U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

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97-03A
ERISA SEC. 403(c)(1) & 404(a)(1)(A)

Mr. Samuel Israel
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2029 Century Park East
Suite 480
Los Angeles, California 90067

Re: Identification Number: A00506

Dear Mr. Israel:

This is in response to your request for an advisory opinion concerning the application of the Employee Retirement Income Security Act of 1974 (ERISA) to the payment of certain plan termination expenses by tax qualified retirement plans administered by the Insurance Commissioner of the state of California (the Commissioner) in its capacity as liquidator of companies which sponsored the plans.

You represent that the Commissioner from time to time is required by California law to "take over" insurance companies that are legally insolvent. Upon taking over an insurance company, the Commissioner acts as a liquidator or conservator of the company and as such is responsible under California law for the winding down and termination of the insolvent insurance company. In connection with its administration of the insurance company during the winding down period, the Commissioner pays creditors and takes other necessary actions to see to the orderly termination of the company.

On occasion, the Commissioner takes over insolvent insurance companies that have tax qualified pension or profit sharing plans, where the insurance companies themselves are no longer operating and have terminated employment of all their employees. In some of these cases, remaining assets in the insurance company's estate are sufficient to pay only a portion of its policyholders; in other cases, the insurance company estate has no remaining assets.[1] In all of these cases, plan participants have expressed concern about their benefits, have requested that the Commissioner take all necessary steps to terminate the plans and distribute their benefits, and in some cases have commenced litigation to force a termination of the plan.

You represent that the Commissioner does not receive a fee from any of the plans for administering the plans. In connection with terminating the plans, however, the Commissioner will engage outside legal counsel and pension administration firms to (i) amend the plan to comply with legislative, case law and regulatory developments; (ii) audit the plan where applicable; (iii) prepare and file annual statements; (iv) prepare benefit statements and calculate accrued benefits; (v) notify participants and beneficiaries of their benefits under the plan; and (vi) seek a determination letter from the Internal Revenue Service (IRS) concerning the status of the plan in connection with its termination. You have further represented that, with respect to certain plans administered by the Commissioner, the

[1] You indicate that under the priority categories specified in California Insurance Code section 1033 for the distribution of estate assets, costs of administering the liquidation are the first priority, and that policyholder claims come ahead of the claims of other unsecured creditors (except to the extent that their claims have preference under state or federal law).

plan documents specifically permit the plan administrator to pay expenses incurred in connection with the administration of the plan. In other cases, the Commissioner proposes to amend the plans to include a provision which permits such payments.

You inquire whether, in the circumstances described above, the various fees and expenses for services engaged by the Commissioner in connection with terminating a plan would be appropriate expenses of the plan. You also inquire whether the amendment of a plan to allow it to pay expenses would be an appropriate and permissible amendment.[2]

Your inquiry specifically identifies three defined contribution plans currently being administered by the Commissioner. You have also requested general guidance regarding the payment of plan termination expenses by defined benefit plans. The views expressed in this opinion would generally be the same for both defined contribution and defined benefit pension plans. We note, however, that there may be special issues, beyond the scope of this response, relative to defined benefit plans which are within the jurisdiction of the Pension Benefits Guarantee Corporation under Title IV of ERISA.

ERISA section 404(a)(1)(D) requires plan fiduciaries to discharge their duties in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of Titles I and IV of ERISA. Thus, evaluating the propriety of the payment by a plan of particular expenses first requires an examination of the language of the plan documents. If the plan documents permit the plan to pay the expense, then the fiduciary must determine whether such payment would be consistent with Title I of ERISA (and Title IV, if applicable), including the general fiduciary responsibility provisions of sections 403 and 404 of ERISA.

Section 403(c)(1) provides, subject to certain exceptions not here relevant, that the assets of an employee benefit plan shall never inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan. Similarly, section 404(a)(1)(A) requires that plan fiduciaries discharge their duties to the plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing them benefits and defraying reasonable expenses of administering the plan.

The prohibited transaction provisions also come into play in connection with payments for administrative services. Subsections 406(a)(1)(C) and (D) of ERISA provide, in part, that a fiduciary with respect to a plan shall not cause the plan to engage in a transaction if he or she knows or should know that such transaction constitutes a direct or indirect furnishing of goods, services or facilities between the plan and a party in interest with respect to the plan, or a transfer to, or use by or for the benefit of a party in interest of any assets of the plan.

Subject to the limitations of section 408(d) of ERISA, section 408(b)(2) provides an exemption from the prohibitions of section 406(a), provided that the services to the plan are necessary and are provided pursuant to a reasonable contract or arrangement for reasonable compensation. Regulations issued by the Department clarify the terms "necessary service" (29 C.F.R. 2550.408b-2(b)), "reasonable contract or arrangement" (29 C.F.R. 2550.408b-2(c)), and "reasonable compensation" (29 C.F.R. 2550.408b-2(d) and 2550.408c-2) as used in section 408(b)(2). The

[2] ERISA section 402(b)(3) provides that every employee benefit plan shall provide a procedure for amending the plan and for identifying the persons who have authority to amend the plan. The primary purpose of this provision is to ensure that every plan has a workable amendment procedure. See Curtiss-Wright Corp. v. Schoonejongen, 115 S.Ct. 1223 (1995). Whether a plan contains such provisions, and whether they are complied with in a given case are questions which depend upon the particular facts and as to which the Department expresses no views. We note, however, that you have asked the Department to assume that, in each case, the sponsoring employer had reserved in the plan document the right to amend the plan, and that the Commissioner has the authority to amend the plan by virtue of its status, under California law, as liquidator of such employer.

appropriate plan fiduciary(ies) must determine, based on all of the relevant facts and circumstances, whether the conditions of section 408(b)(2) are satisfied.

In addition, section 406(b)(1) of ERISA prohibits a plan fiduciary from dealing with the assets of a plan in his or her own interest or for his or her own account. Section 406(b)(2) provides that a fiduciary with respect to the plan shall not in his or her individual or any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.

With respect to the prohibitions of section 406(b), the regulation in 29 C.F.R. 2550.408b-2(a) indicates that section 408(b)(2) of ERISA does not contain an exemption for an act described in section 406(b) of ERISA, even if such act occurs in connection with a provision of services which that section exempts from the prohibitions of section 406(a).

At the outset, it should be noted that it is a fiduciary determination as to whether to pay particular expenses out of Plan assets.[3] Accordingly, in making such determinations, the Commissioner must act prudently and solely in the interest of the plan participants and beneficiaries, and in accordance with the documents and instruments governing the plan insofar as they are consistent with the provisions of ERISA. See ERISA sections 403(c)(1), 404(a)(1)(A), (B), and (D). In this regard, the Commissioner must assure that payment of the expenses by the plan is authorized by the plan, and is in the interest of the plan participants and beneficiaries; and that the amount of the expense is reasonable.

With regard to ERISA section 404(a)(1)(D), relating to the documents and instruments governing the plan, if the plan document is silent as to the payment of administrative expenses, the Department takes the position that the plan may pay reasonable administrative expenses. If the plan document provides that the employer will pay any of such expenses, and if the employer has reserved the right to amend the plan document, ERISA would not prevent the employer (or in this instance, the Commissioner) from amending the plan to require, prospectively, that the relevant expenses be paid by the plan. However, the prohibition on self-dealing in section 406(b)(1) of ERISA would preclude an employer (or the Commissioner) from exercising fiduciary authority to use plan assets to pay for an amendment to the plan that acquits the employer of an obligation to pay plan expenses.

Concerning sections 403 and 404 of ERISA, as a general rule, reasonable expenses of administering a plan include direct expenses properly and actually incurred in the performance of a fiduciary's duties to the plan. On the other hand, the Department has long taken the position that there is a class of discretionary activities which relate to the formation, rather than the management, of plans. These so-called "settlor" functions include decisions relating to the establishment, design and termination of plans and, except in the context of multiemployer plans, generally are not fiduciary activities subject to Title I of ERISA. See letter to John N. Erlenborn from Dennis M. Kass (March 13, 1986). Expenses incurred in connection with the performance of settlor functions would not be reasonable plan expenses as they would be incurred for the benefit of the employer and would involve services for which an employer could reasonably be expected to bear the cost in the normal course of its business or operations. See letter to Kirk F. Maldonado from Elliot I. Daniel (March 2, 1987). However, while the decision to terminate a plan is such a settlor or business function, activities undertaken to implement the plan termination decision are generally

[3] ERISA establishes a functional approach to determine whether an activity is fiduciary in nature. Under section 3(21) of ERISA, a fiduciary includes anyone who exercises discretion in the administration of an employee benefit plan; has authority or control over the plan's assets; or renders investment advice for a fee with respect to any plan assets. The Department has indicated that it will examine the types of functions performed, or transactions undertaken, on behalf of a plan to determine whether such activities are fiduciary in nature and therefore subject to ERISA's fiduciary responsibility provisions. See 29 C.F.R. 2509.75-8, D-2.

fiduciary in nature. Accordingly, reasonable expenses incurred in implementing a plan termination would generally be payable by the plan. This would include expenses incurred in auditing the plan, preparing and filing annual reports, preparing benefit statements and calculating accrued benefits, notifying participants and beneficiaries of their benefits under the plan, and, in certain circumstances, amending the plan to effectuate an orderly termination that benefits the participants and beneficiaries.

With regard to expenses attendant to amending a plan to maintain its tax-qualified status and to obtaining a determination from the Internal Revenue Service concerning the status of the plan in connection with termination, we note that, while ensuring the tax-qualified status of a plan confers significant benefits on the plan sponsor, or in the case of a liquidation, the estate of the plan sponsor, maintenance of tax-qualified status may also be in the interest of plan participants. In the case of a plan that was intended to be maintained as a tax-qualified plan and that permits the payment of reasonable expenses from the assets of the plan, it is the view of the Department that a portion of the expenses attendant to these activities may constitute reasonable expenses of the plan. Where, as here, there are benefits to be derived by both the plan sponsor (or the estate of the plan sponsor) and the plan, and where one party appears to be acting in both a settlor capacity on behalf of the plan sponsor (or the estate of the plan sponsor), and in a fiduciary capacity on behalf of the plan's participants and beneficiaries, it would generally be necessary, in order to avoid violations of ERISA sections 406(b)(1) and 406(b)(2), to have an independent fiduciary determine how to allocate the expenses attributable to those benefits. However, because the State of California, as liquidator, does not stand to benefit in its own interest or for its own account within the meaning of section 406(b)(1), and in view of the State's broader interest in protecting all of its citizenry, the Department will not seek to enforce any requirement for the State to engage an independent fiduciary to allocate expenses incurred in connection with plan terminations where the Commissioner has determined that an amount payable by a plan is in proportion to the benefit conferred on the plan relative to the benefit conferred on the estate of the plan sponsor.

Finally, you represent that there are numerous insurance company liquidations in which there are no funds to pay the claims of policyholders and other claimants and, indeed, the assets in the employer's estate are insufficient to pay even the basic administrative costs of the insurance company liquidation (such as publication of notices, mailing of proof of claim forms, receipt of claims and forwarding to guarantee associations, court appearances, etc.). Under these circumstances, you state, the Commissioner may seek permission from the supervising court to end all work and close the estate, and it is not uncommon for an estate to be closed without completion of claims adjustment, corporate dissolution, or completion of other tasks. For such estates, you represent, employee benefit plan assets are the only assets available to pay for termination of the plan.[4] If, in accordance with the State's statutory priorities for the payment of claims from the estate of an insolvent insurance company, there are no assets of the estate to pay claims to the IRS that would result from disqualification of the plan, any benefit conferred by maintaining tax qualified status of the terminating plan would inure only to the plan participants. In such cases, it is the view of the Department that the use of plan assets alone to terminate a plan, and to maintain its tax-qualified status as terminated, may be consistent with the above-cited provisions of Title I of ERISA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (41 Fed. Reg. 36281, Aug. 27, 1976). Section 10 of the Procedure describes the effect of advisory opinions.

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[4] You indicate that, in theory, California Insurance Code section 1035 would permit the Commissioner to pay costs of administering a liquidation from the appropriation of the Department of Insurance when estate assets are insufficient to pay such costs. In practice, however, you state that the appropriation includes very little in the way of funds for this purpose. For purposes of this letter, we have assumed that funds would not be available from the Department of Insurance appropriation.

Sincerely,

Robert J. Doyle
Director of Regulations and Interpretations