

**Practitioner Viewpoint: Turning the Tables
Practitioner Issues for DOL Consideration**

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1. Broader “Fiduciary” Definition (Marcia Wagner and Warren Widmayer)

The DOL is on a campaign to expose and minimize conflicts in the retirement plan industry. And they are accomplishing this goal, at least in part, through the new fee disclosure rules (*i.e.*, 408(b)(2) and participant-level fee disclosures). But the DOL is also seeking to implement rules that would address the problem of conflicts “head on”. Specifically, the DOL is in the process of proposing a new “investment advice fiduciary” definition. If the DOL stays on track with its proposal, many non-fiduciary advisors would become subject to the fiduciary standards under ERISA for the first time. Additionally, any advisors that do not want to become subject to the fiduciary requirements of ERISA would need to fess up to clients and make certain “in your face” disclaimers concerning their non-fiduciary status.

The DOL released its initial proposed regulations to modify the existing regulatory definition of a “fiduciary” on October 21, 2010. However, due to the high volume of comments submitted in connection with this proposal, including comments from members of Congress, the DOL announced on September 19, 2011 that it would be re-proposing this definition to take into account further input from the public.²

Overview of Existing Regulatory Definition

ERISA has a functional definition of a fiduciary. If you provide “investment advice” within the meaning of ERISA, you are automatically deemed to be a fiduciary. Under the current regulation, a person is deemed to provide fiduciary investment advice if:

- (1) such person renders advice to the plan as to the value or advisability of making an investment in securities or other property
- (2) on a regular basis,
- (3) pursuant to a mutual agreement or understanding (written or otherwise)
- (4) that such services will serve as a primary basis for investment decisions, and
- (5) that such person will render advice based on the particular needs of the plan.

¹ The discussion of Mr. Razim’s topic, “Does Employer Workforce Restructuring in Anticipation of PPACA Violate ERISA § 510?,” was written by Lisa Van Fleet, Bryan Cave, Gulf Coast Area TE/GE Council.

² <http://www.dol.gov/opa/media/press/ebsa/EBSA20111382.htm>.

It should be noted that this 5-factor definition of “investment advice” is narrower than the definition under federal securities law. For example, the Investment Advisers Act of 1940 has a rather expansive view of the advisory activity that is subject to regulation as investment advice.

Two Specific Changes to Existing Regulatory Definition

Assuming that the DOL’s re-proposed rule will follow its initial proposal, two specific changes would be made to the existing definition of “investment advice.” Under the existing rule, advisors are deemed to provide investment advice if, among other requirements:

- there is a mutual understanding or agreement that the advice will serve as a "primary basis" for plan investment decisions, and
- the advice is provided on a "regular basis."

However, under the DOL’s proposed rulemaking, an advisor would be deemed to provide investment advice if there is any understanding or agreement that the advice "may be considered" in connection with a plan investment decision, regardless of whether it is provided on a regular basis. Thus, casual advice or even one-time advice could trigger fiduciary status. Under both the existing and the initial proposed rules, advice would constitute "investment advice" only if it is individualized advice for the particular plan client.

Safe Harbor “Disclaimer” for Avoiding Fiduciary Status

In addition to broadening the existing "investment advice" definition, the DOL’s initial proposal introduced a safe harbor that advisors would need to follow to avoid fiduciary status. Generally, to avoid being characterized as an investment advice fiduciary, an advisor would have to "demonstrate" that the plan client knows, or reasonably should know, that (a) the advice or recommendations are being made by the advisor in its "capacity as a purchaser or seller" of securities or other property, (b) the interests of the advisor are adverse to those of the client, and (c) the advisor is not undertaking to provide "impartial investment advice." Although the initial proposed rule did not actually require the advisor to provide these disclaimers in writing, it clearly contemplated some type of notice or acknowledgment form for the plan client.

Potential Impact on Providers

If the proposed regulations were finalized in their current form, non-fiduciary advisors would undoubtedly need to change their service model and re-define their role as plan advisors. To avoid fiduciary status, they would effectively be forced to furnish written disclaimers to plan clients, stating that they are not providing impartial advice, as contemplated under the proposed DOL guidance. Alternatively, a provider could accept its status as a plan fiduciary. However, as a fiduciary, it would no longer be able to provide investment advice for any variable compensation (*e.g.*, 12b-1 fees) and it would be subject to ERISA and the prohibited transaction rules.

Outlook for DOL Proposed Regulations

Since the DOL announcement that it would be re-proposing its “fiduciary” definition, it has clarified that its re-proposed rule would only impose fiduciary status on those advisors who provide “individualized” advice to plan clients. The DOL has informally indicated that the re-proposed rule will be substantially similar in approach to its initial proposal. Its rulemaking this time around will be coordinated with the U.S. Securities and Exchange Commission (the “SEC”), which is working on its own proposal to impose fiduciary status on broker-dealers as authorized under the Dodd-Frank Act.³ The DOL’s re-proposed rule is expected in the first part of 2013.

³ Under the powers conferred by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the SEC is authorized to issue regulations that will impose on broker-dealers the same fiduciary standard that applies to investment advisers under the Investment Advisers Act of 1940, as amended (the “Advisers Act”). As required under the Dodd-Frank Act, on January 21, 2011, the SEC’s staff published its study on the different standards of conduct that currently apply to broker-dealers and investment advisers. In sum, the SEC staff’s report recommended that the SEC create a uniform fiduciary standard that would apply to both brokers and investment advisers when they provide personalized investment advice to retail customers. Of the 5 commissioners serving on the SEC, the 2 Republican appointees released a separate statement,

Practical Implications of Broader “Fiduciary” Definition.

The DOL’s pending proposal to broaden its “investment advice fiduciary” definition is likely to “shake up” the retirement plan industry, pressuring many retirement plan advisors to provide their services in a fiduciary capacity for a level fee. If the DOL’s re-proposed rule is similar to its initial proposal, any advisor that is unwilling to advise plan clients on these terms may, as a practical matter, be forced out of the retirement plan business. Given the significance of this anticipated change, financial advisors should evaluate and re-consider their business model for ERISA plan clients, especially those who do not currently hold themselves out as plan fiduciaries.

Recordkeepers are constantly adapting and developing new types of arrangements, and they may be able to offer assistance with the problems associated with variable compensation (which is prohibited under ERISA’s prohibited transaction rules in the case of a fiduciary advisor). For example, working with recordkeeping platforms that are able to offer level payouts may be one possible approach. Advisors can also explore the use of ERISA budget accounts (also known as ERISA fee recapture accounts) as a means for leveling the compensation payable to the advisor. Advisory firms that currently receive variable compensation may also wish to consider providing investment advice to ERISA plans as a dual-registered RIA, which would enable the firm to charge a level asset-based fee. There are no “one size fits all” solutions for all firms, especially since every advisor’s service model will need to be fully compliant with both ERISA and securities law. However, financial advisors and advisory firms should strongly consider the potential impact of the DOL’s proposal in the near future, and investigate potential and possible solutions in the days ahead.

2. Does Employer Workforce Restructuring in Anticipation of PPACA Violate ERISA § 510? (Prepared by Lisa Van Fleet, Presented by Edward Razim)

Issue:

To avoid the Patient Protection and Affordable Care Act (“PPACA”) coverage mandate and the pay or play penalty, does an employer risk a claim under § 510 of the Employee Retirement Income Security Act of 1974 (“ERISA”) if it limits an employee to part-time work, including:

- (a) restructuring employees into a part-time work force,
- (b) preventing an employee from working enough hours to be characterized as full-time, or
- (c) moving a full-time employee to part-time status?

Background:

ERISA § 510 states, in part, the following:

“It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant ... for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan, this title, or the Welfare and Pension Plans Disclosure Act.”

Under PPACA, beginning in 2014, employers will be penalized if they do not provide all full-time employees with affordable healthcare coverage (the “pay or play” penalty), as codified in § 4980H of the Internal Revenue Code of 1986 (“Code”).

In response to the pay or play penalty, employers, especially those with high-turnover, lower-wage workforces, may desire to restructure their workforce and replace full-time employees with part-time employees, thereby reducing the number of employees covered under the coverage mandate.

In addition, PPACA defines a full-time employee as an individual who works 30 or more hours per week, while many employers view part-time employees as those working less than 40 hours per week. Thus, under the

criticizing the report and making the following points: (i) the SEC staff’s report does not reflect the views of the SEC or its individual commissioners, (ii) the report failed to properly evaluate the existing standards of care applicable to broker-dealers and investment advisers as required by the Dodd-Frank Act, and (iii) additional study, rooted in economics and data, is required to support any recommendation for a uniform fiduciary standard.

PPACA coverage mandate, employers who only provide healthcare to full-time employees that work at least 40 hours per week, will be penalized if they do not expand their coverage to employees working between 30 and 40 hours per week.

Proposed Resolution:

First, ERISA § 510 does not apply to an employer that is restructuring its workforce by hiring part-time employees to replace full-time employees, even if solely for the purpose of avoiding the pay or play mandate. To be covered by ERISA, the individual must be a participant, and typically, a participant must first be an employee. As such, an employer is not deemed to interfere with the rights of a participant if the employer hires the employee with the intention her or she will work less than 30 hours per week, will never participate in the health plan, and will not be eligible for the PPACA healthcare coverage.

Next, ERISA § 510 does not apply to an employer that limits a full-time employee to part-time status if the employer does so for reasons other than avoiding the pay or play penalty. To establish a prima facie case under ERISA § 510, an employee must show prohibited employer conduct taken for the purpose of interfering with the attainment of any protected right to which the participant may become entitled.

Finally, even if an employer moves current full-time employees to part-time status solely to avoid the pay or play penalty, ERISA § 510 will not apply. To qualify for relief under ERISA § 510, the participant must show interference with attainment of a right protected by ERISA to which he or she may be entitled under a plan. The PPACA coverage mandate is merely an excise tax under the Code that applies to employers that do not provide certain healthcare benefits to full-time employees; it is not an ERISA protected right that may be enforced under ERISA § 510. For example, assume an employer provides healthcare coverage for employees that work at least 40 hours per week. An employee works 35 hours per week and is not currently eligible for coverage under the plan. If the employer limits the employee's hours to less than 30 hours per week beginning in 2014 to avoid the pay or play penalty, the employer has not interfered with a right under ERISA and the employee would not have an ERISA § 510 claim.

But, if an employee is currently eligible for healthcare coverage under an ERISA plan and the employer limits their hours to avoid coverage for such plan and the pay or play mandate, that may give rise to an ERISA § 510 claim. However, health and welfare benefits are not vested under ERISA so an employer is free to modify the eligibility going forward under an existing plan without interfering with the attainment of a right to which a participant may become eligible under ERISA § 510.

Modifying the above example, assume an employer currently provides healthcare coverage for employees that work at least 30 hours per week. As above, an employee works 35 hours per week but is now eligible for healthcare coverage under the ERISA plan. If the employer limits the employee's hours to less than 30 hours per week beginning in 2014 to avoid both the pay or play penalty and the coverage under the current plan, the employee may have a claim under ERISA § 510 since the employer is interfering with the employee's right to coverage under the plan. On the other hand, if the employer also amends the plan to limit coverage to employees who work at least 40 hours a week, the employee would not have an ERISA § 510 claim.

3. Lifetime Income Options(Marcia Wagner and Warren Widmayer)

One of the key retirement security goals of the Obama Administration is to “reduce barriers to annuitization of 401(k) plan assets” and promote “guaranteed lifetime income products, which transform at least a portion of retirees’ savings into guaranteed future income, reducing the risks that retirees will outlive their savings or that their living standards will be eroded by investment losses or inflation.”

DOL and IRS Request for Information.

In connection with the Administration's goals to promote DC plan annuitization, the DOL, Internal Revenue Service and the Treasury Department issued a joint release on February 2, 2010, requesting information regarding lifetime income options for participants in retirement plans. In this release, these agencies announced that they were currently reviewing the rules under ERISA and the related rules under the Internal Revenue Code, to determine whether and how they could enhance the retirement security of participants by facilitating access to lifetime income arrangements. The requests for information addressed a range of topics, including participant education, required disclosures, 401(k) plan and other tax-qualification rules, selection of annuity providers, ERISA Section 404(c) and QDIAs.

The Retirement Security Project.

The Retirement Security Project, a joint venture of the Brookings Institution and the Urban Institute, has released two white papers regarding DC plan annuitization. These papers have generated a significant amount of interest, given the fact that they were co-authored by Mark Iwry, who was recently appointed by the Treasury Secretary to serve as the Deputy Assistant Secretary for Retirement and Health Policy. The white papers include proposals to encourage DC plan annuitization by using deferred annuities as the default investment for participants for certain purposes.

Some observers, however, have reservations about the appropriateness of using annuities as a default investment, given the fact that the needs of individuals tend to vary considerably during the decumulation phase of retirement. Some experts have been critical of default annuities, noting their inflexible nature and that default annuitization may not be easily reversed by participants (without significant economic cost). The Government Accountability Office, the watchdog or investigative arm of Congress, has also noted that, for some participants, default annuities may not be appropriate, given their health or other conditions. Proponents of default annuities have developed a proposal to offer default annuities over a two-year trial period, during which the retiree would receive monthly income unless the retiree opted and made an affirmative decision by the end of the trial period to take a lump sum.

Legislative Proposals.

A number of bills have been introduced in Congress, which are designed to provide tax incentives to save for retirement through annuities (e.g., Lifetime Pension Annuity for You Act, Retirement Security for Life Act). These bills typically encourage annuitization by exempting a percentage of annuity income up to a stated threshold (e.g., \$5,000 for individuals or \$10,000 for couples). Although they typically do not extend this exemption to annuity payments from defined benefit plans, they do exempt annuity payments made from DC plans.

In contrast to these tax-related measures, the Lifetime Income Disclosure Act puts a different spin on the subject of lifetime income and 401(k) plans. Under this proposed legislation, 401(k) plan sponsors would be required to inform participants annually of how their account balances would translate into guaranteed monthly payments – a "retirement paycheck for life." The goal of this legislation is to give participants an understanding of how much projected retirement income they can expect from their savings. The legislation directs the DOL to issue tables that employers may use in calculating an annuity equivalent and model disclosures. Employers and service providers who use the model disclosure and guideline assumptions would be insulated from liability under ERISA.

Lifetime Income Hearing by Senate Special Committee on Aging.

On June 16, 2010, the U.S. Senate Special Committee on Aging convened a hearing entitled, "The Retirement Challenge: Making Savings Last a Lifetime." The hearing explored options to help retirees transform their retirement savings into lifetime income, taking a close look at 401(k) plan participants in particular. According to Senator Kohl, chairman of the Senate Special Committee on Aging, the hearing was the start of a legislative debate about how the government can help Americans make their retirement savings last a lifetime. In his opening statement, he stated that, "[o]ur goal is to find ways to ensure retirees have access to lifetime income options that provide adequate consumer protections at a reasonable cost." In his view, the focus of most education efforts have been on encouraging people to save, and not about how to make their savings last.

At the hearing, Phyllis Borzi (Assistant Secretary of Labor) and Mark Iwry (Deputy Assistant Secretary for Retirement and Health Policy at the Treasury Department) presented their early analysis of the responses they received to the RFI on lifetime income options, jointly released by the DOL, IRS and Treasury on February 2, 2010. The RFI attracted more than 780 responses from the public. Many of the comments were submitted by individuals who said they were worried that the RFI was the first step in a government plan to take over 401(k) plans. However, Assistant Secretary Borzi clarified that the DOL and the Obama administration had no intention of taking over workers' 401(k) plans. She indicated that the agencies simply wanted to know if promoting lifetime income vehicles were a good idea, and, if so, if there were ways for the government to improve access to them. These comments from the DOL were consistent with Senator Kohl's opening statement, in which he had also clarified that he was in favor of making lifetime income options available at a

fair price, and that he did not advocate any type of mandate that would force people to purchase lifetime income products.

Joint Hearing by DOL, IRS and Treasury in September 2010.

On September 14th and September 15, 2010, the DOL, IRS and the Treasury Department held a 2-day joint hearing to consider the specific issues raised in the various comments submitted by the public in response to the RFI regarding lifetime income options.

In contrast to the jointly released RFI on February 2, 2010, which solicited comments on a broad array of topics concerning lifetime income options, the September hearing focused on 5 specific areas of concern.

They included the following 2 areas of general policy-related interest:

- Specific Concerns Raised by Participants. Participants and participant representative groups had expressed concern about lifetime income options in general (*e.g.*, inflation risk, product complexity and fees, the long-term viability of issuers of annuity products, limited availability of death benefits and withdrawal options). The agencies heard testimony exploring and addressing these concerns.
- Alternative Designs of In-Plan and Distribution Lifetime Income Options. The respective agencies were also interested in exploring the different ways in which lifetime income options can be made available in plans, including both insurance and non-insurance design solutions (*e.g.*, managed payout funds).

The hearing also focused on the following 3 areas of specific interest:

- Fostering Education to Help Participants Make Informed Retirement Income Decisions. The agencies were interested in hearing about the type of information that would help participants make better informed decisions regarding their retirement income. DOL Interpretive Bulletin 96-1 provides guidance on how plan sponsors can provide “investment education” to participants without fiduciary liability, and the DOL appears to be interested in expanding it to cover “retirement income education.”
- Disclosure of Account Balances as Monthly Income Streams. Along the lines of various legislative proposals such as the *Lifetime Income Disclosure Act*, the agencies were interested in hearing how participants may be more likely to choose lifetime income options if their benefit statements were to include disclosures noting what their individual accounts are worth when converted to a hypothetical monthly benefit.
- Modifying Fiduciary Safe Harbor for Selection of Issuer or Product. Under current law, a DOL regulatory “safe harbor” provides guidelines on how a plan fiduciary can prudently select an annuity provider for its DC plan.⁴ This safe harbor is largely procedural, requiring an objective, analytical search for an annuity provider, in consultation with an expert as necessary. The agencies heard testimony on whether these safe harbor standards should be modified, and whether they should apply more broadly to other types of lifetime income products.

Given the specificity of these 3 areas, it appears that the DOL and Treasury Department (and IRS) have narrowed their areas of focus, which could signal that these agencies are preparing to move ahead with rulemaking in these areas. In fact, the IRS has already begun to take action.

IRS Tax Relief.

Required Minimum Distributions. The IRS addressed various tax-qualification requirements for DC plans with variable group annuity investment options for participants in PLR 200951039. This private letter ruling was helpful to the benefits community since it illustrated how these plans were viewed with respect to the age 70½ minimum distribution requirements and for purposes of the QJSA rules. In sum, DC plans with annuity investment options were not subject to any “surprise” interpretations with respect to these rules.

The IRS recently followed this up with a proposed regulation that would relax the minimum required distribution rule in order to promote longevity annuities, an annuity product with an income stream that begins

⁴ 29 CFR 2550.404a-4.

at an age later than normal retirement, such as age 80 or 85. Proposed regulations issued on February 2, 2012 represent the first of what will be a series of actions to allow such annuities in tax-qualified retirement plans. The market for longevity annuities is currently very small, but the Administration would like to see an expansion of their use because they allow retirees to self-manage a significant portion of their retirement assets until a relatively advanced age. Such a deferred annuity would commence regular monthly payments at the elected age (e.g., age 80) and provide protection against outliving retirement assets, but the minimum distribution rules presented an obstacle to their use, because they generally require plan distributions to commence at age 70 ½ (rather than a later date consistent with the annuity starting date under a longevity annuity). Under the proposed regulation, a plan or IRA investment in a qualifying longevity annuity would be exempted from the minimum distribution rules. To qualify, the annuity premium would have to be limited to the lesser of \$100,000 or 25% of a participant's account balance, and the starting date of the annuity could be no later than age 85.

Split Annuities. Another proposed regulation issued on February 2, 2012 would encourage DB Plan sponsors to offer split distribution options, where participants may elect to receive a portion of their accrued benefits as an annuity and the other portion as a lump sum. The goal of the proposed rule would be to give participants greater flexibility in their lifetime income choices, eliminating the "all or nothing" choice that many DB Plan participants currently face when deciding between a lump sum or an annuity.

Under current law, if a plan were to offer split options to participants, statutory actuarial assumptions (*i.e.*, applicable mortality table and applicable interest rate under Section 417(e)(3) of the Internal Revenue Code) would generally need to be used to calculate each bifurcated benefit (*i.e.*, partial lump sum and partial annuity). Under the proposal, however, plans would only be required to use the statutory assumptions to calculate the partial lump sum, meaning that the plan's regular conversion factors would be used to calculate the partial annuity.

For example, let us assume that a newly retired participant (age 62) has accrued a normal retirement benefit of \$1,350 per month (payable at age 65). Let us further assume that this benefit either has an **immediate** monthly annuity value of \$1,200 (determined using the plan's regular conversion assumptions), or an immediate lump sum value of \$100,000 (determined using statutory assumptions). If the participant were to elect 25% of his benefit as an annuity (and the remaining 75% as a lump sum), under the proposed regulations, the participant would be entitled to a \$300 immediate monthly annuity and a \$75,000 current lump sum. As illustrated, the proposed regulations would allow the plan to use simple arithmetic (25% x \$1,200) to arrive at the value of the partial annuity. Conversely, a much more complex calculation would be required under the current rules, if the statutory assumptions (rather than the plan's regular conversion assumptions) were used to calculate the immediate partial annuity.

New Tax Rules Favoring Annuities. The IRS has also released a pair of revenue rulings to further encourage the annuitization of plan benefits. Unlike the proposed regulations on longevity annuities, these rulings are effective immediately.

- Revenue Ruling 2012-4 encourages employers to use their defined benefit plans as a way to offer lifetime income options for their employees' 401(k) account balances. Specifically, if an employer sponsors both defined benefit and a defined contribution plans, participants may be permitted to roll over their 401(k) balance to the defined benefit plan, and convert it into a plan annuity. The advantage of this arrangement for participants is that they can easily annuitize their 401(k) benefit at favorable rates (rather than the rates otherwise available in the retail marketplace).
- Revenue Ruling 2012-3 confirmed that offering deferred annuities in a 401(k) plan will not accidentally trigger IRS death benefit rules. Under these rules, defined benefit plans must pay death benefits to a participant's surviving spouse in the form of special type of annuity, unless the spouse opts out. 401(k) plans are typically exempt from these rules, as long as they provide for payment of the participant's account balance to the surviving spouse. Before the Revenue Ruling was released, there was a concern that the spousal death benefit rules might apply to a 401(k) participant who invests in deferred annuities. The good news is that the IRS has clarified that they will not, eliminating another obstacle for plan sponsors that want to use deferred annuities.

4. How Should "Excess" Revenue Sharing be Allocated to Participant Accounts? (Brad Huss)

Issue

Methodology for allocating to participant plan accounts "excess" revenue sharing amounts (revenue sharing in excess of plan expenses) deposited into plan trust.

Background

Frost Letter

- DOL Advisory Opinion 97-15A
- Allows receipt of 12b-1 fees or sub-transfer agent fees by a fiduciary service provider
- Requires dollar for dollar offset against fees otherwise payable by plan if the fiduciary advises on investments

Frost letter provided that the plan would be entitled to any such fees that exceeded the plan's liability to Frost, but the Department conditioned this statement by saying: "We express no opinion herein as to the propriety of such a pass-through of fees under Federal securities laws. Questions concerning the application of the Federal securities laws are within the jurisdiction of the SEC."

A number of plan service providers refused for many years to permit the allocation of excess revenue sharing amounts to participant accounts, citing concern of "preferential dividend" treatment.

In light of recent legal changes, many service providers are now permitting deposit of revenue sharing amounts into plan trust for either payment of expenses or allocation to participant accounts.

Revenue Ruling 80-155 states that a defined contribution plan will not be qualified unless all funds in the plan are allocated to participants' accounts in accordance with a definite formula defined in the plan.

Questions arise as to how to make the allocation of revenue sharing amounts to participant accounts.

Suggested Answer

The Department should issue guidance providing that plan sponsors and fiduciaries have considerable discretion in determining, as a matter of plan design or a matter of plan administration, how revenue sharing amounts deposited into the plan trust will be allocated among participants and beneficiaries. See DOL Field Assistance Bulletin 2003-3 with respect to plan expenses.

5. When Using a Bundled Service Provider, When may the Use of Plan Assets to Pay Administrative Expenses Violate ERISA? (Dan Brandenburg)

Many retirement plans, especially small plans, are using investment funds with high fees that produce significant amounts of revenue sharing instead of the cheapest funds to help defray the cost of plan administration. For purposes of this conversation, I am assuming that a plan sponsor can have plan participants defray the cost of plan administration so long as the costs of plan administration are reasonable and are properly disclosed. See ERISA Section 404(a)(1)(A)(ii), DOL Advisory Opinions 2003-09A, 97-15A, 97-16A and 97-19A; Field Assistance Bulletin No. 2012-02, *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), reh'g denied, 569 F.3d 708 (7th Cir. 2009), cert. denied, 130 S. Ct. 1141 (2010); *Tibble v. Edison International*, 2010 WL 2757153 (C.D.Cal.), decided July 8, 2010; and *Tussey v. ABB, Inc.*, No. 2:06-CV-04305-NKL, 2012 WL 113291 (W.D. Mo. March 31, 2012).

(Query: Is that assumption still reasonable after the *Hecker*, *Tibble* and *Tussey* cases?)

Many of the bundled providers are selling high fee and high revenue sharing investment products in lieu of charging employers for plan administration. In addition, in many cases the employer has to purchase one or more proprietary or retail funds instead of buying a "street name" and/or institutional fund. The proprietary funds typically provide more revenue sharing dollars directly to the bundled provider so that the bundled provider does not have to charge an administrative fee to the employer. There is no one accepted definition of revenue sharing. A revenue sharing arrangement can be set up so that that all of the providers' fees are paid

from the funds or that the fees from the funds offset the amount of administrative fees due from the employers. In either case, often the employer will allocate expenses to the participants based on account balances.

There are three issues: Is revenue sharing itself a prohibited transaction? Is the allocation of expenses to participants based on account balances as compared to being allocated per capita or per transaction reasonable? Is the use of retail funds or proprietary funds rather than institutional funds reasonable?

As an initial matter, one must consider whether or not there is a prohibited transaction inherent in a revenue sharing arrangement. Is there a violation of the exclusive purpose duty or prudence requirement of ERISA, Section 404, if the fees from the revenue sharing arrangement offset the employer's responsibility or the revenue sharing arrangement pays all of the administrative fees? See ERISA Section 404(a)(1)(A)(ii) – plan assets may be used to “defray” the reasonable costs of administering the Plan.

(Note that if the Plan Sponsor has multiple arrangements with a vendor, the Plan Sponsor needs to be careful that each arrangement pays for itself and that one arrangement does not subsidize another arrangement.)

Secondly, regarding the allocation of expenses, one must consider that the expenses inherent in administering a million dollar account, a \$100,000 account and a \$10,000 account are not all that much different.

Assume, for example, that a 401(k) plan has bi-weekly deposits of employee deferrals and employer matching contributions and provides for employee investment direction. Assume that the plan has 40 participants. Further assume a 1.3% load with 75 basis points going to revenue sharing that can be used to pay for plan administration. The load on a \$1,000,000 account is \$13,000, with \$7,500 going to plan administration; the load on a \$100,000 account is \$1,300, with \$750 going to plan administration; and the load on a \$10,000 account is \$130, with \$75 going to plan administration. Depending on investment and other activity in the account, assume that the administrative fee in the \$1,000,000 account is probably overstated; the administrative fee in the \$100,000 account is probably about right; and the administrative fee in the \$10,000 account is probably understated.

Can one justify this arrangement? Is the arrangement more appropriate if there are 400 participants? 4,000 participants? Can one argue that over the period of plan participation of a career participant (whatever that is) it all works out to be equitable? Should one use a hybrid fee arrangement where the participant is charged both an account based or transaction based fee and an asset based fee? The danger with that kind of arrangement is that in the early years of plan participation, the fees can dramatically reduce the account values.

A common practice is to encourage the plan sponsor to use a “proprietary” fund, a fund managed in whole or part by the bundled provider. That fund will produce a larger revenue sharing payment to the bundled provider which will allow the bundled provider to forgo charging the plan sponsor any fees for plan administration in excess of the revenue sharing amount. Assuming that the proprietary fund is not a “better” fund than a non-proprietary fund, this raises a question as to whether this practice violates the “exclusive purpose” under ERISA.

It is important to engage in a discussion as to what is an appropriate standard for plan sponsor behavior with regard to the use of revenue sharing. It may be too early for the Department of Labor to provide additional guidance until the case law develops further, but, nonetheless, the case law seems to be stricter than the DOL guidance. I would encourage the release of further guidance after all parties views are heard and considered.

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