Introduction

This paper examines the use of company stock as an investment option in various types of qualified and nonqualified deferred compensation plans from an ERISA and securities law perspective. It is intended to provide the reader with a basic understanding of the issues associated with such usage, including opportunities for the employer, employees, and the financial advisor. Choosing to offer company stock as an investment option in an employer-sponsored employee benefit plan involves many considerations of which many financial advisors and plan sponsors are unaware.

ERISA Section 407

Any discussion of the use of company stock or, more precisely, employer securities, in a retirement plan subject to ERISA, has to be understood within the meaning of ERISA section 407 which specifies certain limitations on a plan's holding of employer securities. Except as otherwise provided, a plan may not acquire or hold any employer security which is not a qualifying employer security. Furthermore, a plan may not acquire any qualifying employer security, if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan. Certain exceptions apply to plans that were in existence prior to January 1, 1985.

The general 10 percent limitation on the portion of plan assets that may consist of qualifying employer securities does not apply to any acquisition or holding of qualifying employer securities by an eligible individual account plan. The term "eligible individual account plan" means an individual account plan which is: (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on the date of enactment of this Act and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in Internal Revenue Code ("Code") section 408.

Generally speaking, the portion of an eligible individual account plan which consists of applicable elective deferrals (and earnings allocable thereto) is treated as a separate plan: (i) which is not an eligible individual account plan; and (ii) to which the requirements of ERISA section 407 apply. This treatment applies to an eligible individual account plan if any portion of the plan's applicable elective deferrals (or earnings allocable thereto) are required to be invested in qualifying employer securities or qualifying employer real property or both: (i) pursuant to the terms of the plan; or (ii) at the direction of a person other than the participant on whose behalf such elective deferrals are made to the plan (or a beneficiary). However, if, on the last day of the preceding plan year, the fair market value of the assets of all individual account plans maintained by the employer equals not more than 10 percent of the fair...
market value of the assets of all pension plans (other than multiemployer plans) maintained by the employer, the plan will still be considered an eligible individual account plan. Also, if, pursuant to the terms of the plan, the portion of any employee’s applicable elective deferrals which is required to be invested in qualifying employer securities and qualifying employer real property for any year may not exceed one percent of the employee’s compensation which is taken into account under the plan in determining the maximum amount of the employee’s applicable elective deferrals for such year, the plan will still be considered an eligible individual account plan. Finally, an individual account plan that is an employee stock ownership plan as defined in Code paragraph 4975(e)(7) is not subject to the 10 percent limitation.

ERISA paragraph 407(d)(1) defines the term "employer security" to mean a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. ERISA paragraph 407(d)(5) defines the "qualifying employer security" to mean an employer security which is: (i) stock; (ii) a marketable obligation (as defined in subsection 407(e)); or (iii) an interest in a publicly traded partnership (as defined in subsection 7704(b) of the Code), but only if such partnership is an existing partnership as defined in section 10211(c)(2)(A) of the Revenue Act of 1987 (Public Law 100-203).

ERISA subsection 407(e) defines the term "marketable obligation" to mean a bond, debenture, note, or certificate, or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") if: (i) such obligation is acquired—
(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;
(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or
(C) directly from the issuer, at a price not less favorable to the plan than the price paid currently for a substantial portion of the same issue by persons independent of the issuer; or
(ii) immediately following acquisition of such obligation—
(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and
(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and
(iii) immediately following acquisition of the obligation, not more than 25 percent of the assets of the plan is invested in obligations of the employer or an affiliate of the employer.

Security Law Issues Associated with the Use of Employer Securities in Qualified Retirement Plans subject to ERISA

Disclaimer
This discussion of security law issues associated with the use of employer securities in qualified retirement plans subject to ERISA is a cursory overview meant to give the reader an appreciation of the challenges associated with the use of employer securities as an investment option inside of a qualified retirement plan. It is not a comprehensive recitation of all applicable rules and legal issues. Before any plan sponsor undertakes to offer its employer securities as an investment option in its plan, it should consult with legal counsel on the securities, tax, and ERISA law implications of so doing.

Background

The two major laws that impact on the discussion of employer stock as an investment option in a qualified retirement plan subject to ERISA are the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"). The overarching issue in the context of retirement plans is whether a participation interest in the affected plan is a "security" within the meaning of the 1933 Act and, if it is a security, whether such security has to be registered within the meaning of the 1934 Act. A secondary is whether offering an employer's stock that is privately held and non-registered as an investment in a qualified retirement plan could trigger registration of said stock.

Summary of the 1933 Act

For the registration requirements of the 1933 Act to apply, a "security" must be "offered" or "sold."¹ The term "offer" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value, but does not include preliminary negotiations or agreements between an issuer and an underwriter.² The definition of "security" includes a "certificate of interest" or "participation in any profit-sharing agreement," as well as an "investment contract."³

A "Sale" within the Meaning of the 1933 Act

The term "sale" includes every contract of sale or disposition for value of a security or interest in a security.⁴ From a regulatory perspective, the SEC takes the position that the issuance of employer stock to a plan (unless made in exchange for employee contributions) does not constitute a "sale."⁵ The SEC's rationale for this position is that the participants in the plan "do not individually bargain to contribute cash or other tangible or definable consideration to such plans."

The ability of participants to choose how to invest the employer contributions made on their behalf to a noncontributory plan among the different investment opportunities offered by the plan does not involve a sale, even if employer stock is one of the investment choices.⁶ There are a number of exemptions from the registration requirements of the 1933 Act, both with respect to the employer stock itself and the participation interests in the plan. Although the statutory language is expressly limited to situations in which an amount in excess of the amount of the employer contributions is invested in employer securities, the SEC takes the position that this exemption does not apply if any employee contributions

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¹ 1933 Act sec. 5(a)(1), (c).
² 1933 Act sec. 2(a)(3).
³ 1933 Act sec. 2(a)(1).
⁵ SEC Rel. No. 33-6188, Part II, 5, d.
may be invested in employer securities (even if not all of the employer contributions are invested in employer securities).\(^7\) The issue of whether the participation interests in the plan need to be registered is a separate consideration from that of registration requirements applicable to employer stock.\(^8\)

**Acquisition of Employer Securities by the Plan**

If the employer contributes its stock to the plan, no sale has occurred, so that the registration requirements will not apply.\(^9\) Likewise, if the employer securities are purchased by the plan with pre-existing funds attributable to employer contributions, the purchase is likely to be exempt, but the applicable exemption may depend upon the party from whom the stock is purchased.

If the employer stock is purchased on the open market from persons who are not underwriters or dealers, the exemption provided by section 4(a)(1) of the 1933 Act (i.e., transactions by any person other than an issuer, underwriter, or dealer are exempt from the registration requirements of the 1933 Act) applies.\(^10\) If the employer stock was purchased directly from the employer, the exemption provided by section 4(a)(2) of the 1933 Act (i.e., transactions by an issuer not involving a public offering) generally exempts the purchase from the registration requirements of the 1933 Act.\(^11\)

**Participant-Directed Purchases**

If each participant has the right to decide whether his or her contributions are to be invested in employer stock, registration is required even if the shares are purchased on the open market. This is because, for purposes of applying the registration requirements, the process can be analyzed as if it were comprised of two separate transactions: (i) the plan's purchase of the stock on the open market, which transaction need not be registered; and (ii) the plan's sale of that stock to the individual employees, which sale must be registered. Registration is required of the second transaction because the employer's level of involvement in a tax-qualified retirement plan is necessarily so significant as to result in the second transaction being treated as if it were effected directly by the employer.\(^12\)

**Regulatory Safe Harbors**

There are three regulatory safe harbors for the plan's purchase of employer stock: (i) Rule 147\(^13\); (ii) Regulation D\(^14\); and (iii) Rule 701.\(^15\) Note - these safe harbors apply only to sales of employer stock by the employer to the plan. They do not apply to re-sales of employer securities by participants who receive distributions of employer securities from the plan.\(^16\) Following is a brief description (without elaboration) of the safe harbors that obviate the need for an employer to register its securities.

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\(^7\) SEC Rel. No. 33-6281, Part II, B, 1.
\(^8\) See SEC Rel. No. 33-6188, Part V, A.
\(^9\) SEC Rel. No. 33-6188, Part V, A.
\(^10\) SEC Rel. No. 33-6188, Part V, A, fn. 165. 1933 Act sec. 4(1) was effectively redesignated 1933 Act sec. 4(a)(1) by P.L. 112-106, sec. 201(b)(1) and (c)(1), effective Apr. 5, 2012.
\(^14\) SEC Rel. No. 33-6188, Part V, A. 1933 Act sec. 4(1) was effectively redesignated 1933 Act sec. 4(a)(1) by P.L. 112-106, sec. 201(b)(1) and (c)(1), effective Apr. 5, 2012.
\(^15\) SEC Rel. No. 33-6188, Part V, A. 1933 Act sec. 4(1) was effectively redesignated 1933 Act sec. 4(a)(1) by P.L. 112-106, sec. 201(b)(1) and (c)(1), effective Apr. 5, 2012.
Rule 147 is a statutory exemption from the registration requirements of the 1933 Act for sales of employer securities that are conducted solely within a single state.\(^{17}\) Regulation D, comprised of Rules 500 through 508, offers three different exemptions from the registration requirements, which each have different maximum dollar limits governing private placement exemptions.\(^{18}\) Rule 701 provides a safe harbor exemption from the registration requirements for compensatory arrangements maintained by privately held employers, provided that certain conditions are met.\(^{19}\) Within the purview of Rule 701 is a “compensatory benefit plan,” defined as any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, deferred compensation, pension or similar plan.\(^{20}\) The plan can be maintained by the employer, a parent corporation, a majority-owned subsidiary, or a majority-owned subsidiary of the employer’s parent (collectively referred to as the “Controlled Group”).\(^{21}\) Rule 701 can be used to register both (i) the employer securities held by a tax-qualified retirement plan and (ii) the plan interests in such a plan (e.g., a 401(k) plan) that permits employee contributions to be invested in employer securities.\(^{22}\) Rule 701 also applies to the conversion of a tax-qualified profit-sharing plan into an Employee Stock Ownership Plan, if that would result in the employee contributions to the profit sharing plan being invested in employer securities in the Employee Stock Ownership Plan at the election of the participant.\(^{23}\)

**Registration of Employer Securities**

If no exemption from registration applies to the acquisition of employer securities by the plan, or if participation interests must be registered because the plan is voluntary and contributory and employee contributions may be invested in employer securities, then both the employer securities and the participation interests in the plan typically are registered using Form S-8.

**Participation Interests as a “Security”**

The Securities and Exchange Commission (“SEC”) takes the position that whether or not a participation interest in a tax-qualified retirement plan is a “security” will depend on whether or not participation in the plan is voluntary, and on whether or not employees can elect to contribute to the plan.\(^{24}\) The SEC’s conclusions apply whether the plan is a defined contribution plan or a defined benefit plan. The most important consideration, from the perspective of the typical plan sponsor of a 401(k) plan, is whether the employee’s participation interest is a security under the 1933 Act that would have to be registered under the 1934 Exchange Act.

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\(^{17}\) 1933 Act sec. 3(a)(11).
\(^{18}\) See 17 C.F.R. secs. 230.500 to .508.
\(^{19}\) 1933 Act sec. 5.
\(^{20}\) Rule 701(c)(2), 17 C.F.R. sec. 230.701(c)(2). Note that this term is not coextensive with the term "employee benefit plan" contained in ERISA sec. 3(3). In that regard, stock option, stock appreciation, and most other forms of stock-based plans are not subject to ERISA, because they are typically designed as "top-hat" plans, exempt from most ERISA Title I requirements.
\(^{21}\) Rule 701(c), 17 C.F.R. sec. 230.701(c).
\(^{22}\) See SEC No-Action Letter issued to Nissan Motor Corporation (avail. 4/22/94).
\(^{23}\) SEC No-Action Letter issued to Professional Food Service Management, Inc. (avail. 2/2/89); SEC No-Action Letter issued to Willdan Associates (avail. 7/28/93). Note that the conversion of the employer contribution accounts is not an event that requires compliance with the registration requirements. SEC Rel. No. 33-6188, Part III, A, 1.
Following is a breakdown of the various categories of retirement plans and a discussion of whether the participation interests therein constitute securities that would be subject to registration. Obviously, if the participation interest in a particular category of retirement plan is not a security, there is no need to consider the registration issue for the participation interest.

(1) **Involuntary, Noncontributory Plan.** A participation interest in an involuntary, noncontributory plan is not a security.  

(2) **Involuntary, Contributory Plan.** The SEC has taken the administrative position that a participation interest in an involuntary, contributory plan is not a security.

(3) **Voluntary, Noncontributory Plan.** The SEC has taken the administrative position that a participation interest in a voluntary, noncontributory plan is not a security.

(4) **Voluntary, Contributory Plan.** The SEC has taken the administrative position that a participation interest in a voluntary, contributory plan is a security. Under this view, a security will exist if participants can elect to make contributions to a plan, without regard to whether or not the participant contributions may be invested in employer stock. Some courts have held that an interest in a voluntary, contributory plan is not a security.

After determining whether a participation interest in a particular category of plan is, itself, a security, the focus shifts to whether such participation interest needs to be registered as a security. Even though the participation interests in a plan may be securities, they generally are not required to be registered unless employee contributions can be invested in employer stock. Just because the participation interests may be exempt from the registration requirements, they still are subject to the antifraud provisions.

**The 1934 Act**

As a general rule, an employer must register its stock under the 1934 Act if (i) the stock is listed on a national securities exchange or (ii) the employer has more than $10,000,000 of assets and either 2,000 or more shareholders or 500 or more shareholders who are not accredited investors (as defined by the 1933 Act).

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28 SEC Rel. No. 33-6188, Part II, A, 2, d.
30 1933 Act sec. 3(a)(2). See the SEC Division of Corporation Finance Compliance and Disclosure Interpretations, Section 226.13, available at www.sec.gov/divisions/corpfin/guidance for a discussion of the impact of a plan that allows employee contributions to be invested in investments other than employer stock to be commingled with diversified funds.
31 1933 Act sec. 17.
32 1934 Act sec. 12(b).
by the SEC). However, if the employer has more than one class of stock, only the class that is so listed or widely held need be registered. The investment of the assets of a retirement plan in employer securities generally will not, by itself, require registration of the employer securities under the 1934 Act, regardless of the number of participants in the plan, because the plan is considered to be a single shareholder for this purpose. This same rule may also enable the plan to avoid having to register the participation interests in the plan under the 1934 Act.

**ERISA Aspects of Allowing Participants to Direct Investments into Employer Securities**

The discussion in this section of the paper assumes that the plan sponsor's securities are registered and publicly traded; thus, it focuses on the ERISA aspects of allowing employer securities as an investment choice for participants and not on the securities law aspects thereof. This discussion also assumes that the requirements of ERISA section 407 (discussed above) have been satisfied.

**Employer-Motivated Purchases of Employer Securities**

The backdrop for this discussion is the ERISA "prudent man" standard of care found in ERISA section 404(a)(1). It provides that a plan fiduciary must discharge his or her duties with respect to the plan solely in the interest of the participants and beneficiaries and -

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; ...

ERISA section 404(a)(2) provides that in the case of an eligible individual account plan, the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities. Since ERISA was enacted, the twin aspects of diversification and prudence have been litigated ever more frequently as many employers have made their employer securities as an investment option to participants in participant-directed defined contribution plans or that have chosen make any matching employer contributions in the form of employer securities instead of cash.

An issue dividing circuit courts, which the U.S. Supreme Court would ultimately settle in *Fifth Third Bancorp v. Dudenhoeffer,* was whether fiduciaries of defined contribution plans that include an ESOP, and plans that include employer stock generally, are entitled to a presumption of prudence regarding

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33 1934 Act sec. 12(a); 1934 Act sec. 12(g)(1), as amended by Jumpstart Our Business Startups Act (JOBS Act), P.L. 112-106, sec. 501 (increasing statutory asset threshold from $1 million and shareholder threshold from 500), effective Apr. 5, 2012. See Rule 12g-1, 17 C.F.R. sec. 240.12g-1 (increasing asset threshold to $10 million as of May 9, 1996).
34 1934 Act sec. 12(g)(5).
35 1934 Act sec. 12(g)(5); Rule 12g5-1(a)(3), 17 C.F.R. sec. 240.12g5-1(a)(3).
36 Rule 12g5-1(a)(3), 17 C.F.R. sec. 240.12g5-1(a)(3).
their decisions to purchase or hold on to employer stock despite substantial declines in the value of the stock. The Court held in *Dudenhoeffer* that there is no such special presumption of prudence, although ESOP fiduciaries are not subject to a duty to diversify.

**Employee-Motivated Purchases of Employer Securities**

ERISA section 404(c) offers a way for plan fiduciaries to transfer liability for investment decisions made by participants and beneficiaries from the fiduciaries to the persons who make those decisions if certain requirements are met. NOTE - a complete analysis of ERISA section 404(c) is beyond the scope of this paper and is mentioned here only in the context of employer securities being offered as an investment option available to participants. In order to be a plan that is afforded the protections of ERISA section 404(c) (i.e., a “404(c) plan”), the 404(c) regulations provide that the plan must satisfy the following three basic requirements: (i) it is an individual account plan described in section 3(34) of ERISA; (ii) the plan provides an opportunity for a participant to exercise control over assets in his or her individual account; and (iii) the plan provides a participant an opportunity to choose, from a broad range of investment alternatives, the manner in which some or all of the assets in his or her account are invested.

Here is what the 404(c) regulations say about what constitutes a “broad range” of investment alternatives: (i) there must be at least three designated investment alternatives from which participants may select; (ii) each of the designated investment alternatives must be diversified; (iii) taking into account all of the funds that constitute designated investment alternatives, the participant, by choosing among them, must be able to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the affected participant; (iv) each of the designated investment alternatives, when combined with other investments available to participants, tends to minimize through diversification the overall risk of a participant’s portfolio; (v) in determining whether a plan provides a participant with a reasonable opportunity to diversify his or her investments, the nature of the investment alternatives offered by the plan and the size of the portion of the individual’s account over which investment discretion is exercised must be considered; and (vi) if the investment lineup is restricted such that the participants cannot adequately diversify, the plan fiduciary in charge of constructing the designated investment alternatives must add look-through investments (i.e., mutual funds) in order to achieve adequate diversification.

Investment alternatives offered in addition to the three core investment alternatives required by 29 C.F.R. sec 2550.404c-1(b)(3) are not required to be diversified in order to be eligible for coverage by ERISA section 404(c). The preamble to the regulation states: "Under this analysis, ERISA section 404(c) would protect plan fiduciaries from liability for losses attributable to participants’ investment choices, such as the decision to allocate their contributions to the prior employer stock fund. To the extent that the prior employer stock fund includes shares representing employer matching contributions that were made in shares of stock without the employee’s election, however, ERISA section 404(c) does not apply. The fact that participants have the right only to withdraw assets from the prior employer stock fund does not change this conclusion. The DOL’s position is that ERISA section 404(c) provides protection only with respect to the consequences of participants’ affirmative elections, and the failure to exercise an election right is not treated as an affirmative election (with the exception of default elections.

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38 29 C.F.R. sec. 2550.404c-1.
39 29 C.F.R. sec. 2550.404c-1(b)(3).
as described in ERISA section 404(c)(5), as added by Pub. L. No. 109-280, §624(a), and amended by Pub. L. No. 110-458, §106(d), applicable to plan years beginning after Dec. 31, 2006)."

It is a generally recognized fiduciary duty to prudently select and then monitor the investment options available to participants in a participant-directed investment program designed to qualify under ERISA section 404(c). Thus, even though the investment lineup available to participants may include three or more broadly diversified funds from which the participants and beneficiaries may choose, the applicable plan fiduciary would need to consider the prudence of initially offering or continuing to offer employer stock as one of the non-core investment options.

**Defined Benefit and Other Plans**

As discussed above, ERISA section 407 limits the amount of qualifying employer securities that can be held by employee benefit plans other than eligible individual account plans, such as defined benefit plans. This limitation should not, however, be interpreted as implying that holdings of qualifying employer securities are somehow presumptively prudent. Rather, the plan's investment in qualifying employer securities must be reviewed for prudence in the same manner as any other plan investments.

One issue that sometimes arises is whether an employer may satisfy its obligation to contribute to a defined benefit or money purchase plan in property other than cash to satisfy contribution requirements are treated as a sale or exchange between the plan and the employer, and hence a transaction prohibited by ERISA paragraph 406(a)(1)(A) unless an exemption is available. However, as discussed above, because ERISA subsection 408(a) exempts transactions involving employer securities from the prohibitions of ERISA section 406, employers sometimes make contributions to plans in the form of securities. The DOL takes the position that all contributions of property to defined benefit plans and welfare plans may be such sales or exchanges, even if the contribution does not satisfy the employer's contribution requirements.

**Corporate Governance Issues Involving Employer Securities**

The investment of defined contribution plan investments in qualifying employer securities raises certain corporate governance issues. Before deciding to offer qualifying employer securities as an investment option, plan sponsors should check with their legal counsel to determine the existence of any corporate governance issues and the satisfactory resolution of those issues. Especially in the case of employee stock ownership plans, participants have certain rights with respect to the employer securities allocated to their accounts in the ESOP.

**Rollovers as Business Start-Ups (ROBS)**

One technique that has received a lot of press attention in recent years is the Rollovers as Business Start-ups ("ROBS") arrangement. Promoters of this arrangement suggest a technique by which an individual with a large IRA balance or an account balance with another employer's plan who wants to access capital to start a business establishes a 401(k) plan in the new business and then rolls the proceeds of the IRA into the newly-established 401(k) plan. Once the assets are in the 401(k) plan,

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41 See 29 C.F.R. sec. 2509.94-3.
they are used to purchase stock from the owner of the newly-established business, thus supplying start-up capital for the business at no tax cost, according to what the promoters of the ROBS arrangements claim.

Following is a more detailed discussion of the ROBS technique. Under a typical ROBS arrangement scenario, a new business owner first creates a C corporation. After incorporation, the newly-created corporation adopts a retirement plan that includes a provision allowing 100 percent of the plan assets attributable to rollovers to be invested in employer stock. Next, the business owner either rolls over or executes a direct transfer of the proceeds from an existing tax-deferred account, such as a 401(k) plan account with a former employer or an IRA, to the ROBS plan. Once the funds are in the ROBS plan, the corporation issues all of its capital stock. It then transfers the stock to the ROBS plan in exchange for the proceeds held in the rollover account. The bottom line is that the corporation receives the start-up capital it needs and the ROBS plan has assets in the form of employer stock theoretically equal to the value of the compensation paid.

The IRS has informally advised that ROBS arrangements are subject to misuse and will be subject to special scrutiny. For example, the IRS will review whether the ROBS arrangement discriminates in favor of highly compensated employees in terms of benefits, rights and features (particularly, the right to acquire employer stock); whether the employer stock was improperly valued; whether the ROBS promoter is deemed to have rendered investment advice, whether fees paid to the ROBS promoter constitute a prohibited transaction, and whether the ROBS arrangement meets the permanency rule for tax qualification. One example of a misuse of ROBS arrangements is that the stock's value often is set as the value of the available assets, without a proper determination as to the true value. The ROBS transaction could also be the subject of various ERISA party in interest prohibited transaction violations under ERISA section 406(a)(1), to include:

- sale or exchange, or leasing, of any property between the plan and a party in interest;
- lending of money or other extension of credit between the plan and a party in interest;
- transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

ERISA section 406(b) deals with fiduciary prohibited transactions and states that a fiduciary with respect to a plan shall not: (i) deal with the assets of the plan in his own interest or for his own account; (ii) in his individual or in 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; or (iii) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan. The ROBS arrangement could potentially violate one or more the fiduciary prohibited transaction rules, depending upon how the arrangement is established and operated.

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Federal income tax laws are complex and subject to change. The information in this memorandum is based on current interpretations of the law and is not guaranteed. Neither Nationwide, nor its employees, its agents, brokers or registered representatives gives legal or tax advice. You should consult an attorney or competent tax professional for answers to specific tax questions as they apply to your situation.

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