Comments on Voluntary Fiduciary Correction Program

May 18, 2000

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VFC Program
Office of Enforcement
Pension and Welfare Benefits Administration
U.S. Department of Labor
Room N5702
200 Constitution Avenue, NW
Washington, D.C. 20210

Re: Voluntary Fiduciary Correction Program

Dear Ms. Smith:

The American Society of Pension Actuaries (ASPPA) offers the following comments in regard to the Department of Labor's Notice of a Voluntary Fiduciary Correction Program (VFC Program), announced in Volume 65 of the Federal Register at pages 14,164 and following on March 15, 2000. ASPPA fully supports the efforts of the Department to develop and carry out the VFC Program and congratulates the Department on the deliberate and thoughtful manner in which the Department has advanced the VFC concept.

ASPPA is a national organization of approximately 3,700 members who provide actuarial, consulting, administrative, legal and other professional services for about one-third of the qualified retirement plans in the United States, the majority of which are maintained by small businesses. ASPPA's mission is to educate pension actuaries, consultants, administrators and other benefits professionals and to preserve and enhance the private retirement system as part of the development of a cohesive and coherent national retirement income policy. Its large and broad based membership gives it unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by smaller employers.

As the original proponents of a voluntary fiduciary correction program, ASPPA welcomes the release of VFC and appreciates the Department's willingness to embark on this effort. ASPPA believes that VFC in its current form is an important development in obtaining greater voluntary compliance with the fiduciary requirements of ERISA and in providing greater benefit security for participants. Nevertheless, we believe that the program as currently structured is only a first step, and we offer these comments with a view to improving the program so that it may gain widespread acceptance and become an important tool in fiduciary compliance.

We believe that the success of the Internal Revenue Service's Employee Plans Compliance Resolution System (EPCRS) (IRS Rev. Proc. 2000-16) was facilitated by frequent public statements by IRS officials that applicants would not be unduly targeted and that the required corrections, penalties and fees would be reasonable from the sponsor's perspective. It is our suggestion that the Department can enhance the chances for success of the VFC Program by similarly stating in appropriate public forums that applicants will not be subject to investigations at a rate greater than non-applicants and by requiring corrections that are reasonable from the fiduciary's perspective.

ASPPA has the following suggestions that we believe will increase acceptance and use of VFC:

1. Anonymous Pre-application Contact. We strongly believe that the success and utility of VFC, and voluntary correction in general, will be substantially increased by clearly establishing the ability of fiduciaries, plan sponsors and their advisors to preliminarily contact the Department on an anonymous basis to discuss potential fiduciary breaches and methods of correction. It is the opinion of ASPPA that such no-name discussions can, and should, include the negotiation of tentative correction methods that will not be binding on the Department upon the later filing of a VFC application with respect to the transaction that was the subject of the anonymous discussions.

ASPPA suggests that, at a minimum, the VFC Program incorporate a provision permitting ERISA practitioners to discuss a case informally with the Department, on an anonymous basis, to ensure that the transaction at issue is eligible for the VFC Program. This could be similar to the procedures long used in the IRS's Walk-in Closing Agreement Program of EPCRS. The purpose of the anonymous discussion would be to obtain feedback on whether a potential applicant should use the VFC Program, what methods of correction would be acceptable (in

situations not covered by the Department's guidance or where the guidance is reasonably subject to different interpretations), and, in rare circumstances, to clarify ambiguities that may arise concerning potential criminal aspects.

2. Broader Scope of No-Action Letter. The VFC Program provides that the Department generally will issue the applicant a no-action letter with respect to a breach identified in the application if: (1) the eligibility requirements of Section 4 of the VFC Program are satisfied; and (2) a Plan Official corrects a breach. Section 2(a) of the VFC Program and the language of the sample no action letter in Appendix A to the Program indicate only that Department will not initiate a civil investigation under Title I of ERISA regarding the responsibility of the Plan Official who is the applicant for any transaction described in the no-action letter and that Department will not assess a civil penalty under section 502(l) of ERISA on the correction amount paid to the plan by the applicant.

It is crucial to the success of VFC that the no-action letter issued by the Department under the Program should protect not only the applicant but also any identified Plan Official or other party potentially responsible for a breach described in the application from civil enforcement action initiated by Department. The applicant may not necessarily be the person(s) or entity responsible for the breach. This would permit a corporate employer, for example, to correct a fiduciary error and protect both the corporate employer and its employees, officers, directors and agents who may otherwise be exposed to individual fiduciary liability. Possible criminal liability would not be affected. Because an application under VFC will be successful only if there has been full correction of the transaction, as specified by the Department, we believe that a broader scope of relief should be afforded by the no action letter.

3. Limitation on Sanctions. Section 2(c)(6)(i) of the VFC Program states that compliance with the terms of the VFC Program will not preclude the Department from taking any action, such as removing persons from positions of responsibility with respect to a plan or pursuing other non-monetary injunctive relief, against any person responsible for the transaction at issue. Reserving broad, open-ended enforcement actions by The Department can only dampen the attractiveness of the VFC Program because of potential adverse consequences of participating in the correction effort. We believe that the Department should limit possible penalty actions under Section 2 of the VFC Program, such as removal of person(s) serving as fiduciaries with respect to a plan, to egregious violations identified in the application. In our view, this minimum level of protection is necessary to encourage applicants to come forward under the Program.

Section 2(e) of the VFC Program provides that the Department also reserves the right to conduct an investigation and take any other enforcement action relating to a transaction identified in a VFC Program application in certain circumstances, such as prejudice to the Department that may be caused by the expiration of the statute of limitations period. Thus, theoretically, an application may trigger a protective suit by the Department if the Department believes the application will not be approved and the statute of limitations is about to expire. Without further assurances from the Department, it is possible many potential VFC Program applicants will wait until the applicable statute of limitations expires before considering the VFC Program. This delaying effect will not help to protect plan participants and beneficiaries.

4. Greater Flexibility in Correction Method. Section 7, "Description of Eligible Transactions and Corrections under the VFC Program," imposes limitations on application of the Program as follows:

(1) The Department will not accept applications concerning correction of breaches not described in Section 7.

(2) The Program provides in Section 7 that the correction methods set forth therein "are the only acceptable correction methods under the VFC Program for the transactions described."

We believe that wider acceptance of VFC and successful voluntary correction will be encouraged by broadening the scope of transactions which qualify for correction under the Program, and by permitting corrections not described in Section 7 following informal guidance through the anonymous preapplication review discussed in paragraph 1. It is also the opinion of ASPPA that VFC will be more successful if more flexible methods as to the means of correction under Section 7 are applied. For instance, the correction method prescribed for transaction No. B.3 in Section 7 (Loan at Below-Market Interest Rate to a Person Who Is Not a Party in Interest) provides that the sole means of correction consists of:

a. The borrower "or the Plan Official" must pay the Principal Amount plus Lost Earnings through the recovery date and

b. "The Plan Official" must also pay the difference in the value of the remaining payments on the loan.

There are a number of equally compensatory means of correction that could be allowed in this instance including:

(1) A renegotiation of the loan with the borrower as of the Recovery Date to impose the appropriate interest rate.

(2) Acquisition of the loan, without any discount, by the Plan Official as of the Recovery Date and after the plan had received an amount equivalent to the appropriate interest rate through the Recovery Date.

(3) Sale of the loan to an unrelated third party as of the Recovery Date and after the plan had received an amount equivalent to both the appropriate interest rate through the Recovery Date and any discount from outstanding balance afforded to the purchaser.

All of the above additional means of correction would make the plan whole and allow some flexibility in means of correction.

In circumstances involving correction of a prohibited loan, the correction method should not be limited to repayment. In certain circumstances distribution of the loan to the party in interest is an appropriate correction.

In addition, ASPPA believes that the VFC Program should permit, in appropriate circumstances, correction of a prohibited transaction by means of a transaction that would otherwise be prohibited. Reasonable safeguards and requirements, such as are required for a prohibited transaction exemption, could be incorporated into VFC.

5. Revision of "Correction Amount." Under Section 7.3, "Sales and Leaseback of Real Property to Employer," footnote 9 talks about how the resale to the plan will simply be the reversal of a prohibited transaction and therefore permissible as long as the plan did not make improvements while it owned the property. The Department should discuss appropriate methods of correction if improvements have been made because normally this is what happens in the case of leased unimproved real property.

More generally, and in coordination with the EPCRS program of the IRS, the Department should permit, under VFC Section 5(b)(5), parallel filings with both the IRS program and the VFC Program. Section 5(b)5 should explicitly permit correction consistent with the correction methods set forth in Rev. Proc. 2000-16, since employers may be correcting the same error simultaneously under both VFC and EPCRS. In this connection, it is noted that the IRS has announced that correction under the VFC Program will, in most cases, be accepted by IRS as sufficient correction for EPCRS purposes.

VFC should be expanded to include other fiduciary breaches. One area where there is a need for the Program involves a plan that has entered into a contract with a service provider or custodian involving an excessive surrender charge. Another involves a fiduciary who realizes too late that it has failed to monitor investments causing a loss to the plan.

In addition, we believe that the "General Rules for Acceptable Correction" set forth in Section 5 may be overly harsh in that the "correction amount" as defined in Section 5 includes not only a calculation of "lost earnings" (as defined therein) but also a requirement that "restoration of profits" be calculated as an alternative measure. We request that the Department reconsider the element common to each of the correction methods which requires restoration of profit. We are concerned that fiduciaries may avoid utilizing the VFC Program in situations in which restoration of profits exceeds lost earnings. Profit of the fiduciary should not be used as a measure of the correction amount unless there is shown to exist a causal connection between the use of plan assets and the profit made by the fiduciary. Leigh v. Engle (7th Cir. 1984) 727 F.2d 113; 4 EBC 2702. Because Section 5(b)6 may lead to windfall gain for participants, we recommend that correction of transactions be restoration of the principal amount plus lost earnings rather than the greater of lost earnings or restoration of profits.

6. Notice to Plan Participants Should Not be Required. ASPPA fully supports appropriate disclosure to plan participants. We believe, however, that the requirement under the VFC Program that the applicant must provide written notice of the correction and the VFC application to plan participants is not necessary for the protection of participants. The method of correction is mandated by VFC and the applicant is subject to investigation by the Department to verify the truthfulness of the application and that correction was in fact made. We further believe the notice requirement will significantly reduce the willingness of fiduciaries and plan sponsors to utilize VFC. We note that under current voluntary compliance procedures resulting from an investigation by the Department that notice to plan participants is not required. In addition, notice to plan participants is not required when a consent judgment is entered into by a fiduciary with the Department as a result of litigation by the Solicitor's Office, even though the judgment is a matter of public record. ASPPA strongly believes that it is not necessary and not

appropriate that a fiduciary or plan sponsor who voluntarily corrects under VFC be subjected to potentially onerous notice requirements that are not imposed upon fiduciaries who are the involuntary subjects of investigations or litigation by the Department. We recognize that the Department does require notice to participants, or even the public, in some circumstances, such as an application for a prohibited transaction exemption. ASPPA feels, however, that VFC is more akin to the traditional voluntary compliance sought by the Department, where notice is not required, than these other situations where notice is required. Also, we note that notice to plan participants is not required under the IRS's EPCRS Program.

ASPPA also recognizes that there may be some circumstances under VFC where notice to certain plan participants may be appropriate, such as where the current VFC Program requires a "special" notice to retirees or terminated participants who are receiving a supplemental distribution. We believe that notice to plan participants under VFC should be limited to these special situations and should not be a general requirement for all VFC applications.

Under the VFC procedure as initially proposed, Section 5(e) provides that the applicant or plan administrator must provide written notice of the correction "to all plan participants." As written, the section requires notice even to plan participants who are not affected by the correction. At a minimum, the notification requirement should be limited to those participants affected by the correction in those instances where applicable.

In addition, some clarification is necessary as to the timing for distribution of the notice. Section 5(e) requires the notice be provided "no later than the date required for distribution of the Summary Annual Report." It is assumed that the reference is to the SAR next due to be distributed following completion of the correction. However, clarification would be helpful.

7. The Example under Section 5(b)7. The example is one in which participant deferrals could be identified within two days of a payroll. The "loss date" is therefore established two days after the payroll. We believe the example should contain language such as, "assuming no unusual or change of circumstances caused delay in deposit." Even then, there is concern that the employer should have more than two days to make a deposit without incurring a penalty when the deposit is delayed on account of circumstances such as a change in payroll service and similar occurrences.

8. Independent Fiduciary. Under Section 7C, Purchases, Sales and Exchanges, 2(b) requires that the "determination as to which correction alternative the plan chooses must be made by an independent fiduciary." Compare this with (c)4 which simply requires the independent fiduciary's report that the property is a prudent investment for the plan rather than requiring that the independent fiduciary determine which course of action was correct. We suggest that the independent fiduciary only be required to approve a course of action proposed by the general plan fiduciaries rather than determining the course of action which is appropriate.

9. Form 5500 Filing Requirements. Section 2(c)(6)(iii) of the VFC Program provides that the Department may impose civil penalties under section 502(c)(2) of ERISA based on the failure or refusal to file a timely, complete, and accurate annual Form 5500 report. Under current VFC Program guidelines, amended annual report filings may be required if possible breaches of ERISA have been identified, or if action is taken to correct possible breaches in accordance with the VFC Program. ASPPA believes that it will be important to the success of VFC that the Department state that compliance with the VFC Program will not trigger retroactive liability under section 502(c)(2) of ERISA for deficient or inaccurate Form 5500 filings if such deficiency or inaccuracy relates to transactions reported in the Form 5500 filing. If complying with the VFC Program provides the Department the opportunity to identify and reject a prior Form 5500 filing for possible breaches of ERISA and thereby impose significant penalties, our concern is that many potential applicants will not utilize the VFC Program. We believe that requiring correction of a prior filing would be sufficient without leaving open the possibility of the imposition of penalties.

10. Eligibility for the VFC Program. Section 4(b) of the VFC Program makes eligibility dependent on the application containing no evidence of potential criminal violations as determined by the Department. We recommend revising section 4(b) to remove all reference to potential criminal violations. First, the Department already retains authority under section 2(c)(5) to investigate potential criminal transactions identified in a VFC application. It is therefore unnecessary to exclude the entire application from the Program.

Second, under Section 501 of ERISA, any violation of ERISA committed by a person with willful intent may be criminal. In the sample transaction described at Section 7B(2), for example, would the application for correction of the below market-interest loan require a statement that the transaction at issue was not entered into with knowledge of illegality or "willfully?" If not, what does Section 4(b) mean and why include the requirement in the

VFC Program?

Finally, the requirement unduly narrows the applicability of the VFC Program. The VFC Program should encourage employers to correct fiduciary violations, including criminal violations, committed by former employees or third parties. The current requirement of Section 4(b) of the VFC Program, however, precludes using the VFC Program in far too many cases where it would otherwise be available and helpful.

11. Required Application Statement. Section 6(b) of the VFC Program provides that the application must be prepared by a Plan Official or his or her authorized representative, such as an attorney, accountant or other service provider. Section 6(g) requires that the penalty of perjury statement be signed by a plan fiduciary with knowledge of the subject transaction and the authorized representative, if any. We see no reason why a representative, such as an attorney, accountant or other service provider, who submits a VFC application on behalf of a client should be required to sign a penalty of perjury statement concerning events that almost always will be beyond the personal knowledge of the service provider. It is sufficient that a plan fiduciary with knowledge of the subject transaction is required in all cases to sign the penalty of perjury statement.

In addition, the negative representations required by the penalty of perjury statement are significantly broader than the eligibility requirements for VFC as set out in section 4 of the Program. For example, section 4(a) requires that neither the plan nor the applicant be "Under Investigation," which is defined as meaning a plan or person that is being investigated pursuant to ERISA section 504(a), which authorizes investigations by the Secretary of Labor, or any criminal statute affecting a transaction involving an employee benefit plan. The required statement under penalty of perjury, however, must state in relevant part that the applicant has not been informed by either the Department nor any other Federal agency of an intention to investigate or examine the plan or otherwise make inquiry with respect to the transaction described in the application. We believe that a plan should be eligible for VFC even if one or more of the issues raised in the VFC application are also the subject of a civil investigation by another Federal agency, such as an IRS examination. The IRS allows plans to participate in the EPCRS program without regard to investigations by the Department.

If the Department is not willing to delete this proviso from VFC, then it should be reworded so as to eliminate the current ambiguity in the provision. Specifically, it should be reworded to state that the applicant has not been informed of an intention to investigate, examine or otherwise inquire about the plan with respect to an issue described in the application. The phrase, with respect to the issue described in the application, should be defined to mean a specific inquiry with respect to a prohibited transaction or other breach and not simply a document request that could lead to an examination of a breach set forth in the VFC application.

12. Clarification of a Determination of Interest Rates. The VFC procedure requires an independent financial institution to determine and verify the correctness of interest rates with respect to certain prohibited loans. See Section 7B, "Loans," 1(b). Some clarification would be helpful as to the means for determination of appropriate interest rates.

13. Terminated Participants. There is a requirement that evidence be presented to the Department of distributions made or attempts to find terminated participants who are entitled to additional distributions as a result of the correction of a transaction. The concern is that, in order to present this evidence as part of the application, the attempts to locate lost participants and distribute funds to them will have to be made well in advance of the filing of the application with the Department. Such pre-filing actions by the applicant could cause former participants and others to communicate to the Department and trigger an investigation before there is a chance to submit the VFC application. Thus, if the applicant has set aside the necessary funds for payment of lost participants, this should be sufficient for submission under the Program.

14. Independent Expert. Section E, "Plan Expenses," states that if the trustee pays an investment advisor more than other comparable advisors charge, then this breach can be corrected by having an appraiser determine the reasonable value of the services and require any qualifications of such appraiser to be set forth in the application. This statement is vague. Who is qualified to make the determination as to the reasonable value of the services? Perhaps the opinion of an independent "expert" would be better evidence in many instances.

15. Waiver of Excise Tax on Prohibited Transactions. ASPPA strongly believes the VFC Program should include a waiver of excise taxes on transactions corrected under VFC that are prohibited transactions. The possibility that the transaction that is the subject of a VFC application may be referred by the Department to the IRS for imposition of excise taxes is a substantial disincentive for plan sponsors and other Plan Officials to submit under the Program. ASPPA understands that the Department's prior Pension Payback Program, which appears to have served in certain respects as a pattern for parts of VFC, included a partial waiver of excise taxes. The

voluntary and remedial nature of VFC makes it appropriate to afford a waiver of excise taxes under VFC as well.

These comments are filed on behalf of ASPPA's Governmental Affairs Committee and were written principally by Anthony Karachale, Fredric Singerman and R. Bradford Huss. Others participating in the preparation of these comments were Bruce Ashton, Craig Hoffman, Michael Canan and Martin Heming.

If you have any questions with regard to this matter, please feel free to address them to any of the undersigned.

Very truly yours,

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