

BENEFITS LAW

JOURNAL

Reprinted from *Benefits Law Journal*, Winter 2005, Volume 18, Number 4, pages 72–76,
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Simplified and Expanded Voluntary Fiduciary Correction Program

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The Employee Benefits Security Administration (EBSA) recently proposed changes to the Voluntary Fiduciary Correction (VFC) Program. Although the changes are not yet final, plan fiduciaries can use the revised and expanded VFC Program immediately.

In general, the VFC Program provides employers, plans, and plan fiduciaries with relief from EBSA enforcement actions and certain penalties for specific fiduciary breaches under the Employee Retirement Income Security Act of 1974 (ERISA). The VFC Program describes the specific violations for which relief is available, the acceptable methods to correct such violations, and the VFC Program's application procedures. The proposed changes are designed to encourage employers, plans, and fiduciaries to take advantage of the VFC Program.

Simplified Application Process

The EBSA simplified the VFC Program's application procedures in several ways. The revised VFC Program now provides a model application form, simplifies calculation of correction amounts, and reduces required documentation in certain circumstances.

New Model Form

Although use of the model application form is wholly voluntary, the form assists fiduciaries by providing an outline of information and documentation that must be included in the filing. The model form requires identification of the transactions corrected under the VFC Program, the correction amount, and a detailed narrative describing the fiduciaries involved, the fiduciary breach, and the corrective actions taken. In addition, the model form includes two items required in all VFC Program applications: a VFC Program checklist and a penalty of perjury statement that must be signed and dated by a plan fiduciary with knowledge of the transaction. The model form will help practitioners avoid common application errors and will streamline applications.

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Simplified Calculations

Along with the model form, the revised VFC Program simplifies the definitions of “lost earnings” and “restoration of profits” used in the calculation of correction amounts. Under the VFC Program, the amount that must be restored to the plan, known as the “principal amount,” is based on either the losses to the plan resulting from a breach or the profits gained by improper use of plan assets.

Previously, “lost earnings” was defined as the greater of two calculations designed to place the plan in the same position as if the breach had not occurred. The first earnings calculation assumed that the principal amount was invested in accordance with applicable plan provisions, less actual net earnings or realized net appreciation or loss. The second earnings calculation assumed that the principal amount earned interest at the underpayment rate defined under the Internal Revenue Code (IRC). Section 6621(a)(2), less actual net earnings or realized net appreciation or loss.

“Lost earnings” are now calculated under the VFC Program using a three-step process whereby applicants (1) determine the applicable underpayment rate under IRC Section 6621(a)(2) for each quarter from the loss date through the date on which the plan is repaid the principal amount, known as the “recovery date;” (2) select the applicable factors under Internal Revenue Service (IRS) Revenue Procedure 95-17 for such quarterly underpayment rate for each quarter from the loss date through the recovery date; and (3) multiply the principal amount by the applicable factor for each quarter. If the recovery date is not in the same quarter as the loss date, the applicable factor for each subsequent quarter must be applied to the sum of the principal amount and all earnings as of the end of the immediately preceding quarter. Applicants must also calculate interest on lost earnings if lost earnings are paid to the plan after the recovery date, using the same methodology but applying the applicable factors to lost earnings rather than the principal amount. If the sum of lost earnings and any interest on lost earnings exceeds \$100,000, applicants must calculate the amount of lost earnings and any interest on lost earnings using a higher underpayment rate under IRC Section 6621(c)(1). Thus, since calculation of lost earnings under the VFC Program no longer requires determination of hypothetical plan investment earnings as if the breach had not occurred, the revised VFC program eliminates the need to prepare and compare multiple calculations.

Under the original VFC Program, “restoration of profits” was either the amount of actual profit from the loss date to the recovery date, or if the actual profits were indeterminable, an amount equal to the interest on the principal amount using the underpayment interest rate defined under IRC Section 6621(a)(2). In addition, if profits were

restored to the plan after the recovery date, applicants had to pay additional earnings to the plan.

The revised VFC Program requires restoration of profits only if the plan assets were used for a specific purpose, if actual profits are determinable *and* if restoration of profits exceeds any lost earnings amount plus interest. Thus, EBSA anticipates that under the revised VFC Program restoration of profits will be necessary in few instances. If required, the amount of restored profits is calculated using a method similar to that used to calculate lost earnings under the revised VFC Program, using the factors under IRS Revenue Procedure 95-17 and including the use of the alternate interest rate where the correction amount exceeds \$100,000.

New Online Calculator

To further simplify corrective calculations, the EBSA Internet site now provides an online calculator, which automatically performs VFC Program calculations. Applicants using the online calculator to determine lost earnings need only enter the principal amount, loss date, recovery date, and date of final payment. For restoration of profits calculations, applicants need only input the amount of profit, the date the profit was realized, and the date the profits were restored. In both instances, the online calculator selects the applicable underpayment rate for the relevant time period and provides the appropriate lost earnings and interest or restoration of profits amount. VFC applicants must submit calculations and supporting data with their applications. Since the online calculator does not save calculations, applicants must either print and save a copy for their records or cut and paste the calculations into a separate document. The new online calculator provides great assistance for practitioners since it requires entry of limited data to perform calculations.

Reduced Documentation

Finally, the revised VFC Program reduces the amount of supporting documentation required in many filings. In particular, the VFC Program no longer requires that applicants provide information relating to the plan's fidelity bond. In addition, employers and plan fiduciaries may now provide a summary of late contributions and repayments where correction of delinquent participant contributions involve amounts less than \$50,000, and even where corrections involve amounts greater than \$50,000 if such amounts are remitted within 180 days after receipt by the employer. This abbreviated documentation is in lieu of the more detailed information, including copies of accounting and payroll records, normally required to identify the date and amount of each contribution withheld or made to the plan.

Expansion of Excluded Plans and Fiduciaries

In general, a plan or plan fiduciary “under investigation” cannot use the VFC Program. The revised VFC Program expands the term “under investigation” to include a civil or criminal investigation or examination of either the plan or the applicant by *any* federal agency in connection with a plan transaction, including the mere notice of *any* federal agency’s intent to conduct an investigation. Previously, a person was considered “under investigation” only if subject to an investigation, or notice of investigation, by the EBSA under ERISA or any criminal statute. The EBSA notes, however, that mere contact by an agency official is insufficient to be deemed an investigation.

New Covered Transactions

The VFC Program now covers three additional transactions—participant loans that violate IRC limitations, the sale of a previously purchased illiquid asset, and a plan sponsor’s delinquent remittance of participant loan repayments.

Participant Loans Above Tax Code Limits

First, the revised VFC Program now permits correction of participant loans, where the amount or duration of the loan exceeds permitted IRC limits. Because administrative errors frequently occur in processing participant loans, this newly covered transaction may prove highly useful to plan fiduciaries. Since a prohibited transaction can occur due to administrative error and no fault of the participant, the EBSA desired to expand the VFC Program to facilitate correction of such errors. Correction under the revised VFC Program requires that the participant repay excess loan amounts to the plan with the remaining amount of the loan re-amortized or requires that the plan reform the duration of the original loan with adjusted monthly repayment amounts, as applicable. The latter correction is unavailable if the maximum repayment term permitted under the plan loan provisions has passed since the date of loan origination. Although the IRC imposes income tax if loan limits are exceeded, the EBSA has had informal discussions with the Treasury Department regarding development of a coordinated correction program to relieve associated tax liabilities for participants with loans corrected under the VFC Program.

Illiquid Assets

Second, under the revised VFC Program, a plan fiduciary may authorize a plan to divest an illiquid asset to a party in interest. The revised VFC Program describes three scenarios through which the plan may have obtained an illiquid asset where correction is required.

The first scenario involves an acquisition from a related party resulting in a prohibited transaction. In the second scenario, the plan fiduciary fails to exercise proper care in purchasing a plan asset. The third scenario simply involves a plan asset purchase from an unrelated third party that is not a prohibited transaction and involves no fiduciary breach, but nevertheless becomes an illiquid asset. In all of these scenarios, to divest the illiquid asset to a party in trust, the plan fiduciary must determine that the asset has failed to either appreciate or provide a reasonable rate of return, that sale of the illiquid asset is in the plan's best interest, and that despite reasonable efforts the illiquid asset cannot immediately be sold for its original purchase price or current market value, if greater. In this instance, the VFC Program permits the plan fiduciary to sell the illiquid asset to a party in interest for an amount equal to the higher of the fair market value of the asset on the date of the correction or its original purchase price, plus incidental costs.

Delinquent Loan Repayments

Lastly, the VFC Program now explicitly covers a plan sponsor's failure to transmit participant loan repayments to a plan within a reasonable time after withholding or receipt from a participant. The VFC Program incorporates correction of this failure into the general rules that cover other late plan contributions as previously indicated in an EBSA Advisory Opinion issued in 2002.

A Useful Guide for Corrections

Employers and plan fiduciaries have historically been hesitant to take advantage of the VFC Program for numerous reasons, including the absence of anonymity in the submission procedures and the limited excise tax relief in some instances. Others have hesitated to use the VFC Program because there is no formal self-correction option. However, the EBSA noted under the original VFC Program that if a potentially liable party corrected a transaction on its own as specified in the VFC Program, and if the transaction was later discovered on audit, any penalty assessed on an applicable recovery amount (within the meaning of ERISA Section 502(l)) would be limited to additional amounts required by EBSA to be paid following the audit. Thus, even if employers and plan fiduciaries choose not to utilize the revised VFC Program, the correction methods set forth under the VFC Program should prove useful in shaping self-correction methods and presumably should limit potential penalty amounts in the event of an audit. The VFC Program provides a number of helpful examples of correction methods, and the online calculator can help employers and plan fiduciaries more readily determine the costs of such corrections.