

Pension ANALYST



Important Information

Plan Administration and Operation

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DOL Expands and Simplifies Voluntary Fiduciary Correction (VFC) Program

WHO'S AFFECTED The Voluntary Fiduciary Correction (VFC) Program is available to anyone who may be liable for certain fiduciary violations under the Employee Retirement Income Security Act (ERISA), including employee benefit plan sponsors, officers, trustees, plan administrators or other parties-in-interest.

The information in this publication does not apply to plans that are not subject to ERISA, such as governmental and nonelecting church plans, non-ERISA 403(b) programs, 457 plans, and non-qualified executive benefit plans that are not subject to ERISA.

BACKGROUND AND SUMMARY In 2000, the Department of Labor (DOL) created the Voluntary Fiduciary Correction (VFC) Program. This program allows plan sponsors and fiduciaries to voluntarily correct certain fiduciary violations and avoid civil and criminal penalties. In 2002, the DOL made revisions to this program, which included the addition of a prohibited transaction class exemption to provide excise tax relief for four specific transactions.

In April 2005, the DOL's Employee Benefits Security Administration (EBSA) made additional changes to the VFC Program to simplify the submission process and expand the availability of the program. The revised Program now:

- Provides a [model application form](#);
- Simplifies the calculation of correction amounts;
- Requires reduced documentation for certain transactions;
- Formally includes delinquent loan repayments in the list of covered transactions and covers three additional transactions: 1) participant loans in excess of the plan limit on loan amounts; 2) participant loans in excess of the plan limit on loan duration; and 3) holding of an illiquid asset previously purchased by a plan.

At the same time, the DOL proposed a new prohibited transaction class exemption for a plan's purchase of certain assets that have become illiquid.

The changes to the VFC Program are currently just proposed and are therefore still subject to change, but they are also effective immediately. However, the prohibited transaction exemption is not yet available.

ACTION AND NEXT STEPS Plan fiduciaries and their legal counsel should decide whether to review plan transactions to determine if they meet all ERISA standards. If violations have

occurred, the individuals responsible should discuss the VFC Program with their legal counsel to determine if it is an appropriate option for their situation.

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RELATED DOCUMENTS

[Glossary of Special VFC Terms](#)
[Eligible Transactions and Corrections Under the VFC Program](#)
[Model Application Form](#)
[List of EBSA Regional Offices](#)

The Department of Labor's (DOL) Employee Benefits Security Administration has revised the Voluntary Fiduciary Correction (VFC) Program. This program allows certain persons (including fiduciaries, plan sponsors, parties in interest or other persons in a position to make corrections) to voluntarily correct certain breaches of fiduciary responsibilities.

ERISA sets forth the responsibilities of employee benefit plan fiduciaries. A fiduciary who breaches any of these responsibilities is personally liable for any losses to the plan as a result of that transaction, and must restore to the plan any profits he made through the use of those assets. A fiduciary may also be liable for a co-fiduciary's breach, or for knowing participation in a fiduciary breach.

Before the creation of the VFC Program, fiduciary breaches were generally corrected through consultation and negotiation with the DOL, resulting in a penalty of 20% of a negotiated amount. Through the VFC Program, a fiduciary breach (or possible breach) may be corrected without prior negotiation with the DOL. If all the requirements of the program are met, the DOL will not initiate a civil investigation or civil action with respect to the breach, and will not impose the 20% penalty.

Program Eligibility

The VFC Program can only be used if a plan representative has not received oral or written notification of an investigation of the plan (or notice of intent to conduct an investigation) by the DOL, or other Federal agency (i.e., IRS, Securities and Exchange Commission, or Pension Benefit Guaranty Corporation). However, if the DOL has contacted a plan representative about a complaint that is not related to the transaction to be corrected, the VFC Program is still available.

The VFC Program cannot be used if there is any evidence of potential criminal violations.

Revised Procedure for VFC Program Correction

A number of changes have been made to the program to encourage its use. The steps a fiduciary must take to correct a breach through the revised VFC Program are described below.

STEP 1: Determine if identified violations can be corrected under the VFC Program.

Three types of prohibited transactions have been added to the list of transactions to be corrected. In addition, delinquent participant loan repayments have formally been added to the list of eligible transactions. Fiduciaries can now correct the following prohibited transactions under the VFC Program:

1. Delinquent Participant Contributions and Loan Repayments to Retirement Plans.
2. Delinquent Participant Contributions to Insured Welfare Plans.
3. Delinquent Participant Contributions to Welfare Plan Trusts.
4. Loan at Fair Market Interest Rate to a Party in Interest.
5. Loan at Below-Market Interest Rate to a Party in Interest.
6. Loan at Below-Market Interest Rate to a Person Who is Not a Party in Interest.
7. Loan at Below-Market Interest Rate Solely Due to a Delay in Perfecting the Plan's Security Interest.
8. Loan Amount in Excess of Plan Limitations (*new*).
9. Loan Duration in Excess of Plan Limitations (*new*).
10. Purchase of an Asset (Including Real Property) by a Plan from a Party in Interest.
11. Sale of an Asset (Including Real Property) by a Plan to a Party in Interest.
12. Sale and Leaseback of Real Property to Employer.
13. Purchase of an Asset (Including Real Property) By a Plan from a Person Who is Not a Party in Interest at a Price Other Than Fair Market Value.
14. Sale of an Asset (Including Real Property) By a Plan to a Person Who is Not a Party in Interest at a Price Other Than Fair Market Value.
15. Holding of an Illiquid Asset Previously Purchased by a Plan (*new*).
16. Payment of Benefits Without Properly Valuing Plan Assets on Which Payment is Based.
17. Duplicative, Excessive, or Unnecessary Compensation Paid by a Plan.
18. Payment of Dual Compensation to a Plan Fiduciary.

STEP 2: Use the VFC Program method of correction.

The program provides specific correction methods for each of the 18 covered transactions. It also provides detailed guidance for determining the amount to be restored to the plan, including calculation of lost earnings, if any. The appropriate correction must be made before the VFC application is submitted. Unlike the IRS correction program (EPCRS), there is no ability to negotiate a correction method under the VFC Program.

The correction methods relating to retirement plans, including the calculation methods for plan losses or earnings, are described in the document titled "[Eligible Transactions and Corrections Under the VFC Program](#)." The revised VFC Program contains simplified calculation methods for determining lost earnings, including an [Online Calculator](#) to automatically perform calculations.

The cost of the correction cannot be paid from plan assets.

STEP 3: File an application with the appropriate EBSA Regional Office.

The DOL has now provided a [model application form](#) that filers may use to assist with submissions. Although filers are not required to use this form, the DOL encourages its use to avoid common errors that result in processing delays and rejections. The form provides an outline of the information and supplemental documentation that must be submitted, as well as the required Penalty of Perjury Statement, which has also been simplified.

A plan fiduciary, plan sponsor, party in interest, or other person who is in a position to correct a fiduciary breach must prepare the VFC Program application. An attorney or accountant authorized to represent one of these persons may also prepare the application. Each application must include the name, address and telephone number of a contact person who is authorized to respond to questions from the EBSA.

The revised program simplifies the application process by:

- Not requiring applicants to provide information regarding the plan's fidelity bond; and
- Permitting filers to provide summary documentation when delinquent participant contributions or loan repayments are being corrected and either: (1) the amount involved is \$50,000 or less, or (2) the amount involved is more than \$50,000 but the contributions were remitted within 180 days of their due dates.

Each application must include

- A detailed narrative describing the error and the corrective action;
- Supporting documentation, such as copies of relevant plan documents, documentation establishing Lost Earnings and Restoration of Profits amounts, if applicable, and proof of payment;
- A Penalty of Perjury Statement; and
- A completed and signed [Checklist](#).

The application must be sent to the appropriate EBSA Regional Office. We have provided a list of the [EBSA Regional Offices](#) in a separate document.

STEP 4. No-Action Letter

If the application meets all requirements of the program, EBSA will issue a no-action letter. This letter states that EBSA will not conduct a civil investigation or assess the 20% penalty regarding the transaction(s) corrected under the VFC Program. However, the no-action letter does not prevent EBSA from investigating to ensure the VFC Program application was factual and complete, and that the corrective action was taken.

Relief from Excise Taxes for Certain Transactions

The IRS generally imposes a 15% excise tax when a prohibited transaction occurs. Although the VFC Program prevents the imposition of the DOL's 20% penalty, the IRS excise tax is generally still imposed. However, the IRS will not impose the 15% excise tax for four specific transactions if certain requirements are met.

The four transactions that are eligible for the excise tax relief are:

- Delinquent participant contributions and/or loan repayments to pension plans, if the contributions or loan repayments are submitted no more than 180 days late.
- Loans at fair market interest rate to a party in interest with respect to the plan.
- Purchase or sale of an asset (including real property) between a plan and a party in interest at fair market value.
- Sale and leaseback of real property to the employer.

Prohibited transactions that do not fall into one of these four categories are not exempt from the excise tax, even if corrected under the VFC Program.

For any of these four prohibited transactions to qualify for the excise tax exemption, all of the following requirements must be met:

- The transaction is corrected under the VFC Program, and the applicant receives a no-action letter.
- With respect to the last three transactions described above, the plan assets involved in the transaction did not exceed 10% of the fair market value (as defined in the [“Glossary of Special VFC Terms”](#)) of all plan assets at the time of the transaction. In addition, the transaction was at least as favorable to the plan as the terms available in arms-length transactions between unrelated parties.
- The transaction was not part of an agreement, arrangement or understanding designed to benefit a party in interest.
- The applicant has not used the VFC Program and received excise tax relief for a similar type of transaction for the three-year period before the date of submission of the VFC application.
- Interested persons are given a notice within 60 calendar days after the date the VFC application is submitted.

To meet the notice requirement:

- The notice must include an objective description of the transaction and the steps taken to correct it.
- The notice must be written in a manner that the average plan participant or beneficiary can understand.
- The notice must provide for a 30-calendar day period in which interested persons can provide comments to EBSA. The comment period begins on the day the notice is distributed.
- Within 60 days of the VFC submission, EBSA is given a copy of the notice, including the date it was distributed.

The cost of preparing and distributing the notice cannot be paid from plan assets.

The notice can be distributed by a bulletin board posting where it is reasonable to believe all interested persons will see it, by sending it through regular mail or electronic mail, or by any combination of methods.

At the same time that the DOL revised the VFC Program, it also issued a proposed prohibited transaction class exemption to provide excise tax relief for a fifth transaction. The proposed exemption would apply to a plan’s purchase of certain assets that have become illiquid, and/or the sale of these assets to a party in interest, provided the plan receives the higher of the fair market

value at the time of correction, or its original purchase price, plus incidental costs. However, excise tax relief for this transaction is not available until the DOL issues final rules on this exemption.

Limitations to the VFC Program

A no-action letter promises only that EBSA will not investigate or assess a penalty for the specific breach described in the VFC Program application. EBSA can still take any of the following actions:

- Conduct a criminal investigation of the transaction;
- Make appropriate referrals of criminal violations;
- Seek to remove any person responsible for the transaction from positions of responsibility with respect to the plan;
- Refer information about the transaction to the IRS;
- Impose penalties for failure or refusal to file a timely, complete, and accurate annual Form 5500.

Use of the VFC Program and receipt of a no-action letter does not prevent a government agency other than EBSA from taking enforcement action regarding the breach.

Additional Information about Correction of Delinquent Contributions

Due to the number of inquiries received, the DOL has published a list of frequently asked questions about the VFC Program correction method for delinquent contributions. The list is available at http://www.dol.gov/ebsa/faqs/faq_vfcp2.html.

Next Steps

Plan fiduciaries and their legal counsel should decide whether to review plan transactions to ensure no ERISA requirements have been violated. If fiduciary breaches have occurred, the individuals responsible should discuss the VFC Program with their legal counsel to determine if it is appropriate for their situation.

Pension Analyst by Prudential Retirement

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