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Too Many Benefits: Use of Plan Assets to Benefit Employer



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From time to time, I am asked whether a 401(k) plan can be used to obtain a benefit of some kind for the plan sponsor. Generally speaking, the answer is, no, it cannot.

More specifically, the question is often framed as: “Can a plan sponsor pick a bank’s 401(k) offering in order to obtain better terms for its debt financing from the bank?” However, there is nothing unique about the legal issues presented by this banking arrangement . . . the rules in this area apply to any benefit received by a plan sponsor or fiduciary from the use of plan assets. For example, it would also be problematic for the company president, as a fiduciary, to receive free financial planning and investment advice because of the placement of plan assets.

Before analyzing the specific violations in this case, we should review the ERISA concepts governing the loyalties of plan fiduciaries.

ERISA mandates that fiduciaries operate a plan for the “exclusive purpose” of providing retirement benefits. In performing that task, fiduciaries are held to the standard of a hypothetical prudent and

knowledgeable investor. ERISA also provides a set of prohibited transaction rules, including three which apply exclusively to fiduciaries; they prohibit fiduciaries from using their authority over plan assets to obtain financial benefits for themselves (or for others where the relationship may affect their judgment).

Under the fiduciary rules (but not the prohibited transaction restrictions—see below), plan sponsors and fiduciaries may incidentally benefit from a plan, so long as the participants’ interests come first. In that sense, the exclusive purpose rule is not so exclusive. That is, so long as the plan sponsor and other fiduciaries act for the primary purpose of providing retirement benefits, the exclusive benefit provision does not prohibit the receipt of ancillary benefits by the fiduciaries (which would include the plan sponsor).

Similarly, with the prudent man rule, so long as the fiduciaries engage in a prudent process to select and monitor the plan’s providers and investments, there is no prohibition on the receipt of ancillary benefits. But, if the application of the exclusive purpose and prudent man rules would have required the selection of a different provider, then it would be a breach of their ERISA responsibilities for

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fiduciaries to select the provider that is offering the added benefit to the company or the fiduciary (which in our hypothetical is the bank that would provide the plan sponsor with favorable financing).

However, the analysis does not end there. The prohibited transaction rules must also be considered. That is because those rules (sometimes called PT's) are absolute; there is no test of reasonableness. The PT's that apply to the use of fiduciary authority are found in section 406(b) of ERISA. Under that section, it is prohibited for fiduciaries to use their authority over plan assets to cause themselves to receive a benefit. Thus, if the plan sponsor uses its authority to place plan assets with a provider who returns the favor through the payment of any benefit, a prohibited transaction has oc-

curred. In our example, that could include the granting of favorable financing by a bank.

If that occurred, the consequence would be that the benefit of the preferred financing would belong to the plan and not to the corporation. In other words, the corporation would be obligated to pay the plan an amount equal to the value of the preferred treatment. In addition, there would be penalties under both the Internal Revenue Code and ERISA. Further, the prohibited transaction would need to be brought to an end, which could involve moving the 401(k) assets to another provider or unwinding the favorable financing arrangement.

For a case involving favorable loans, see *Whitfield v. Tomasso*, 682 F.Supp. 1287 (E.D.N.Y. 1988). Another example of the application of these rules can be found

in DOL ERISA Technical Release No. 86-1, which held that the use of directed brokerage to obtain goods or services for the employer was a prohibited transaction.

Even though they have been in effect for 30 years, ERISA's prohibited transaction rules continue to surprise people because they are absolute and unforgiving. Nonetheless, they are in place to protect participants and are, for that matter, among the easiest of ERISA's restrictions to enforce.

As a word of advice, if you are a plan fiduciary and you believe that the plan sponsor or any of its fiduciaries could benefit from a transaction involving plan assets, consult with an ERISA attorney. The prohibited transaction rules are neither logical nor intuitive. You need expert help. ❖

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