



Employee Benefits Update

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Are ERISA Budgets Plan Assets? The DOL Sheds Some Light

The Department of Labor (DOL) recently issued Advisory Opinion 2013-03A (Opinion), which addresses several legal issues surrounding ERISA budgets – arrangements plans commonly used to benefit from some or all amounts generated by revenue sharing arrangements between a plan's recordkeeper and plan investment alternatives (e.g., mutual funds). The Opinion provides important clarification concerning when such amounts are considered plan assets, and provides important reminders to plan fiduciaries of their responsibilities when analyzing and structuring these arrangements.

Background

Individual account plan recordkeepers often provide a platform of investment alternatives from which a plan fiduciary (typically the employer sponsoring the plan or a committee consisting of the employer's employees) may select plan investments. The investment alternatives typically consist of both affiliated and unaffiliated funds, some of which may provide revenue sharing to the recordkeeper in the form of 12b-1 fees, shareholder and administrative services fees, and other payments. Because these payments are a form of compensation the recordkeeper receives for services to the plan, the plan fiduciary must evaluate the reasonableness of the revenue sharing payments together with other forms of compensation the recordkeeper receives.

In recent years, many recordkeepers and plan fiduciaries have negotiated a variety of arrangements to enable the plans to share in the benefits of revenue sharing payments. While the details of these arrangements vary, they have generally been structured in one of two ways. Some

capture and deposit some or all of the revenue sharing payments to a plan account that may then be used to pay for plan expenses or be reallocated to participant accounts. Others provide for the recordkeeper to maintain records of revenue sharing payments received as a result of plan investments, and allow the plan fiduciary to direct the recordkeeper to pay third parties for administrative services provided to the plan.

Prior to the issuance of the Opinion, there was little guidance as to whether amounts credited under the second type of arrangement were considered plan assets. If they were, the credits would be subject to many requirements imposed by ERISA including, among others, trust requirements, and would need to be used to defray reasonable plan administrative expenses or be reallocated to participant accounts each year.

The Opinion

The Principal Arrangement

In the Opinion the DOL examined an arrangement utilized by Principal Life Insurance Company (Principal). Under the arrangement, Principal receives and retains as payment for its services revenue sharing payments from affiliated and unaffiliated funds and insurance company separate accounts offered in an ERISA plan. According to Principal, these amounts are not deposited to a custodial account or otherwise segregated for the benefit of a plan. Rather, pursuant to its agreement with certain plans, Principal maintains bookkeeping records of the revenue sharing payments it receives in connection with a plan's investments and tracks credits based on the revenue

sharing payments. Principal then pays plan administrative expenses from its general assets as directed by the plan fiduciary (or as provided in the parties' agreement) or deposits an amount equal to the credits in a plan account on a periodic basis.

The DOL's Analysis

Recognizing that ERISA does not expressly define plan assets, the DOL reiterated that the determination of what constitutes plan assets is made based on ordinary notions of property rights, and generally includes any tangible and intangible property in which the plan has a beneficial ownership interest. This would necessarily require an examination of all of the facts and circumstances, including consideration of contracts and other legal documents, and the actions and representations of the parties. The DOL noted that the mere segregation of assets by the recordkeeper to facilitate payments of credits would not, in and of itself, create property rights in the plan.

Applying these rules to Principal's disclosed arrangement, the DOL found nothing in the circumstances described that indicated the amounts recorded in the bookkeeping account would be plan assets before the plan actually receives them. However, the DOL noted that the plan's contractual right to receive those payments would be a plan asset and accordingly, if Principal failed to pay amounts as required, the plan would have a claim against Principal that would be a plan asset.

The DOL also noted that regardless of whether these credits are plan assets, plan fiduciaries continue to have general fiduciary obligations to prudently select and monitor plan service providers. In general, the engagement of a plan service provider constitutes a prohibited transaction unless the engagement is reasonable, for necessary services and for no more than reasonable compensation. Thus, plan fiduciaries must prudently evaluate the reasonableness of the services to be provided and the compensation to be received for those services – including any revenue sharing and ERISA credit arrangement. Finally, because a fiduciary has an ongoing obligation to monitor service provider arrangements, it must also have sufficient information regarding the formula, methodology and assumptions used by a service provider to calculate ERISA credits, and the capability to confirm that credits provided are consistent

with the terms of the parties' agreement. The inability of the plan fiduciary to do so could result in a fiduciary breach and possibly a prohibited transaction.

Next Steps for Plan Fiduciaries

Based on the Opinion, plan fiduciaries should:

- Periodically review and evaluate the plan's arrangement with its recordkeeper. If the plan's compensation structure is asset-based – including revenue sharing arrangements – the plan fiduciary should monitor whether plan asset growth may warrant renegotiation of the parties' fee arrangement.
- To the extent some or all of the recordkeeper's compensation is paid through a revenue sharing arrangement, evaluate whether the plan has or should seek an ERISA budget arrangement to recapture some or all of these payments for the benefit of the plan.
- If the plan has an ERISA budget arrangement, consider if and when amounts credited become plan assets. To do so, evaluate all of the facts and circumstances of the arrangement, including the existence of a segregated account in the name of the plan, contractual provisions describing the arrangement, disclosures required under ERISA Section 408(b)(2), and other communications and representations between the parties.
- In the event amounts credited under the arrangement are plan assets, confirm how these amounts can and must be spent. Generally, any amounts not spent on defraying reasonable plan administrative expenses must be allocated to participant accounts by the end of each year. If the amounts credited under the arrangement are not plan assets, the amounts may be used to pay reasonable plan administrative expenses, and need not be allocated to participant accounts by the end of each year.
- Confirm that the plan document language regarding payment of plan expenses is consistent with the service agreement's provisions and the plan's operation.
- Regardless of structure, confirm that credits are only used for the benefit of participants and beneficiaries. If credits are used to defray administrative expenses, confirm that the expenses are reasonable and for plan administration – the amounts may **not** be used to pay settlor expenses.
- If amounts are to be reallocated to participant accounts, consider how these amounts will be allocated (pro rata, per capita, etc.) and confirm that the methodology is consistent with the plan terms and fiduciary standards.

- Periodically consider the desirability of alternative compensation structures such as lower-cost share classes that do not provide revenue sharing payments to the recordkeeper.
- Consider and address the ability to access data necessary to confirm that credits are consistent with the terms of the parties' arrangement. Plan fiduciaries must have access to this information to discharge their monitoring obligations.

FOR MORE INFORMATION

The Opinion serves as an important reminder of the fiduciary issues involved in entering into and maintaining an ERISA budget arrangement. For more information regarding the Opinion and its implications to your arrangement, please contact any member of our [Employee Benefits & Executive Compensation](#) group.

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