

May 2003

DOL Addresses Plan Expenses — And Gets It Right

On May 19, 2003, the Department of Labor (DOL) issued guidance addressing the allocation of plan expenses among participants in a defined contribution plan. Field Assistance Bulletin 2003-3 (the "Bulletin") represents an important — and welcome — change in the DOL's thinking about the allocation of plan expenses.

The new guidance establishes that plan sponsors and fiduciaries have significant flexibility in establishing rules for allocating expenses among participants in defined contribution plans, including whether expenses are allocated on a pro rata or per capita basis when charged to the plan as a whole, or whether expenses will be charged to individual participants engaging in specified transactions. The Bulletin does not address when a particular expense is properly charged to the plan in the first instance. Instead, it assumes that the expenses at issue are proper for plan administration and are reasonable in amount.

Allocating Expenses Among Participant Accounts

The Employee Retirement Income Security Act (ERISA) does not specifically address how plan expenses may be allocated among the accounts of participants and beneficiaries. Thus, the Bulletin takes the position that a plan sponsor has "considerable discretion" in specifying how expenses will be allocated in the plan document. According to the DOL, a method of allocating expenses set forth in the plan document becomes "part of defining the benefit entitlements under the plan" required to be followed by a plan fiduciary unless inconsistent with other ERISA requirements.

If the plan documents do not set out a method for allocating expenses, the fiduciary must select an allocation method consistent with general fiduciary duties, including the duty to act solely in the interest of plan participants and beneficiaries. The Bulletin makes clear that an allocation method does not fail to be "solely in the interest of participants" merely because it disfavors one class of participants versus another, provided that a "rational basis" exists for the method selected.

According to the Bulletin, a pro rata allocation of expenses based on account balances would be permissible in most cases. However, a per capita method would also be reasonable for allocating "fixed" administrative expenses, such as recordkeeping, legal, auditing and annual reporting expenses. Expenses for investment advisory services could be allocated on either a pro rata or per capita basis, without regard to actual utilization by particular participants, or else be charged directly to the accounts of the participants who utilize the service. However, it would presumably not be prudent for a fiduciary to charge an expense tied directly to account balances, such as investment fees, on a per capita basis.

About Face on QDRO Expenses

In Advisory Opinion No. 94-32A, the DOL said that a plan's expenses for processing a qualified domestic relations order (QDRO) could not be imposed directly on the participant (or alternate payee) to whom the order related. The DOL explained that such a charge would be an impermissible barrier to the exercise of the individual's statutory rights. The Bulletin abandons this position as not "legally compelled" by ERISA.

Expenses Applied to Users or Groups

The QDRO position reflects an expansion, by the DOL, of the ability of a plan to charge participants for services as they use them and not charge the plan as a whole. The Bulletin states that plan expenses for the following defined contribution plan activities may be charged to the accounts of the specific participant or beneficiary: processing hardship withdrawals; calculating benefits under different distribution options; making distributions; and processing QDROs.

The Bulletin also makes clear that different allocation methods may apply to different participant groups. In particular, the Bulletin states that a plan may charge vested separated participant accounts with a pro rata or per capita share of plan expenses, without regard to whether the accounts of active participants are similarly charged.

Documentation and Other Issues

The DOL's position that an expense allocation method set forth in a plan document is part of the definition of the "benefit entitlement" makes it advisable to address the allocation of expenses in the plan document whenever possible. This will minimize the potential for challenges on the basis that a plan fiduciary has acted imprudently in allocating a particular expense or using a particular allocation method. The DOL specifically notes that the summary plan description must describe any provision resulting in the imposition of a fee or charge as a condition to the receipt of benefits under the plan, as well as any circumstances that may result in the offset or reduction of benefits. Plan expense disclosures will need close attention.

A key open issue is how the DOL's new position will apply to defined benefit plans. Although the Bulletin is specifically aimed at defined contribution plans, the DOL's underlying rationale would apply to defined benefit plans as well. However, amending a defined benefit plan to reduce the participant's benefit amount for the expenses of processing a QDRO, for example, would arguably violate the anti-cutback rule in Section 411(d)(6) of the Internal Revenue Code (the "Code").

IRS Issues May Intersect

Allocating expenses to particular participants or groups of participants raises other issues under the Code as well. Internal Revenue Service regulations do not permit a plan to impose a "significant detriment" on participants who elect not to receive an immediate distribution of their plan accounts (above the minimum cash-out amount). It is unclear whether imposing expenses on deferred vested participants that are not imposed on active participants would violate this provision. Moreover, it is unclear whether imposing expenses in a non-uniform manner would create a separate benefit structure or benefit, right or feature requiring separate non-discrimination testing under Section 401(a)(4) rules.

Nonetheless, the Bulletin provides very welcome clarity and flexibility as to how plan expenses may be allocated among participants, and eliminates the unfair treatment of QDRO expenses under prior DOL authority.

Action Steps

Employers will want to review plan documents to determine whether to amend to clarify which expenses are to be charged to the plan, and how such expenses are allocated. SPDs should also be reviewed and revised as necessary to reflect any applicable expense charges.

If you have any questions about the application of plan expenses and this new guidance to your plan, please contact the Seyfarth Shaw employee benefits group attorney with whom you work or any employee benefits group attorney listed on the website at www.seyfarth.com

ATLANTA

One Peachtree Pointe
1545 Peachtree Street, N.E., Suite 700
Atlanta, Georgia 30309-2401
404-885-1500
404-892-7056 fax

BOSTON

Two Seaport Lane, Suite 300
Boston, Massachusetts 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO

55 East Monroe Street, Suite 4200
Chicago, Illinois 60603-5803
312-346-8000
312-269-8869 fax

HOUSTON

700 Louisiana Street, Suite 3850
Houston, Texas 77002-2731
713-225-2300
713-225-2340 fax

LOS ANGELES

One Century Plaza
2029 Century Park East, Suite 3300
Los Angeles, California 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK

1270 Avenue of the Americas, Suite 2500
New York, New York 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO

400 Capitol Mall, Suite 2350
Sacramento, California 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO

101 California Street, Suite 2900
San Francisco, California 94111-5858
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS

Boulevard du Souverain 280
1160 Brussels, Belgium
(32)(2)647.60.25
(32)(2)640.70.71 fax

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