the Department should consider extending such a
position to any post-filing discussions that may require additional corrections, in order to further encourage use of the Program.

3. **Notice**

**Background:** One of the principal requirements of the Program is that written notice of the correction be provided to all plan participants. The notice must state that correction was made pursuant to the applicant’s participation in the Program, and that the participant may obtain a copy of the application and all supporting documentation from the plan administrator upon request. There is no requirement to describe the breach or specific correction method. No distinctions are drawn as to the type of transaction being corrected or its materiality to the plan.

The Program release does not specifically indicate at what point the notice must be provided, other than the statement that it must be provided no later than the date required for distribution of the Summary Annual Report.

**Comment:** The notice requirement may pose a serious deterrent to use of the Program by plan sponsors and service providers. The burden and cost of notice to each participant could be significant for large plans. In addition, providing the notice may create undue confusion and uncertainty for the plan participants where the transaction being corrected affected only a few participants, or was relatively small in relation to plan assets. The IRS voluntary compliance programs have worked successfully without requiring these types of broad plan-wide notices, although, in practice, notices are provided to all plan participants who are affected by the correction.

Notices should not be required to be furnished to participants prior to the Department approving an application. In the event the application were rejected or additional corrective action were required, the notices would become inaccurate and would need to be supplemented, requiring a second round of notices and additional costs. Furthermore, it should be possible to include the notices in the Summary Annual Reports as a means of reducing the cost.
**Recommendation:** The purpose of the Program is for plan sponsors, fiduciaries and other parties who may have potential fiduciary liability to correct the possible violations on a voluntary basis and make the plans whole. The Program will work effectively to accomplish this purpose only if its terms encourage parties to come forward and take appropriate corrective action. The notice requirement in its present form, however, will discourage applicants through the expenses and risks that it would involve. The result would be to defeat what the Program is trying to accomplish.

In order to reduce the expenses and risks involved in providing notice, the Department should make the following modifications: First, notice should be limited based on a materiality standard, to create a balance between the costs and risks of providing notice and the potential exposure of the correcting party. If the amount involved in the breach were less than a certain percentage of plan assets -- say, 5% -- then the breach would not be material to the plan’s financial condition, and notice to the plan participants should not be necessary. Second, where the breach affected only certain participants, notice should be limited to those participants. Third, the Department should clarify when and how the notices have to be provided. They should not be required to be sent to participants until after the Department has accepted the Program application, to avoid the need for supplemental or corrective notices. In addition, the Department should clarify that it would be permissible to include the notice in the Summary Annual Report. Finally, the deadline for providing notice should be extended to the next date required for distribution of a Summary Annual Report that is more than forty-five days after the applicant has received the no action letter. This would avoid the problem of there being insufficient time in advance of the Summary Annual Report distribution date to prepare and print the notices.

4. **Types of Transactions Covered**

**Background:** The types of transactions covered by the Program at this stage are limited. Furthermore, the Program release makes clear that only the specific type of violation described is covered. For example, the no action relief for a purchase of real estate from the plan sponsor
would not extend to any diversification violation, because the description of the eligible transaction does not include the diversification issue (Section 2(c)(8)).

**Comment:** Because of its limited scope, there are few fiduciary violations that could be completely resolved under the Program.

**Recommendation:** We understand the Department’s concern in launching such a program that it start with a narrow subset of potential violations, as was done here. This also was the case with the IRS voluntary correction programs, which have gradually been expanded over the years to include a greater variety of potential violations and correction measures. We would hope that as it gains experience, the Department will expand the Program in the same manner. We further hope that the Department will be open to input from us and other groups on an ongoing basis as to additional types of transactions to consider for relief under the Program and alternative correction methods, and how to provide complete relief for all aspects of a transaction.

5. **Form 5500 Implications**

**Background:** Corrections made under the Program may require changes to previously-filed Forms 5500. For example, there may be a need to report a prohibited transaction for a prior plan year, or to correct the value of assets described for one or more prior plan years (as required in the correction procedure in Section 7.D. of the Program release, dealing with improperly valued assets).

**Comment:** Failure to file a complete and accurate Form 5500 can result in penalties under ERISA and the Code. The possibility of incurring such penalties will discourage use of the Program.

**Recommendation:** Penalties related to Form 5500 filings should be waived where a previously-filed Form 5500 is being amended as part of the correction process under the Program.

6. **Use of Program Information**
**Background:** Successful applicants will receive a no-action letter that limits the ability of the Department to take enforcement action as to the specific matters covered in the Program application. However, the Program release states that the Department may initiate investigations where it becomes aware of possible criminal behavior, any material misrepresentations or omissions in the Program application, or other abuse of the Program; also, use of the Program does not preclude action by other governmental agencies. There is no discussion of the possible use of Program application information outside the Program.

**Comment:** The Department should not use the information disclosed in applications to target particular plans or companies for ERISA enforcement investigations outside the Program. To do so would discourage use of the Program and any type of voluntary disclosure to the Department. By comparison, the IRS, recognizing this problem, has committed (albeit informally) not to use information provided through its voluntary correction programs in targeting companies for audits.

**Recommendation:** The Department should provide assurance that it will not use Program application information to target companies for ERISA enforcement investigations.

7. **Supplements or Amendments to Applications**

**Background:** The Program release does not expressly permit or prohibit a fiduciary from supplementing or amending an application.

**Comment:** Program applicants may discover additional information after filing their applications that would be relevant to the matters described in the applications. The Program procedure should permit such information to be added to the application so long as the application is still under consideration by the Department.

**Recommendation:** The Program procedure should permit an applicant to supplement or amend a pending application to take into account later discovered information about the breaches or violations described in the application, or about related fiduciary breaches or violations that also are eligible for correction under the Program.
Conclusion

We appreciate the opportunity to comment on the Program, and would be happy to meet with the Department to discuss any of the issues raised in this letter. If you have any questions or would like to arrange such a meeting, please contact us.