

RESEARCH MEMO

TIC INTERNATIONAL CORPORATION

To: MANAGERS, CONSULTANTS, OTHER PROFESSIONALS

From: DAVID LIVINGSTON, DIRECTOR OF RESEARCH

Re: **GUIDELINES FOR ALLOCATING PLAN EXPENSES TO INDIVIDUAL ACCOUNTS
IN A DEFINED CONTRIBUTION PLAN**

INTRODUCTION

The Department of Labor (DOL) recently released the third so-called *Field Assistance Bulletin (FAB)*. A FAB is intended to provide guidance to DOL investigators who conduct compliance audits as well as to practitioners who have day-to-day responsibility for compliance with federal laws and regulations. The latest FAB (2003-3) deals with the subject of what rules apply to the allocation of plan expenses to individual participants **under a defined contribution pension plan where individual accounts are maintained.**

The purpose of this Memo is to highlight the basic allocation of expense guidelines outlined in *Field Assistance Bulletin 2003-3* published by the DOL on May 20, 2003. The entire text of the Bulletin may be downloaded at:

http://www.dol.gov/ebsa/regs/fab_2003-3.html

Two principal issues are discussed in this *Bulletin*: (1) the extent to which plan expenses are required to be allocated on a **pro rata v. a per capita basis**; and (2) the extent to which plan expenses may properly be charged **to an individual participant**, rather than plan participants as a whole. For purposes of discussing these issues, the *Bulletin* first assumes that the expenses are proper plan expenses under ERISA section 404(a)(1)(A)(ii) and second, assumes that the expenses at issue are reasonable with respect to the service to which they relate.

Throughout this Memo, the initials "FAB" are used to refer to Field Assistance Bulletin 2003-3.

BACKGROUND

ERISA itself contains no provisions specifically addressing how plan expenses may be allocated among plan participants and beneficiaries. ERISA section 104(b)(4) does, however, address certain instances in which a plan may impose a reasonable charge to cover the cost of furnishing copies of plan documents and instruments upon request initiated by a participant or beneficiary.

Also, ERISA section 262 permits group health care plans, subject to certain conditions, to require the payment of 102% of the premium cost per eligible participant covered under the plan for COBRA. This allows for 2 percentage points to be added for the administrative costs of COBRA.

Further, the DOL's regulations related to participant-directed accounts under IRS ERISA section 404(c) and 408(b)(1) provide that "reasonable expenses" associated with a participant's exercise of an investment option under the plan to direct investments or to take a participant loan **may be charged separately to an individual participant.**

With these relatively few exceptions, ERISA is silent on the issue of passing plan expenses along to participants. As a result, **plan sponsors and fiduciaries have considerable discretion** in determining, as a matter of plan design or of plan administration, how plan expenses will be allocated among participants and beneficiaries. *FAB 2003-3* provides the following guidelines for making these determinations.

ALLOCATING EXPENSES AMONG ALL PARTICIPANTS – PRO RATA V. PER CAPITA

If a method of allocation is spelled out in the plan document, the trustees are obligated to apply that charge based on the allocation method stated in the plan document. However, according to the Bulletin: "When the plan documents are silent or ambiguous on this issue, fiduciaries must select the method or methods for allocating plan expenses." (page 2 of the Bulletin)

In considering how to allocate expenses for a particular service to a participant, **the Bulletin cites two alternative methods** for making such an allocation: **a per capita charge** which would be the same for each participant, or **a pro rata charge**, the latter based on the assets in an individual account in the case of a defined contribution plan. The FAB indicates:

While a pro rata method of allocating expenses among individual accounts would appear in most cases to be an equitable method of allocation of expenses among participants, **it is not the only permissible method.** A per capita method of allocating expenses among individual accounts (i.e., expenses charged equally to an account without regard to the assets in the account) may also provide **a reasonable method of allocating certain fixed administrative expenses of the plan** such as recordkeeping, legal, auditing, annual reporting, claims processing, and similar administrative expenses.

On the other hand, where fees or charges to the plan are determined on the basis of account balances, **such as investment management fees**, a per capita method ... among all participants would appear to be arbitrary.

With regard to services which provide investment advice to individual participants, a fiduciary may be able to justify the allocation of such expenses on either a pro rata or per capita basis and without regard to actual utilization of the services by particular individual accounts. **Investment advice services might also be charged on a utilization basis** ... whereby the expense would be allocated to an individual account solely on the basis of a participant's utilization of the service.

As this citation suggests, the allocation of a specific expense to a particular participant versus its equal allocation to each participant will require the trustees to undertake a very careful study of how much the expense really is and then to determine what seems to be a prudent and reasonable way to recover the expense. **The DOL readily concedes that such analysis will not always generate a nice clean black-and-white answer and that trustees will just have to do the best they can in making a judgment call when selecting an appropriate allocation method.**

ALLOCATING EXPENSES TO AN INDIVIDUAL V. ABSORBING IT AS A GENERAL PLAN EXPENSE

The Bulletin also focuses on the extent to which an expense may be allocated (or charged) solely to a particular participant's individual account rather than allocated among the accounts of all participants (e.g., on a pro rata or per capita basis).

In that regard the Bulletin concedes that a 1994 Advisory Opinion which precluded any charge being assessed for the processing of a domestic relations order **is no longer the DOL's position.** In a reversal of its earlier position, the DOL states on page 3 of the latest FAB:

Since the issuance of AO 94-32A, the Department has had an opportunity to review the Act [ERISA] and the opinion in the context of a broader array of plan expense allocation issues raised in the course of investigations. **On the basis of this review, the Department has determined that neither the analyses or conclusions set forth in that opinion are legally compelled by the language of the statute.**

Translated, this statement seems to say that it is permissible to charge individual participants for the processing of a domestic relations order. The statement recognizes for the first time, that it is not unusual for a domestic relations order to go through several modifications before it meets the requirements necessary to be a QDRO. Each time the plan needs to seek the advice of an attorney (usually fund counsel) concerning whether or not the order is a QDRO, often resulting in additional fund expense. Of course, if the trustees decide to assess a charge for processing a domestic relations order, a plan amendment or trustee resolution would be required to detail the person or persons who would be responsible for payment of the charge and to set forth a reasonable method for determining the processing charge (such as the hourly rate for review by a fund attorney if not already included in his or her retainer).

A copy of the DOL Advisory Opinion 94-32A can be easily located at:

<http://www.dol.gov/ebsa/programs/ori/advisory94/94-32a.htm>

EXAMPLES OF EXPENSES WHICH CAN BE CHARGED TO INDIVIDUAL ACCOUNTS (pages 3 and 4 of FAB 2003-3)

The DOL's position, as set forth in the FAB, permits the allocation of five common fund expenses directly to an individual participant's account. These expenses include the costs to:

1. **Determine if a domestic relations order** or a child medical support order to be considered a "qualified" order.
2. **Process hardship withdrawals** (if the plan permits such withdrawals). Presumably this would include fees involved in determining if the requirements for "hardship" are met and other expenses involved in making the distribution.
3. **Calculate benefits payable** under different plan distribution options (e.g., lump sum, single life annuity, joint and survivor annuity, etc.)
4. **Process benefit distributions** including check writing fees. These charges may be assessed for benefit distributions paid on a periodic basis (e.g., monthly check writing expenses). According to the DOL, ERISA does not preclude such charges.
5. **Maintain accounts for terminated vested participants.** According to the FAB: "... plans may charge vested separated participant accounts without regard to whether the accounts of active participants are charged such expenses and without regard to whether the vested separated participant was afforded the option of withdrawing the funds from his or her account or the option to rollover the funds to another plan or IRA.

It should be noted, however, that the IRS and the tax rules may make such charge impermissible. In particular, IRS Regulation 1.411(a)-11(c)(2)(i) states that a consent to distribution, which is required if the distribution is more than \$5,000, is NOT valid if "a significant detriment" is imposed on the participant who does not consent to a distribution. If a charge to maintain the account is considered to be a "significant detriment" by the IRS, it may be impermissible notwithstanding the DOL's position. (This problem is cited in the May issue of *Employee Benefits Client Alert* prepared by Powell, Goldstein, Frazer and Murphy.)

SUMMARY OF GUIDELINES FOR TRANSFERRING PLAN EXPENSES TO INDIVIDUAL PARTICIPANTS

In order for a plan to be able to charge expenses to an individual's account (either on a per capita, pro rata, or fee-for-service basis), the following requirements must be satisfied:

1. The plan document must permit the expenses to be charged by the plan.
2. A plan amendment or a separate written policy statement should be prepared regarding charging expenses to an individual's account.

The amendment should spell out what method will be used by the plan (per capita, pro rata or fee-for-service) to allocate each type of expense to an individual account.

3. Participants must be given a SPD or a summary of material modifications outlining the fees that will be charged directly to their accounts.

If these guidelines are followed and assuming that the expenses bear a reasonable relationship to costs, the trustees should be in compliance with the requirements set forth in FAB 2003-3.

CONCLUDING OBSERVATIONS AND A SUGGESTION

This FAB grants great latitude to plan sponsors in designing how their plans will handle certain types of expenses. However, the FAB expresses no view about whether a particular allocation method might violate the Tax Code or any other federal statute. Nor does it cite many examples of situations where a per capita charge or a pro rata charge might not be warranted.

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