ERISA Accounts Meet Plan Asset Rules in New DOL Guidance

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Duty to Review Plan Expenses

Revenue sharing payments, such as 12b-1 and sub-transfer agency fees, are paid by mutual funds to 401(k) plan service providers to compensate them for services undertaken on behalf of plans. *For example*, a plan recordkeeper may receive sub-transfer agency fees to track participant-level ownership of shares. The DOL has recognized that such payments can improve efficiency and reduce the cost of administrative services. At the same time, the complexity of revenue sharing practices contributes to the need for the plan-level fee information required by recently effective regulations. Among other things, these regulations are intended to give plan sponsors the tools to oversee revenue sharing and ensure that plans do not pay excessive amounts for services as a result of such indirect payments.

Levelizing Provider Compensation through ERISA Accounts

One of the strategies developed by recordkeepers to assist plan sponsors in this regard is the so-called "ERISA account" (sometimes also referred to as an "ERISA budget" or an "ERISA expense account"). In instances in which such an account is used, some or all of the revenue sharing allocated to a plan may be used to compensate a plan service provider, such as the recordkeeper itself or the provider of accounting, advisory, or third-party administrator services. From a recordkeeper's perspective, this approach ensures that the recordkeeper's compensation will not exceed the fee stated in its plan contract. Because the recordkeeper does not retain revenue sharing payments for its own benefit, its compensation remains level, which eliminates its incentive to steer plan clients to investment options with high revenue sharing.

In one version of this technique, revenue sharing dollars are paid to a plan account and are part of plan assets. If the account is not zeroed out at the end of the year by payments to service providers, the plan allocates the remainder to participants in order to comply with the IRS requirement that all plan assets be fully allocated to participant accounts.

An alternative version of the ERISA account (sometimes referred to as a "pension expense reimbursement account" or "PERA") requires revenue sharing to be credited to a hypothetical bookkeeping account maintained by the recordkeeper. Under this arrangement, the actual dollars remain with the recordkeeper as part of its general assets and do not belong to the plan. The plan may, however, direct the recordkeeper to use the assets (up to the credited amount) in a number of ways, as specified by its agreement with the recordkeeper, including the compensation of plan providers. This type of account carries over from year to year; however, if the plan discontinues the services of the recordkeeper, the account may be forfeited, in which case the recordkeeper retains the remaining revenue sharing payments that generated the account.

The Plan Asset Question

In Advisory Opinion 2013-03A, the DOL recently issued guidance to Principal Life Insurance Company clarifying the application of plan asset rules to a PERA-type arrangement. The issue is important because if revenue sharing payments held by a recordkeeper are treated as plan assets before being applied for the benefit of the plan or its participants, there would be a violation of ERISA's requirement that all plan assets be segregated and held in a plan's trust. Moreover, possession of plan assets would confer fiduciary status on the recordkeeper holding them and, as a result, the recordkeeper would engage in a fiduciary breach as well as violate the prohibited transaction rules by commingling the revenue sharing money with its own assets.

The new advisory opinion's analysis of what constitutes plan assets begins with the observation that "the assets of an employee benefit plan generally are to be identified on the basis of ordinary notions of property rights." This breaks no new ground, since numerous DOL advisory opinions have previously made this point. The new opinion goes on to note that plan assets generally include any property in which a plan has a beneficial ownership interest and that to determine whether such an interest exists requires consideration of any contracts or legal instruments involving the plan, as well as the actions and representations of the parties involved with the ERISA account.

Thus, according to the opinion, the requisite beneficial interest generally arises if particular assets are held in trust on behalf of the plan, or in a separate account in the plan's name with a third party, such as a bank. In addition, the plan would have a beneficial interest in an ERISA account maintained by a recordkeeper if a document or legal instrument indicates that the funds in that account belong to the plan. The new opinion also indicates that a plan could have a beneficial interest in an ERISA account if an intent

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has been expressed to grant such an interest to the plan. Moreover, a representation (presumably, by the recordkeeper or other service provider) sufficient to lead plan participants and beneficiaries reasonably to believe that revenue sharing funds separately secure promised benefits would create the beneficial interest that turns those funds into plan assets.

On the other hand, the opinion notes that the mere segregation of a service provider's funds to facilitate the administration of its service contract with a plan would not in itself create a beneficial interest in the segregated assets on behalf of the plan. Thus, merely crediting revenue sharing payments to an ERISA account maintained by a recordkeeper, without more, should not create a beneficial interest in the plan.

In the case of Principal Life, to which Advisory Opinion 2013-03A was addressed, the DOL noted that Principal's arrangements and communications with each plan from whose investments Principal received revenue sharing could potentially lead to the conclusion that such amounts are plan assets. Advisory opinions do not attempt to resolve such factual questions, so that Principal could not have expected to receive an ironclad guaranty that the revenue sharing amounts in its possession are not plan assets. It did, however, receive assurance that the DOL saw nothing in the typical PERA arrangement presented by Principal which would lead it "to conclude that amounts recorded in the bookkeeping account as representing revenue sharing payments are assets of a client plan before the plan actually receives them." Thus, the new guidance does not seem to require changes to the standard PERA arrangement.

Caveats

Advisory Opinion 2013-03A makes several observations as to the obligations of plan fiduciaries with respect to an ERISA expense account. First, the client plan's contractual right to receive payments (or have such payments applied to plan expenses) under the arrangement would be a plan asset. If a recordkeeper or other service provider fails to make a required payment under the arrangement, the plan would have a claim against the service provider that would itself be a plan asset.

Since the contractual arrangement that underlies an ERISA account is a plan asset, plan fiduciaries must act prudently in negotiating the specific formula and methodology under which revenue sharing will be credited to the plan and paid back to the plan or to its service providers. The new opinion indicates that the plan fiduciary must understand the formula, methodology, and assumptions to be used by the service provider in implementing the ERISA account. The plan fiduciary should also be capable of monitoring the service provider's performance under the ERISA account arrangement to ensure that amounts payable to the plan are correctly calculated and applied for the plan's benefit. The implication appears to be that if the plan fiduciaries do not have the capability to oversee the service provider's implementation of the ERISA account, the plan should not enter such an arrangement. ❖

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