Bloomberg BNA

Pension & Benefits Daily ™

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Plan Administration

ERISA Accounts Useful for Paying Expenses In Plans, but Have Some Risks, Attorneys Say

ERISA budget accounts are useful tools for managing retirement plan expenses, but they come with advantages and risks and therefore require careful monitoring by plan sponsors and record keepers, benefits attorneys told Bloomberg BNA.

The accounts set up under the Employee Retirement Income Security Act aren't new, but the Department of Labor's fee disclosure final regulations under 29 C.F.R. § 2550.408b-2(b) contributed to a sudden interest in them, Rhonda Migdail, of counsel with Keightley & Ashner LLP in Washington, said June 12.

''I think there was an 'ah-ha' moment when DOL came out with the fee disclosure regulations, and people began to focus more on what these things actually were,'' said Migdail, formerly a manager in the Internal Revenue Service's Employee Plans division.

An ERISA account is a plan-level account that holds excess revenue-sharing payments collected by the plan record keeper. The payments can either be used for plan expenses or be allocated back to the plan participants.

Revenue-sharing payments result from annual marketing or distribution fees on a mutual fund (also called Rule 12b-1 fees), subtransfer agent fees, provider compensation, shareholder or administrative services fees or similar payments.

The fee disclosure rules (RIN 1210-AB08), which were released in February 2012, require certain service providers of ERISA-covered defined benefit and defined contribution plans to provide plan fiduciaries sufficient information to assess the reasonableness of compensation that service providers would receive under contract, to identify potential conflicts of interest and to satisfy reporting and disclosure requirements under Title I of ERISA (22 PBD, 2/3/12; 39 BPR 217, 2/7/12).

Two Types of Accounts. ERISA accounts can either be held inside the plan by the plan sponsor or outside the plan by the record keeper.

The two types of ERISA accounts can roughly be analogized to checking accounts and debit cards, Bruce L. Ashton, a partner in Drinker Biddle & Reath LLP's employee benefits and executive compensation practice group and based in Los Angeles, said June 5.

Under the ''checking account'' model, the money is put back into the plan trust, and therefore is an unallocated account in the plan, so the funds are ''clearly plan assets,'' Ashton said.

''The plan fiduciary, trustee, administrator, whoever it is, can direct that a check be written on that account to pay certain appropriate expenses,'' he said.

Under the ''debit card'' model, the funds are typically made available for the plan record keeper to be used to pay plan expenses at the direction of the plan fiduciary, Ashton said.

ERISA accounts—whether held inside or outside the plan—are much more common among small and midsize sponsors, because large sponsors often are able to eliminate revenue sharing during negotiations, Ashton said.

Advantages and Disadvantages. Both types of accounts offer sponsors and record keepers advantages, but also pose a degree of risk, the attorneys said.

''The advantage of either type of account for the plan is there is money available to pay certain plan expenses without it showing up as an explicit charge against participant accounts,'' Ashton said.

Another advantage is that the accounts allow sponsors to make sure that record-keeping fees don't become excessive, Marcia S. Wagner, managing director of the Wagner Law Group in Boston, said in an e-mail June 5.

A risk with the budget account is that if the record keeper were to become insolvent, the plan might not receive the benefit of the revenue sharing to which it was entitled, she said.

Fiduciaries need to closely watch what happens with the account at the end of the plan year or when the contract with the record keeper is terminated, Wagner said.

Practical Considerations: Plan Sponsors. Ashton said that as a practical and legal issue, plan sponsors need to be attentive to know when they should tell the record keeper that it has been overpaid in plan fees and must remit those funds to the plan.

In Advisory Opinion 2013-03A, the DOL's Employee Benefits Security Administration also addressed revenue sharing, describing several ERISA requirements that should help plan sponsors determine whether revenue-sharing payments made to a plan provider for defined contribution plans constitute plan assets under ERISA (132 PBD, 7/10/13; 40 BPR 1703, 7/16/13).

The advisory opinion doesn't address the fiduciary issues related to the use of amounts held in ERISA accounts, Migdail said. However, ERISA Section 404(a)(1) provides that a fiduciary must act for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan, she said.

''Using the ERISA account funds to pay plan expenses is a generally reasonable approach to take, but the plan document/agreement related to the ERISA account should specifically provide for such use of the ERISA account funds, and the funds should be spent down by the end of the plan year,'' Migdail said.

''Contracts should spell out how record keepers will handle the funds,'' she said.

Practical Considerations: Record Keepers. Record keepers also have practical considerations to keep in mind, the attorneys said.

Record keepers should voluntarily keep track of plan assets to determine whether they are getting paid more than they should be paid, and therefore should remit or reallocate funds to the plan, Ashton said.

''I think it's both a good business practice, but also a good risk management practice, because later they might get sued for not having done it,'' he said.

Wagner said that record keepers need to disclose to their clients as compensation any amounts received from an ERISA account as record-keeper compensation.

Amounts that are credited from a bookkeeping account should be characterized as indirect compensation, and amounts paid from an ERISA budget account should be characterized as direct compensation, Wagner said.

Equalizing Payments. An emerging issue on the ERISA accounts front is whether reallocation of expenses is fair to all participants, because not all investment alternatives or participant accounts have revenue sharing, Ashton said.

Unless a record keeper equalizes the payments, participants who have investments with revenue sharing will bear a greater share of plan costs, Ashton said.

To make sure that participants whose accounts have revenue sharing don't carry more burden than other participants, some record keepers are designing their systems to ''equalize'' the charges against each participant's account, Ashton said. Record keepers use this process to make sure that revenue sharing that comes out of a participant's account is remitted back to the plan and reallocated to the participant's account, rather than being used for overall plan expenses, he said.

The equalization process isn't required, but it is becoming more common, he said.

Ashton said that many consider equalization as a fairer means of reallocating the costs of the plan, but it also portends the possibility ERISA accounts will gradually disappear as revenue sharing is reallocated to participants instead of being used to pay plan expenses.

Migdail said one way to handle equalization is to track each participant's and beneficiary's investments in their accounts, and then reallocate in accordance with those investments on a pro rata basis. However, this approach is complex, and can be very time-consuming and difficult, she said.

Reallocation of funds from ERISA accounts where the amounts have accrued over several years offers a further difficulty due to the coming and going of plan participants, Migdail said.

Further Guidance? The EBSA opinion letter ''was a good opinion and welcome,'' but still left behind some ''nagging questions,'' Ashton said.

For example, he said that according to the letter, the money in the account at the record keeper wasn't a plan asset, but the contractual right to direct the funds meant that they were a plan asset, making it difficult to determine what that means in a practical sense.

''Is that an asset that needs to be reported on the 5500?,'' he asked, referring to the Form 5500, the annual reporting form qualified benefit plans are required to submit to the DOL and the IRS.

If the asset does need to be reported on the Form 5500, ''how do you value it? What does it mean to say the contractual right to direct the record keeper and how to spend the money in that account at the record keeper, what does that mean in a legal and practical sense?''

Migdail said more guidance from the DOL on how to allocate the funds in ERISA accounts would be helpful, and also said issues about how to allocate funds are becoming more common, so this is an area on which retirement industry professionals should focus.

Furthermore, ERISA accounts are likely to be around for a while, she said. ''In light of the way the industry has developed, it will be interesting to see how they are treated going forward. There's a whole spectrum of fees, so further clarification would be useful,'' she said.

Checklist. Plan sponsors and record keepers should consider the following when dealing with ERISA accounts:

- carefully review any revenue-sharing, record-keeping and other plan administrative service arrangements in light of guidance from the DOL;
- make sure account funds are spent down by the end of the plan year;
- keep track of accounts and ensure funds held in them are used for appropriate purposes;
- keep track of individuals who have left the plan;
- if funds remain after plan expenses are paid, reallocate funds on a pro rata basis based on asset classes in which participants were invested;
- determine whether the record keeper has been overpaid in plan fees, and should remit funds to the plan;
- specify in the contract how the record keeper will use the ERISA account funds; and
- for record keepers, disclose direct and indirect compensation from ERISA accounts.

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