Revenue-Sharing Tasks

Meeting DOL fiduciary requirements

THE Department of Labor (DOL) has stated that when selecting a plan service provider, a plan sponsor must assess the reasonableness of the provider's compensation—both direct, hard-dollar fees and indirect revenue sharing—in light of the services provided. The assumption that underlies the now final 408(b)(2) regulations is that, after plan service providers furnish plan sponsors with the mandated information regarding their direct and indirect compensation, a sponsor will use it to meet this requirement. The indirect compensation is likely to consist of revenue sharing—for example, 12b-1 and sub-transfer agency fees paid by mutual funds to recordkeepers and other service providers to compensate them for services undertaken on behalf of plans.

On the surface, the task of monitoring these payments may seem straightforward, but many plan sponsors will not fully appreciate the complexity of plan fee structures. Plan advisers can add value to their services by helping sponsors to structure effective Employee Retirement Income Security Act (ERISA) expense accounts and by providing assistance in monitoring their operations.

One means for a plan sponsor to keep track of revenue sharing and ensure that it is used for the benefit of the plan is to utilize an ERISA expense account. From a recordkeeper's perspective, this approach ensures that the recordkeeper's compensation will not exceed the fee stated in its plan contract. This is all the more important if the recordkeeper is a plan fiduciary and needs to maintain a level amount of compensation. An ERISA expense account is established when the revenue-sharing amounts received by the recordkeeper exceed a specified cost for the recordkeeping services. Because the recordkeeper does not retain revenue-sharing payments in excess of this limit, the firm's compensation remains level, which eliminates its incentive to steer plan clients to investment options with high revenue sharing.

In one version of the ERISA expense account, revenue sharing is credited to a hypothetical bookkeeping account maintained by the recordkeeper for the benefit of the plan, but the actual revenue-sharing dollars remain with the recordkeeper as part of its general assets. The bookkeeping credits can be applied to pay certain plan expenses, such as the cost for services by accountants, actuaries, attorneys or consultants. If the plan discontinues the recordkeeper's services, the balance in the account could be forfeited, depending on the terms of the arrangement. In another form of ERISA expense account, revenue-sharing dollars are actually paid to the plan and become part of plan assets. Here there is no question of forfeiture, but if the account is part of an individual account plan and not used up by the end of the year, it must be allocated to participants' accounts in accordance with Internal Revenue Service (IRS) rules that prohibit unallocated funds.

In its recent Advisory Opinion 2013-03A, the DOL provided guidance as to the fiduciary review needed to set up such an ERISA expense account. Acting prudently, the plan sponsor must ask the recordkeeper for all relevant information, and gain an understanding of the formula and methodology the recordkeeper uses to determine credits to the ERISA expense account. The plan sponsor must then periodically monitor the recordkeeper's calculations and disbursement of revenue-sharing credits to the plan. If the plan sponsor is not confident of its ability to perform these tasks, it should hire an independent fiduciary or seek help from a plan adviser to review the ERISA expense account.

The primary purpose of Advisory Opinion 2013-03A was to clarify the application of the plan asset rules to ERISA expense accounts. If revenue-sharing payments held by a recordkeeper are treated as plan assets before they are applied for the benefit of the plan or its participants, there would be a violation of ERISA's requirement that plan assets be segregated and held in a plan's trust. Further, a recordkeeper's possession of plan assets would confer fiduciary status on the recordkeeper and cause it to violate the prohibited transaction rules by commingling the revenue-sharing funds with its own assets.

Consistent with prior guidance, the DOL's analysis of what constitutes a plan asset is based on the "ordinary notions of property rights." According to the new advisory opinion, whether a plan has property rights to revenue-sharing credits in an ERISA expense account depends on whether there are any plan contracts or legal instruments that provide these credits to the plan.

However, the DOL said it would not conclude that bookkeeping credits were plan assets before the plan actually received them. Thus, we may expect to see more ERISA expense accounts that do not pay revenue-sharing dollars to the plan.

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