

WICKENS
HERZER
PANZA
COOK &
BATISTA

Richard A. Naegele

Attorney at Law

RNaegele@wickenslaw.com

Direct Dial: 440-930-8074

Main: 440-930-8000

Cleveland: 216-447-4418

Facsimile: 440-937-4466

35765 Chester Road
Avon, OH 44011-1262

ERISA FIDUCIARY ISSUES/ AVOIDING AND DEALING WITH PROHIBITED TRANSACTIONS

by

Richard A. Naegele, J.D., M.A.
WICKENS, HERZER, PANZA, COOK & BATISTA CO.
35765 CHESTER ROAD
AVON, OH 44011-1262
RNaegele@wickenslaw.com

Creative Pension and Benefits Seminar

**The Ohio State University
Columbus, Ohio**

May 5, 2006

ERISA FIDUCIARY ISSUES/ AVOIDING AND DEALING WITH PROHIBITED TRANSACTIONS

by Richard A. Naegele, J.D., M.A.

TABLE OF CONTENTS

	<u>Page</u>
I. WHO IS A FIDUCIARY? ERISA §3(21)(A)	1
A. Broad Definition.	1
B. Categories of Fiduciaries.	1
C. Functional Test.....	1
D. Ministerial Functions May Not Be Fiduciary Functions.....	1
II. FIDUCIARY DUTIES. ERISA §404.	2
A. General ERISA Fiduciary Duties.....	2
B. Fiduciary Liability.....	3
C. Bonding.....	3
III. PLANS COVERED BY ERISA FIDUCIARY RESPONSIBILITY RULES. ERISA §§4; 401	3
A. Covered Plans.	3
B. Exempt Plans.	3
IV. PROHIBITED TRANSACTIONS. ERISA §406; IRC §4975	4
A. Parties in Interest.....	4
B. Express Prohibitions for Parties in Interest. ERISA §406(a)	4
C. Fiduciary Prohibited Transactions. ERISA §406(b)	5
D. Prohibited Transactions Are Per Se Violations.....	5
E. Excise Tax on Prohibited Transactions. IRC §4975.	5
F. Individual Retirement Accounts.	6
G. Permitted Activities.....	7
H. Prohibited Transaction Statutory Exemptions. ERISA §408(b); IRC §4975(d)	7
V. PARTICIPANT DIRECTION OF RETIREMENT PLAN INVESTMENTS. ERISA §404(c).	8
A. §404(c) Relief From Some ERISA Standards.....	8
B. Compliance Not Mandatory; Failure to Comply with Section 404(c).	9
C. No Standard for Other Fiduciary Decisions.	9
D. Section 404(c) Requirements. 29 CFR §2550.404c-1.....	9
E. Retained Fiduciary Duties.....	10
F. Sarbanes-Oxley Act of 2002 (SOA).....	10
VI. DOL GUIDANCE FOR FIDUCIARIES.....	11
A. Meeting Your Fiduciary Responsibilities.	11
B. Essential Elements of a Plan.	11
C. Information to be Provided to Employees.....	12
D. Tips for Employers with Retirement Plans.	12
VII. FIDUCIARY RULINGS IN ENRON LITIGATION.....	13
A. Rulings Expand Scope of Fiduciary Responsibilities.	13

**VIII. ALLOCATION OF ADMINISTRATIVE EXPENSES BETWEEN PLAN AND EMPLOYER.
DOL ADVISORY OPINION 2001-01A; DOL FIELD ASSISTANCE BULLETIN 2003-3. 14**

- A. Plan Assets May Be Used to Pay Reasonable Administrative Expenses.
ERISA §404(a)(1)(A) 14
- B. Early Department of Labor Rulings. 14
- C. DOL List of Plan Expenses. 15
- D. Department of Labor opinions. 16
- E. Allocation of Expenses to Former Employees 17
- F. Employer Deduction of Plan Expenses. 17

ERISA FIDUCIARY ISSUES/ AVOIDING AND DEALING WITH PROHIBITED TRANSACTIONS

I. WHO IS A FIDUCIARY? ERISA §3(21)(A)

A. Broad Definition.

ERISA provides a broad definition of who is a fiduciary. The term includes any person or entity who:

1. exercises any discretionary authority or control with respect to a plan. ERISA §3(21)(A)(i);
2. exercises any authority or control with respect to the management or disposition of a plan's assets. ERISA §3(21)(A)(i);
3. renders investment advice with respect to a plan's assets for a fee or other compensation or has authority or responsibility to do so. ERISA §3(21)(A)(ii); or
4. has discretionary authority or responsibility with respect to the administration of the plan. ERISA §3(21)(A)(iii).

B. Categories of Fiduciaries.

The following persons will be considered to be fiduciaries:

1. Plan trustees;
2. Plan administrator;
3. Members of investment or administrative committee;
4. Investment manager; or
5. Any person who selects or appoints any of these people.

C. Functional Test.

There is generally no consent necessary for a person to be considered a fiduciary. If a person has or exercises authority or control over or oversees or engages in the activities listed in ERISA §3(21)(A), he or she can be a fiduciary. *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

D. Ministerial Functions May Not Be Fiduciary Functions.

1. Persons who perform purely ministerial functions within the framework of policies, interpretations, rules, practices, and procedures established by

fiduciaries are generally not fiduciaries. DOL Reg. (29 CFR) §2509-75-8, Q&A D-2.

2. Ministerial functions may include:
 - a. application of rules determining plan eligibility for benefits;
 - b. calculation of benefits;
 - c. preparation of employee communication materials;
 - d. maintenance of employee service records;
 - e. preparation of required government reports or other reports concerning participants;
 - f. orientation of new employees to rights under plan;
 - g. collection of contributions and allocation of contributions as provided in plan;
 - h. processing of claims.
3. It may be difficult to distinguish between ministerial duties and management responsibilities.
4. Attorneys, accountants, actuaries, consultants, and advisers (other than investment advisers) will not normally be considered fiduciaries in the performance of their normal duties. It is possible, however, for consultants to be fiduciaries. DOL Reg. (29 CFR) §2509-75-5.

II. FIDUCIARY DUTIES. ERISA §404.

A. General ERISA Fiduciary Duties.

1. To act solely in the interest of plan participants and beneficiaries. ERISA §404(a)(i);
2. To act for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses in administering the plan. ERISA §404(a)(1)(A);
3. To exercise the same care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with like aims. ERISA §404(a)(1)(B);
4. to diversify plan investments so as to minimize the risk of large losses (unless it is clearly not prudent to do so under the circumstances). ERISA §404(a)(1)(C);

5. To act in accordance with the documents and instruments governing the plan (unless the documents are inconsistent with ERISA). ERISA §404(a)(1)(D); and
6. No fiduciary may maintain indicia of ownership of any assets outside jurisdiction of U.S. district courts. Exceptions in DOL Reg. §2550.404b-1.

B. Fiduciary Liability.

ERISA permits a civil action to be brought by a participant or beneficiary against a fiduciary who has breached his duty. The fiduciary may be held personally liable for any losses to the plan resulting from his or her breach. Any profits obtained by the fiduciary through the use of plan assets must be turned over to the plan.

A fiduciary, however, should not be held liable for a breach of fiduciary duty that was committed prior to becoming a fiduciary. Although the fiduciary may not be liable for the original breach, if he knows about the breach, he should take steps to remedy the situation. Failure to do so could constitute a subsequent independent breach of fiduciary duty by the successor fiduciary.

C. Bonding.

Every fiduciary and anyone who handles funds or other property of the plan, must be bonded. The bond must cover at least 10% of the amount handled by the bonded individual; it may not be less than \$1,000 and need not be for more than \$500,000.

III. PLANS COVERED BY ERISA FIDUCIARY RESPONSIBILITY RULES. ERISA §§4; 401

A. Covered Plans.

Employee benefit plans (welfare plans and retirement plans) maintained by an employer or an employee organization.

B. Exempt Plans.

Plans exempt from rules:

1. Government plans.
2. Church plans for which no election has been made to have provisions of ERISA apply.
3. Plan maintained solely for complying with workers compensation, unemployment or disability insurance laws.

4. Plan maintained outside U.S. primarily for benefit of persons substantially all of whom are nonresident aliens.
5. Excess benefit plan which is unfunded.
6. Unfunded plans maintained by employers primarily to provide deferred compensation to select group of managers or highly compensated employees ("top-hat plans").
7. Agreement described in IRC §736 which provides payments to retired or deceased partner or deceased partner's successor in interest.
8. Keogh plan covering only owner-employees.

IV. PROHIBITED TRANSACTIONS. ERISA §406; IRC §4975

A. Parties in Interest

ERISA §406 lists certain persons or entities defined as "parties in interest". IRC §4975 defines a similar group as "disqualified persons". This group includes:

1. Any fiduciary to, counsel to, or employee of the plan;
2. A person providing services to the plan;
3. An employer any of whose employees are covered by the plan, and any direct or indirect owner of 50% or more of such employer;
4. A "relative", that is, spouse, ancestor, lineal descendant, or spouse of a lineal descendant, or any of the persons or organizations described in (1), (2), or (3);
5. An employee organization, any of whose members are covered by the plan;
6. A corporation, partnership, estate, or trust of which at least 50% is owned by any person or organization described in (1), (2), (3), (4), or (5) above.
7. Officers, directors, 10%-or-more shareholders, and employees of any person or organization described in (2), (3), (5), or (6) above; and
8. A 10%-or-more partner of a joint venturer with any person or organization described in (2), (3), (5), or (6) above.

B. Express Prohibitions for Parties in Interest. ERISA §406(a)

The Plan and the Parties in Interest are expressly prohibited from engaging in any of the following transactions:

1. sale, exchange or leasing of any property between the plan and a party-in-interest. ERISA §406(a)(1)(A);

2. lending of money or other extension of credit between a plan and a party-in-interest. ERISA §406(a)(1)(B);
3. furnishing of goods, services or facilities between the plan and a party-in-interest. ERISA §406(a)(1)(C);
4. transfer to, or use by or for the benefit of a party-in-interest of any asset of the plan. ERISA §406(a)(1)(E); or
5. Acquisition of employer securities or employer real estate property in excess of limits set by law.

C. Fiduciary Prohibited Transactions. ERISA §406(b)

In addition to the prohibited transactions listed in ERISA §406(a), ERISA §406(b) prohibits fiduciaries from:

1. Dealing with plan assets in the fiduciary's own interest or for the fiduciary's own account;
2. Acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries; or
3. Receiving any consideration for the fiduciary's own personal account from any person dealing with the plan in connection with any transaction involving plan assets.

D. Prohibited Transactions Are Per Se Violations.

A Party in Interest cannot enter into a prohibited transaction or cause or allow a plan to do so regardless of motives.

1. Even if transactions would be considered fair and reasonable and show no evidence of scandal or bad faith.
2. Penalty is personal liability for any losses or repayment of any benefit or profit received by the Party in Interest.

E. Excise Tax on Prohibited Transactions. IRC §4975.

1. IRC §4975 provides for an excise tax in the amount of 15% of the amount involved in the prohibited transaction for the period beginning on the date on which the prohibited transaction occurs and ending on the earliest of:
 - a. when the transaction is corrected;
 - b. when a deficiency notice is issued; or
 - c. the date the tax is assessed. IRC §4975(f)(2).

2. The excise tax is assessed annually for each year that the prohibited transaction is outstanding.
3. The excise tax for prohibited transactions occurring prior to August 20, 1996 was 5% of the amount involved in the transaction. It was 10% for prohibited transactions occurring from August 20, 1996 to August 5, 1997, and was increased to 15% for prohibited transactions occurring after August 5, 1997.
 - a. In Revenue Ruling 2002-43, the IRS stated that the applicable excise tax rate for each prohibited transaction is the rate in effect in the first year that the transaction occurred. The rate is then applicable to all years of the prohibited transaction.
4. Although an additional second tier 100% tax may be assessed if the transaction is not corrected within the applicable period, the party in interest/disqualified person has an additional ninety (90) days to correct the transaction and avoid the additional tax. IRC §4975(b).
5. The excise taxes on prohibited transactions are assessed against the party in interest/disqualified person involved in the transaction, not against the plan. IRC §4975(a) and (b).
6. The amount involved in a loan for purposes of the excise tax is the interest on the loan amount, not the entire amount of the loan.
7. Prohibited transaction excise taxes are paid with the filing of IRS Form 5330.
8. Prohibited Transaction Example.
 - a. Party in Interest sells real estate to plan for \$200,000 on 12/15/2001 and corrects transaction on 1/15/2004.
 - b. Excise tax calculation:

1)	2001:	\$200,000	x	.15	\$ 30,000
2)	2002:	\$200,000	x	.15	\$ 30,000
3)	2003:	\$200,000	x	.15	\$ 30,000
4)	2004:	\$200,000	x	.15	\$ 30,000
5)	Total Excise Tax:				\$120,000

F. Individual Retirement Accounts.

1. Prohibited transactions in IRAs have disastrous consequences. A prohibited transaction involving the individual who established the IRA or an IRA beneficiary results in loss of the IRA's status as an IRA. IRC §408(e)(2)(A).
2. The IRC treats the entire IRA as being distributed to the IRA owner or beneficiary on the first day of the taxable year in which the prohibited

transaction occurs. IRC §408(e)(2)(B). Thus, the entire balance in the IRA is included in the gross income of the recipient. The amount includable in income is the fair market value of the IRA on the first day of the taxable year during which the prohibited transaction occurs. Treasury Regulation §1.408-4(d)(1).

3. The excise tax under IRC §4975 is not assessed against the IRA owner or beneficiary as a result of the prohibited transaction.

G. Permitted Activities.

ERISA does not prohibit fiduciaries from:

1. Receiving any benefit from a plan for which the fiduciary is entitled as a participant or beneficiary, calculated and paid on a basis consistent with all other participants and beneficiaries.
2. Receiving reasonable compensation for services rendered, or reimbursement of expenses incurred, while performing services for the plan.
 - a. If fiduciary receives full-time pay from employer or union sponsoring the plan, payment is limited to reimbursement for expenses properly incurred.
3. Serving as a fiduciary in addition to being an officer, employee, agent or other representation of a party in interest.

H. Prohibited Transaction Statutory Exemptions. ERISA §408(b); IRC §4975(d)

1. Certain loans to participants and beneficiaries.
2. Reasonable arrangements with parties in interest for office space and for legal, accounting, or other services needed for the plan.
3. Certain loans to ESOPs.
4. Certain investments by plans in deposits in banks or similar financial institutions whose employees are covered by the plans.
5. Certain contracts for insurance between a plan and an employer maintaining the plan or party in interest.
6. Provision of ancillary bank services to a plan by a bank or similar financial institution that is a fiduciary of the plan.
7. Exercise by a plan of a privilege to convert securities.
8. Various transactions between a bank and certain common or collective trust funds or pooled investment funds.

9. Distribution by a fiduciary of plan assets in accordance with the plan and ERISA.
10. Transactions required or permitted in accordance with withdrawal provisions in multi-employer plans.
11. Mergers of multi-employer plans, or transfers of assets between multi-employer plans where the PBGC determines they meet ERISA requirements.
12. Qualified transfers of assets from single-employer defined benefit plans to qualified retiree health accounts.

I. Administrative Exemptions and Individual Prohibited Transaction Exemptions.

1. In addition to the statutory prohibited transaction exemptions, the Department of Labor (DOL) has authority to grant class exemptions. Class exemptions provide relief for any fiduciary or party in interest meeting the conditions of the exemption.
2. Individual exemptions grant relief from the prohibited transaction provisions for particular transactions identified and described in detail to the DOL. Factors considered by the DOL include:
 - a. the percentage of plan assets involved in the transaction;
 - b. the return on the investment compared to other investments representing a similar risk to the plan;
 - c. the value of the property involved as determined by an independent appraisal or an independent market mechanism in the transaction; and
 - d. whether an independent fiduciary has reviewed the terms of the transaction and will monitor compliance. DOL Reg. §2570.35.

V. PARTICIPANT DIRECTION OF RETIREMENT PLAN INVESTMENTS. ERISA §404(c).

A. §404(c) Relief From Some ERISA Standards.

In the case of individual account plans that permit participants to exercise control over the assets in their accounts, Section 404(c) provides *partial* relief from the standards that otherwise govern fiduciary conduct.

1. If participants actually exercise control over the assets in their accounts, plan fiduciaries will not be liable for any losses that are the direct result of the participants' control.

2. The protection of Section 404(c) is available only to defined contribution plans that allow participant-directed investments, such as 401(k) plans and profit sharing plans. Section 404(c) relief is not available for defined benefit pension plans.

B. Compliance Not Mandatory; Failure to Comply with Section 404(c).

Compliance with Section 404(c) is not mandatory and failure to comply with Section 404(c) does not of itself cause a plan to violate ERISA.

1. Failure to comply simply means that plan fiduciaries may continue to be responsible under ERISA for participant-directed investments.
2. Fiduciaries will need to continue to act prudently in selecting and retaining designated investment alternatives for the plan.

C. No Standard for Other Fiduciary Decisions.

The DOL clearly stated that the requirements of Section 404(c) only apply for purposes of determining whether a plan is a Section 404(c) Plan. The regulations are not intended to be applied to determine whether or to what extent a fiduciary with respect to a plan that is not a Section 404(c) Plan satisfied the fiduciary responsibility provisions of ERISA. A plan that does not satisfy the Section 404(c) requirements may have a prudent and well-diversified portfolio.

D. Section 404(c) Requirements. 29 CFR §2550.404c-1.

Department of Labor Regulations prescribe extensive requirements to qualify as an ERISA §404(c) plan. In order to satisfy ERISA §404(c), a plan must permit each participant to:

1. Choose from a broad range of investment alternatives with at least three (3) diversified investment choices (called "Core Alternatives") with materially different risk/return characteristics.
 - a. The regulations require affirmative investment elections from plan participants. Simply offering participants the opportunity to make investment decisions may not be sufficient for §404(c) protection.
2. Give investment instructions (e.g. make new investment elections and transfer current balances) at least once every three (3) months and possibly more often if appropriate in light of the market volatility of the investment alternatives;
 - a. The three (3) month change of investment rule applies to transfers among the Core Alternatives. Other fixed rate options could require a longer minimum time for the investment, but such options would not be considered Core Alternatives.
3. Diversify investments both generally and within investment categories; and

4. Receive current information from the plan that enables participants to make informed investment decisions.
 - a. DOL Advisory Opinion 2003-11A states that mutual fund "profiles" can be used to satisfy the requirements that a fiduciary provide a prospectus for each mutual fund either immediately before or immediately following a participant's investment in the fund.
 - b. Summary Plan Descriptions are required to inform plan participants if the plan is intended to comply with §404(c).

E. Retained Fiduciary Duties.

If a plan satisfies the Section 404(c) requirements, plan fiduciaries remain responsible for, among other things, the following:

1. the prudent selection and monitoring of plan investment alternatives (such as registered investment advisors, banks, trust companies, mutual funds, insurance companies, etc.);
2. the proper implementation of participant investment decisions;
3. the timely dissemination of required information relating to such investment alternatives; and
4. the avoidance of prohibited transactions (i.e., transactions between the plan and certain parties in interest or transactions involving a conflict of interest among, or self-dealing by, fiduciaries).

F. Sarbanes-Oxley Act of 2002 (SOA).

1. SOA Section 306(b) Blackout Period Notice Requirements for Participants and Beneficiaries under ERISA:
 - a. ERISA Section 101 (29 USC Section 1021) is amended to provide for notice requirements for Blackout periods.
2. SOA Section 306(b)(7): "blackout period" is defined as a period of more than three consecutive business days during which the participants or beneficiaries in an Individual Account Plan are limited to or restricted from their normal right to direct or diversify assets in their accounts or obtain plan loans or distributions. A change in the plan's investment manager will generally result in a blackout period.
3. SOA Section 306(b)(1)(i)(2)(A): The Plan Administrator must notify all affected participants and beneficiaries at 30 days in advance of the blackout period. The Notice shall include:
 - a. the reasons for the blackout period;

- b. the identification of the investments and other rights affected;
- c. the expected beginning date and length of the blackout period;
- d. a statement that the participant or beneficiary shall evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period.

VI. DOL GUIDANCE FOR FIDUCIARIES.

A. Meeting Your Fiduciary Responsibilities.

In May, 2004, the U.S. Department of Labor Employee Benefits Security Administration published on its website (www.DOL.GOV/EBSA) guidance for fiduciaries entitled "Meeting Your Fiduciary Responsibilities". Topics in the guidance include:

1. Who is a Fiduciary?
2. What is the Significance of Being a Fiduciary?
3. Limited Liability.
4. Other Plan Fiduciaries.
5. Bonding.
6. Employee Contributions.
7. Hiring a Service Provider.
8. Fees.
9. Monitoring a Service Provider.
10. Prohibited Transactions.
11. Information for Employees.
12. Reporting to the Government.

B. Essential Elements of a Plan.

The DOL notes that each Plan has certain key elements including:

1. A written plan that describes the benefit structure and guides day-to-day operations;
2. A trust fund to hold the plan's assets;

3. A recordkeeping system to track the flow of monies going to and from the retirement plan; and
4. Documents to provide plan information to employees participating in the plan and to the government.

C. Information to be Provided to Employees.

The DOL states that the following information must be provided to plan participants and beneficiaries:

1. Summary Plan Description (SPD);
2. Summary of Plan Modifications (SMM);
3. Individual Benefit Statement;
4. Summary Annual Report (SAR); and
5. Blackout Period Notice.

D. Tips for Employers with Retirement Plans.

The DOL guidance provides the following tips for employers with retirement plans:

1. Have you identified your plan fiduciaries, and are they clear about the extent of their fiduciary responsibilities?
2. If participants make their own investment decisions, have you provided sufficient information for them to exercise control in making those decisions?
3. Are you aware of the schedule to deposit participants' contributions in the plan, and have you made sure it complies with the law?
4. If you are hiring third-party service providers, have you looked at a number of providers, given each potential provider the same information, and considered whether the fees are reasonable for the services provided?
5. Have you documented the hiring process?
6. Are you prepared to monitor your plan's service providers?
7. Have you identified parties-in-interest to the plan and taken steps to monitor transactions with them?
8. Are you aware of the major exemptions under ERISA that permit transactions with parties-in-interest, especially those key for plan operations (such as hiring service providers and making plan loans to participants)?

9. Have you reviewed your plan document in light of current plan operations and made necessary updates? After amending the plan, have you provided participants with an updated SPD or SMM?
10. Do those individuals handling plan funds or other plan property have a fidelity bond? Bond must be at least 10% of plan assets but bond need not exceed \$500,000.

VII. FIDUCIARY RULINGS IN ENRON LITIGATION.

A. Rulings Expand Scope of Fiduciary Responsibilities.

In September 2003, the Federal District Court for the Southern District of Texas issued its initial ruling in the Enron litigation. The court rejected several motions to dismiss multiple claims of fiduciary breaches involving losses resulting from retirement plan investments in employer stock. *Tittle v. Enron Corp.*, 284 F. Supp. 2d 511 (S.D. Tex. September 30, 2003).

The 173 page opinion adopted many of the positions put forth by the Department of Labor for expansion of fiduciary responsibilities. The following are some of the more significant rulings:

1. A directed trustee may be held liable for breach of fiduciary responsibility for following directions when the directed trustee knew or should have known that the directions were imprudent. A directed trustee still retains some responsibility for investigating whether directions are consistent with the fiduciary responsibility requirements of ERISA. The degree of required investigation depends upon the facts and circumstances.
2. Plan fiduciaries may be held liable for imposing a "blackout" of participants' rights to effect investment and distribution elections while changing trustees and/or recordkeeping if under the circumstances the blackout presents an extreme threat to participants' account balances.
3. Where a corporation serves as a plan fiduciary the officers and directors who carry out the corporation's fiduciary responsibilities may be held personally liable as fiduciaries and, in the absence of a clear delegation of authority, the board of directors of the corporation is presumed to exercise such authority.
4. Individuals who have the power to appoint and remove other plan fiduciaries exercise sufficient discretionary authority over the administration of the plan to cause such individuals to be fiduciaries under ERISA, and the appointing fiduciaries have an ongoing responsibility to monitor the performance of the fiduciaries that they appoint.
5. Corporate officers and directors who are fiduciaries may be liable for breach of fiduciary duty if they fail to disclose to participants and/or other plan fiduciaries nonpublic information that is material to the plan's investment in employer stock. In addition, a plan fiduciary may be held liable for making materially misleading statements to participants

concerning the value of the employer stock or failing to correct materially misleading statements made by others.

6. Plan fiduciaries may not be relieved of liability under Section 404(c) of ERISA for participants' decisions to invest in employer stock if the participants do not receive adequate information regarding employer stock. Moreover, ERISA Section 404(c) does not relieve plan fiduciaries of the responsibility for determining whether it is appropriate to offer employer stock as an investment option under the Plan.
7. The auditor for the employer and the plan may be held liable for equitable relief under ERISA for knowingly participating in a breach of fiduciary duty arising out of the employer's fraudulent accounting practices.
8. Although the decision to impose an age restriction on a participant's right to direct the investment of matching contributions out of employer stock is a settlor function that is not subject to the fiduciary responsibility requirements of ERISA, the plan fiduciaries may breach their fiduciary responsibilities by allowing the plan to continue investing in employer stock if they know or should know that the investment in employer stock under the circumstances is not prudent.
9. Although ERISA Section 404(a)(2) exempts an individual account plan from ERISA's diversification requirement with respect to the plan's investment in qualifying employer securities, the plan fiduciaries may nevertheless have an obligation to diversify the plan's assets where the plan document itself requires diversification and does include an exemption for investment in employer securities.

VIII. ALLOCATION OF ADMINISTRATIVE EXPENSES BETWEEN PLAN AND EMPLOYER. DOL ADVISORY OPINION 2001-01A; DOL FIELD ASSISTANCE BULLETIN 2003-3.

- A. Plan Assets May Be Used to Pay Reasonable Administrative Expenses. ERISA §404(a)(1)(A)
 1. Although ERISA states that the plan assets of a plan must be used exclusively to pay benefits to participants and beneficiaries, ERISA also provides that the plan assets may be used to pay reasonable administrative expenses. There has been much discussion on what are "reasonable administrative expenses".
- B. Early Department of Labor Rulings.
 1. Kirk Maldonado Letter dated March 2, 1987. The Department of Labor stated that it would not be appropriate for a plan to pay expenses incurred in connection with the provision of services to the plan if the payments are made for the employer's benefit in the normal course of such employer's business or operations. This letter further stated that services provided to establish, terminate or design a plan are "settlor functions" which relate to

the employer's business activities, and, therefore, may not be properly paid from the plan.

2. John Erlenborn Letter March 3, 1986. The Department of Labor stated that "settlor functions" refer to a class of discretionary activities which relate to the formation, rather than the management of plans. According to the Department of Labor, these settlor functions are not fiduciary activities subject to Title I of ERISA.

C. DOL List of Plan Expenses.

DOL Kansas City Office lists items to be paid by the plan sponsor or allocated between the sponsor and the plan (Nov. 2000).

1. Plan design for new plan or amendment not required to comply with ERISA (e.g. cash balance redesign).
2. Expenses related to maintenance of tax qualified status (allocated between plan and sponsor based on benefit to plan and sponsor). Note: DOL Advisory Opinion 2001-01A states that the plan can pay the costs of legally mandated amendments, such as amendments necessary to comply with tax law changes.
3. Determination of FASB 87, 88, 106 and 112 liabilities and expenses for financial accounting purposes.
 - a. FASB 87 — Employers' Accounting for Pensions
 - b. FASB 88 — Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.
 - c. FASB 106 — Employers' Accounting for Post-Retirement Benefits Other Than Pensions.
 - d. FASB 112 — Employers' Accounting for Post-Employment Benefits.
4. Determination of maximum deductible employer contribution.
5. Study to decide plan termination.
6. Analysis of assets recoverable on plan termination.
7. Consultation on establishment and design of successor to terminated plan.
8. Asset/liability forecasting relating to plan design or financial accounting issue.
9. Financial forecasting — financial liability — tax implications.
10. EPCRS, CAP, DOL and IRS sanctions or penalties.

11. DOL delinquent filer program fee (DFVC)
12. Nondiscrimination testing (allocate between plan and sponsor).
13. Developing and defining employer's benefits/health care strategies (e.g. benefit design, employer contribution policy).
14. Modeling the impact of proposed legal/regulatory changes on benefit plans and their administration.
15. Preparing for and conducting union negotiations.
16. Any expense for which an employer could reasonably be expected to bear the cost in the normal course of the employer's business or operations.
17. Expenses for which there is more than an incidental benefit to the employer (allocate expense to employer to the extent of the employer's benefit).

D. Department of Labor opinions.

1. QDRO charges — The DOL does not oppose fees charged to the trust as whole. Until recently the DOL disapproved of fees charged to individual accounts. DOL Advisory Opinion 94-32 A (8/4/94). In FAB 2003-3, the DOL reversed its position and stated that QDRO charges may be assessed against the benefits of the individual's account to which such QDRO applies. Any offset policy would be required to be explained to the participant in advance (e.g., in the SPD) before any such offset could occur.
2. Plan Loans — The overriding criteria as to whether administrative loan charges are considered reasonable is whether the charges affect the ability of the plan to offer loans to all employees on a reasonably equivalent basis.
3. Settlor Costs — A settlor cost will occur when the employer receives more than an incidental benefit. When an expense may be chargeable both to the plan and to the employer (e.g. bringing a plan into compliance with §401(a)(4)), the sharing of costs would be the most reasonable solution.
4. Plan Terminations — The employer should be charged with the costs associated with the decision of whether to terminate the plan. The plan may be charged with the legal and actuarial costs associated with wrapping up a previously made decision to terminate the plan.
5. Distribution Expenses — Reasonable distribution expenses may be charged directly to the participant.
6. Based upon the Department of Labor's formal and informal opinions, the following expenses are generally employer expenses:

- a. Actuarial reports which provide information to employers with respect to financial impact of plans on employers;
 - b. Consulting fees incurred by employers in determining plan design;
 - c. Decisions to terminate plans;
 - d. Preparation of plan documents;
 - e. Amendments to plans if the amendment is a settlor function; and
 - f. Closing agreement and EPCRS expenses.
7. Based upon the Department of Labor formal and informal opinions, the following expenses are generally plan expenses:
- a. Actuarial reports that relate to determination of minimum contributions required;
 - b. Preparation of summary plan descriptions;
 - c. Liquidation of plans upon termination;
 - d. QDRO charges; and
 - e. Plan amendments if the amendment involves a fiduciary function or is required due to changes in law (e.g., GUST).
8. Based upon the Department of Labor's formal and informal opinions, the following expenses may be split between the employer and the plan:
- a. Actuarial reports used for the purpose of meeting minimum funding requirements; and
 - b. Amendments; depending upon the nature of the amendment.

E. Allocation of Expenses to Former Employees

In Rev. Rul. 2004-10, the IRS concluded that a defined contribution plan may charge the accounts of former employees for a pro-rata share of the plan's reasonable administrative expenses while not charging the accounts of current employees.

F. Employer Deduction of Plan Expenses.

The IRS stated in PLR 9252029 that an employer's payment of certain investment management fees may be deductible under IRC §§162 or 212 and will not be treated as a contribution to the plan. The issue is whether fees paid by the employer are counted as plan contributions under the IRC §404 deduction limitations. In this ruling, an investment manager separately and directly billed the employer for 100% of the charges for investment management as well as for

custodial, accounting and legal services received by the plan and the employer paid these bills directly. See also: PLR 8941009, PLR 8941010 and PLR 8940014. However, payments by an employer to the plan trustee to reimburse the trust for investment management expenses are deemed to be contributions. PLR 9124036.

The IRS also stated that payments to:

1. The trustees as compensation for their attendance at the meetings and the performance of their trustee services for the plan;
2. Accountants for the preparation of the annual accounting and ERISA reporting requirements; and
3. Legal counsel for services required to maintain the plan's qualification (including plan document preparation and filings, correspondence regarding the qualification of the plans, advice to the plan's fiduciaries regarding their duties under ERISA, interpretation of plan provisions and of the law with respect to plan issues) were all deductible under IRC §162.