Prohibited Transactions

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Overview

- Introduction to the prohibited transaction rules
- Types of exemptions
- Consequences of a prohibited transaction
- Addressing a prohibited transaction
- Department of Labor enforcement activity and prohibited transaction litigation

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Introduction

- The basics of how ERISA works - seemingly everything is prohibited unless an exemption permits otherwise
- Prohibited transactions apply to more than fiduciaries . . . to be explained shortly
- But not every action creates a prohibited transaction and mistakes people make in assuming a prohibited transaction has occurred

Introduction

- ERISA section 406(a) party in interest transactions
  - Defining "party in interest"
  - Types of prohibited transactions
    - Sale or exchange between a plan and a party in interest
    - Any loan or extension of credit between a plan and a party in interest
    - Any transfer of assets from the plan
    - Use of plan assets by or the benefit of a party in interest

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Introduction

- ERISA section 406(b) fiduciary conflicts of interest
- Types of prohibited transactions
  - A use of assets by a fiduciary for his or her own interest for his or her own account
  - Representation of an adverse party in a transaction involving a plan
  - Receipt of consideration for a personal account from any party dealing with a plan transaction involving plan assets

Introduction

- Plans that are covered by the prohibited transaction rules
  - Any plan covered by ERISA – including welfare plans
  - Plan asset “vehicles”
  - Code section 4975 at IRAs and HSAs

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Types of Exemptions

- Statutory exemptions in ERISA and/or the Code
- Class exemptions
- Individual prohibited transaction exemptions

Types of Exemptions

- Commonly used statutory exemptions
  - ERISA section 408(b)(1): participant loans
  - ERISA section 408(b)(2): reasonable compensation
  - ERISA section 408(b)(8): trustees
  - ERISA sections 408(b)(14) and 408(g): investments
  - ERISA section 408(b)(17): transactions with plan service providers

Types of Exemptions

- Commonly used class exemptions
  - PTE 84-14: qualified professional asset managers
  - PTE 80-26: interest fee loans
  - PTEs 91-38 and PTE 90-1: bank collective trusts and insurance pooled separate accounts
  - PTEs 77-3 and 77-4: mutual fund exemptions
  - New: PTE 2016-1: best interest contract exemption

Types of Exemptions

- Individual prohibited transaction exemptions
  - Exemption needs to be:
    - Administratively feasible
    - In the interests of the plan, its participants, and beneficiaries
    - Protective of the rights of participants and beneficiaries
  - Individual exemptions and EXPRO (PTE 96-62)
  - Example: company stock or company assets

Consequences

- Impact on ERISA-covered pension and welfare plans
  - ERISA section 409: fiduciary responsibility for loss and/or disgorgement as well as non-fiduciaries
  - Form 5500 Schedule H reporting and impact

Consequences

- Impacts on Tax-Qualified Plans, IRAs, and HSAs
  - Disqualified person (party in interest) is liable for 15 percent of the "amount involved" per calendar year until correction
  - Certain transactions imposed the tax on fiduciaries
  - IRA prohibited transacts can result in disqualification rather than excise tax
  - Potential exposure to 100 percent of the "amount involved"

Addressing PTs

- First . . . evaluating the potential prohibited transaction
- Second . . . remedying the potential prohibited transaction

Addressing PTs

- Evaluating the potential prohibited transaction
  - Don’t assume that a prohibited transaction exists
  - Parse the definitions of “party in interest” and “disqualified person”
  - Remembering that an ERISA section 406(b) violation can be avoided where a fiduciary does not have authority or control in a particular transaction

Addressing PTs

- Debunking common assumptions
  - A prohibited transaction can occur even where there is no evidence of a fiduciary advancing its own interests – mere existence of a conflict can cause a prohibited transaction
  - A prohibited transaction can occur even in the absence of a direct transaction between a plan and a party in interest
  - Lack of intent will not always protect a fiduciary

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Addressing PTs

- Common remedies
  - Self-correcting, checking the box, and paying Code section 4975 excise tax
  - Correcting and filing under the Department of Labor Voluntary Fiduciary Compliance Program
  - Self-correcting and seeking a retroactive exemption

Enforcement and Litigation

- Department of Labor enforcement
  - Role in investigations
  - Voluntary compliance letters
  - Settlement and litigation
- Private litigation
  - Common claims
  - How prohibited transactions play out in litigation

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Questions?

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50 YEARS OF MAKING RETIREMENT PLANS WORK