

DEPARTMENT OF LABOR

Pension and Welfare Benefit Programs

DEPARTMENT OF THE TREASURY

Internal Revenue Service

[Prohibited Transaction Exemption 77-8;
Application No. D-281]

EMPLOYEE BENEFIT PLANS

Class Exemption Involving Transfer of Individual Life Insurance Contracts and Annuities From Employee Benefit Plans to Plan Participants, Certain Beneficiaries of Plan Participants, Employers and Other Employee Benefit Plans

AGENCIES: Department of Labor, Department of Treasury/Internal Revenue Service.

ACTION: Grant of Class Exemption.

SUMMARY: This exemption enables an employee benefit plan to sell individual life insurance contracts and annuities to (1) a plan participant insured under such policies, (2) a relative of such insured participant who is the beneficiary under the contract, (3) an employer any of whose employees are covered by the plan, or (4) another employee benefit plan, for the cash surrender value of the contracts, provided certain conditions are satisfied. In the absence of this exemption, these sales would be prohibited by the Employee Retirement Income Security Act of 1974 (the Act) and the Internal Revenue Code of 1954 (the Code).

EFFECTIVE DATE: January 1, 1975.

FOR FURTHER INFORMATION CONTACT:

Rhea S. Schwartz, Department of Labor, 200 Constitution Avenue NW., Washington, D.C. 20210, 202-523-6855.

William M. Tartikoff, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C. 20224, Attention: E:EP:PT, 202-566-3089.

(These are not toll-free numbers.)

SUPPLEMENTARY INFORMATION: On January 21, 1977, notice was published in the FEDERAL REGISTER (42 FR 4036) that the Department of Labor and the Internal Revenue Service (the Agencies) had under consideration a proposed class exemption from the restrictions of section 406(a) and 406(b) (1) and (2) of the Act and from the taxes imposed by section 4975 (a) and (b) of the Code, by reason of section 4975(c) (1) (A) through (E) of the Code. The proposed class exemption, which was requested in an application (No. D-281) filed by the American Council of Life Insurance, would have exempted the sale of individual life insurance contracts and annuities by employee benefit plans to plan participants insured under such policies for the cash surrender value of the policy.

The exemption was proposed in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26,

1975-1 C.B. 772. All interested persons were invited to submit comments on the proposed exemption. As indicated in the notice, no exemption was proposed for the sale of life insurance contracts and annuities by plans to employers. However, the Agencies specifically requested comments as to the unavailability of the proposed class exemption with respect to the sale of insurance contracts or annuities by plans to employers and as to whether there was a need for an exemption for such transactions and, if so, the conditions and safeguards under which an exemption for such transactions would be appropriate.

COMMENTS RECEIVED

Thirty-two comments were received with regard to the proposed exemption, all supporting the grant of the exemption. Several comments, while supporting the exemption, contained suggestions for changes.

SALES TO EMPLOYERS

Three comments recommended expansion of the proposed class exemption to include an exemption for the sale of insurance contracts or annuities by plans to employers where appropriate safeguards are provided. The comments indicated that the purchase of such contracts or annuities from the plan by the employer would protect participants who need continued insurance protection and who are unable to secure the funds to purchase the insurance for its cash surrender value from the plan or to maintain the premium payments. It was noted in one of the comments that in the various situations described in the notice of pendency where a plan may not continue individual life insurance contracts in effect until participants' normal retirement, participants entered the plan with the reasonable expectation that insurance protection would be afforded by the employer. The broadening of the proposed class exemption to permit the sale of insurance contracts or annuities by a plan to the employer would thus enable employees to benefit, at little or no cost, from the insurance protection available when the contract or annuity was maintained by the plan, in accordance with their expectations when the contract was originally purchased. The suggestion was accepted and incorporated in the exemption.

SALE TO A RELATIVE OF THE INSURED

Two commentators suggested that plans should be permitted to sell an individual life insurance contract or annuity directly to a relative of the insured participant where such relative is the beneficiary under the contract and where the sale is authorized in writing by the participant. Such a direct transfer would avoid the necessity of a two-step transfer, first from the plan to the participant, and then from the participant to the beneficiary. The position of the plan would not be affected in any manner whether the policy were sold to the par-

ticipant or to a beneficiary. The comment has been accepted because the Agencies see no potential for abuse in this situation and it would permit direct transfers of insurance contracts or annuities which could be made indirectly under the proposed exemption. The term "relative", for purposes of this exemption, includes those persons defined as relatives in section 3(15) of the Act, a "member of a family" as defined in section 4975(e) (6) of the Code, and brothers and sisters of the insured and their spouses.

TRANSFER TO ANOTHER PLAN

Another comment suggested expanding the exemption to permit the transfer of insurance contracts or annuities between employee benefit plans. The transfer of insurance contracts or annuities from one plan to another is a prohibited transaction only where the plans are parties in interest or disqualified persons with respect to each other. Generally, however, two or more plans are not parties in interest or disqualified persons with respect to each other merely because they are maintained by the same plan sponsor, although one plan may be a party in interest or disqualified person with respect to another plan by virtue of being, among other things, a service provider to the other.

Because the Agencies see no potential for abuse in the transfer of insurance contracts or annuities between plans which may be parties in interest or disqualified persons with respect to one another, the suggestion to allow a direct transfer from one plan to another has been incorporated in the class exemption.

GENERAL CONDITION WITH RESPECT TO SALES AND TRANSFERS TO PERSONS OTHER THAN PLAN PARTICIPANTS

With respect to the broadening of the right of plans to sell insurance policies so as to include sales to employers, relatives, and other plans, an additional condition was added requiring that the participant first be afforded an opportunity to purchase any individual life insurance contract or annuity under which the participant is the insured and that the participant consent in writing to such sale. If the participant elects not to purchase the contract or annuity, the employer, relative or other plan may, upon receipt by the plan of the written consent of the participant, purchase the contract or annuity from the plan for an amount at least equal to the amount necessary to put the plan in the same cash position as it would have been in if it had retained the contract, surrendered it and made any distribution owing to the participant of his vested interest under the contract.

SALES OF OTHER POLICIES

A suggestion that the exemption be extended to individual insurance policies not containing life insurance benefits, and a suggestion that the exemption be extended to cover transfers of individual life insurance contracts and an-

nuities from the plan to participants at all times were rejected because insufficient information was provided to determine whether such an extension would be justified.

SALES UPON PLAN TERMINATION

One comment suggested that plan administrators be alerted to the potential applicability of Title IV of the Act in certain situations covered by the exemption. Where a contract is being sold in connection with the termination of a pension plan covered under Title IV, a participant's credit for vested benefits, which would serve to reduce the amount such participant would pay for the contract, may be limited to the participant's entitlement under the allocation rules of section 4044 of the Act. This comment was not incorporated because it is beyond the scope of the exemption.

MISCELLANEOUS

Finally, the agencies wish to note the following points, which were included in the Notice of Pendency of this class exemption:

(1) The exemption does not provide any relief from or relaxation of the requirement set forth in section 401(a)(4) of the Code. In order for a plan to qualify under section 401(a) of the Code, section 401(a)(4) of the Code provides that the contributions or benefits provided under such plan must not discriminate either in form or in operation in favor of employees who are officers, shareholders, or highly compensated. A condition has been included in the exemption imposing a similar non-discrimination requirement for employee welfare benefit plans which desire to make sales of life insurance contracts or annuities pursuant to the exemption.

(2) Under section 408(d) of the Act no exemption may be granted under section 408(a) of the Act for a transaction of the type described herein between a plan and certain persons, such as an owner-employee as defined in section 401(c)(3) of the Code, or a shareholder employee, as defined in section 1379 of the Code. This class exemption is, however, applicable to such persons for purposes of section 4975 of the Code.

(3) For Federal income tax purposes, the value of an insurance policy is not the same as, and may exceed, its cash surrender value. See Rev. Rul. 59-195, 1959-1 C.B. 18. Therefore, for Federal income tax purposes, a purchase of an insurance policy at its cash surrender value may be a purchase of property for less than its fair market value. The Federal income tax consequences of such a bargain purchase must be determined in accordance with generally applicable Federal income tax rules. Any income realized by a participant or relative of such participant upon such a purchase under the conditions of this class exemption, however, will not be deemed a distribution of benefits from the plan to such participant for purposes of subchapter D of Chapter I of the Code relating to qualified pension, profit sharing, and stock bonus plans.

GENERAL INFORMATION

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption granted under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person with respect to a plan to which the exemption is applicable from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that a plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries.

(2) This exemption does not extend to transactions prohibited under section 406(b)(3) of the Act and section 4975(c)(1)(F) of the Code.

(3) The exemption set forth herein is supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

(4) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

(5) In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record, including the written comments submitted in response to the notice of January 21, 1977, the Department and the Service make the following determinations:

(i) The class exemption set forth herein is administratively feasible;

(ii) It is in the interests of plans and of their participants and beneficiaries; and

(iii) It is protective of the rights of participants and beneficiaries of plans.

EXEMPTION

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-1 C.B. 22:

Effective January 1, 1975, the restrictions of sections 406(a) and 406(b)(1) and (2) of the Act and the taxes imposed under section 4975(a) and (b) of the Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply to the sale of an individual life insurance or annuity contract by an

employee benefit plan to (1) a participant under such plan; (2) a relative of a participant under such plan; (3) an employer, any of whose employees are covered by the plan; or (4) another employee benefit plan, if—

(1) Such participant is the insured under the contract;

(2) Such relative is a "relative" as defined in section 3(15) of the Act (or is a "member of the family" as defined in section 4975(e)(6) of the Code), or is a brother or sister of the insured (or a spouse of such brother or sister), and is the beneficiary under the contract;

(3) The contract would, but for the sale, be surrendered by the plan;

(4) With respect to sales of the policy to the employer, a relative of the insured or another plan, the participant insured under the policy is first informed of the proposed sale and is given the opportunity to purchase such contract from the plan, and delivers a written document to the plan stating that he or she elects not to purchase the policy and consents to the sale by the plan of such policy to such employer, relative or other plan;

(5) The amount received by the plan as consideration for the sale is at least equal to the amount necessary to put the plan in the same cash position as it would have been in had it retained the contract, surrendered it, and made any distribution owing to the participant of his vested interest under the plan; and

(6) With regard to any plan which is an employee welfare benefit plan, such plan must not, with respect to such sale, discriminate in form or in operation in favor of plan participants who are officers, shareholders, or highly compensated employees.

Signed at Washington, D.C., this 15th day of June, 1977.

IAN D. LANOFF,
Administrator of Pension and
Welfare Benefit Programs,
U.S. Department of Labor.

JEROME KURTZ,
Commissioner,
Internal Revenue Service.

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