U.S. ERISA
Prohibited Transactions

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Prohibited Transactions

- ERISA and the parallel provisions of the Internal Revenue Code prohibit a number of transactions between a plan and a "Party in Interest".[1]

- "Party in Interest" is a broad definition that includes:

  (a) Any fiduciary (including a trustee),

  (b) Any person providing services to a plan,[2]

  (c) An employer whose employees are covered by the plan,

[1] The corresponding term under the Internal Revenue Code is "Disqualified Person."

[2] This is a broad category and would include, among others, brokers, accountants, attorneys, actuarial firms, etc.

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(d) A union or other employee organization whose members are covered by the plan,

(e) An owner of a 50 percent or more interest in an entity described in (c) or (d),

(f) A relative of an individual described in (a), (b), (c) or (e). “Relative” includes a spouse, ancestor, lineal descendant, or spouse of a lineal descendant,

(g) An entity, 50 percent or more of which is controlled, directly or indirectly, by individuals or entities described in (a), (b), (c), (d) or (e),

(h) An employee, officer, director, or a person directly or indirectly controlling 10 percent or more of an individual or entity described in (b), (c), (d), (e) or (g), or

(i) A person who is a 10 percent or more partner or joint venturer in an individual or entity described in (b), (c), (d), (e) or (g).

Prohibited Transactions

- Prohibited transactions fall into two categories:

    (i) those that apply to all Parties in Interest (including a fiduciary) and

    (ii) those that apply only to a fiduciary.

    – Prohibited transactions between a Party in Interest (including any fiduciary) and a plan, (including funds that are considered "plan assets")[1]
        - Sale, exchange or lease of property
        - Loans and other extensions of credit
        - Furnishings of goods, services or facilities
        - Transfers to, or use by a party in interest of, any fund assets
        - Subject to certain exceptions, acquisition by a Party in Interest, on behalf of the fund, of any employee security or employer real property

[1] If a QPAM is used for these types of transactions, the transaction will be exempt from the prohibited transaction rules.

Prohibited Transactions

- Prohibited transactions solely involving a fiduciary include:
  - Dealing with the assets of the plan in the fiduciary's own interest or for his or her own account.
  - Acting on behalf of a party whose interests are adverse to the interests of the plan in any transactions involving the plan.
  - Receiving any consideration for its own account from any party dealing with the plan in connection with a transaction involving the plan's assets.[1]

[1] For example, a prohibited transaction would occur if a manager of a fund that is considered "plan assets" received a fee from an unaffiliated broker in return for selecting the broker to execute trades for the fund.

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- If the fund can otherwise avail itself of an applicable exemption, under the plan assets regulation (for example, it qualifies as a VCOC or a REOC or the aggregate investment in the fund by benefit plan investors is not significant), the fund will not be considered a plan or a plan asset and transactions with the fund will be shielded from the prohibited transaction rules.

- However, if this shield is not present, the fund will be considered a plan asset subject to the prohibited transaction rules noted above.

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- Even if the fund is considered a plan asset, however, certain transactions by the fund, which would otherwise be prohibited, may be exempt from the prohibited transaction rules.

- There are three types of prohibited transaction exemptions available:
  - (i) Individual Exemptions,
  - (ii) Class Exemptions; and
  - (iii) Statutory Exemptions.

- A number of Class Exemptions have been granted which allow fund managers to avoid committing a prohibited transaction. [1]

[1] Most notably the QPAM Class Exemption 84-14, as amended. See U.S. ERISA QPAM Exemption.

Prohibited Transactions

- The Code imposes a tax on a “disqualified person” who participates in a prohibited transaction.
- The initial tax is 15 percent of the greater of the fair market value of the consideration given or the fair market value of the consideration received in the transaction.
- However, if the prohibited transaction involves the receipt of excess compensation for the performance of services, the initial tax is 15 percent of the excess compensation.
- If the correction is not made within a correction period there is an additional tax of 100 percent of the consideration given or received or the consideration in excess of reasonable compensation, whichever is applicable.