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Revenue Sharing Payments as Plan Assets

The Department of Labor (the "DOL" or the "Department") recently delivered welcome news in an advisory opinion addressing whether certain "revenue sharing" payments constitute "plan assets" under the Employee Retirement Income Security Act of 1974 ("ERISA"). DOL Adv. Op. 2013-03A (July 3, 2013) (the "Advisory Opinion"). Issued on behalf of Principal Life Insurance Company ("Principal"), the Advisory Opinion described a common practice among 401(k) plan recordkeepers which involves offering plan clients the ability to capture some benefit from revenue sharing in the form of so-called "ERISA budgets." On the facts presented, the DOL concluded that the revenue sharing amounts received by Principal are not "plan assets" for ERISA purposes. The Advisory Opinion also discusses a number of significant issues of interest to service providers and their plan clients.

The Request

Principal, like many other financial institutions that provide recordkeeping and other administrative services to ERISA plans, typically makes available a variety of investment options to 401(k) and other participant-directed defined contribution plans. Principal receives payments from some of these investments in the form of Rule 12b-1 fees, shareholder or administrative services fees, and similar payments. Generally, these payments are taken into account in establishing the recordkeeper's fee to its plan clients. Thus, the service provider may retain the revenue sharing payments, but will negotiate agreements with plans to maintain a bookkeeping record of amounts received with reference to the plan's investments and to provide credits to the plan based on a formula or methodology referenced in the services agreement.

This arrangement allows the service provider to apply these credits to pay for plan expenses, such as the costs of services provided by accountants, actuaries, consultants, or attorneys to the plan. Instead of, or in addition to offsetting the cost of plan expenses, a service provider may also contract with the plan to deposit amounts equal to these revenue sharing credits directly into an account maintained on behalf of the plan. Under both types of arrangements, the agreement between the plan and the service provider does not require the service provider to segregate any portion of the revenue sharing payments for the benefit of the plan, nor do plan participants or plan fiduciaries receive any representation to that effect.

While these types of arrangements are common, the Department's prior guidance on this issue was limited to a clarification we requested DOL add to the preamble to Form 5500 revisions. This clarification indicated that revenue sharing payments received by plan service providers are not treated as plan assets for reporting purposes under the Form 5500. *See* Revision of Annual Information Return/Reports, 72 Fed. Reg. 64731, 64744 (Nov. 16, 2007). To address this lack of clear guidance, we requested this advisory opinion from the DOL —

asking DOL to confirm our view that revenue sharing payments received by plan service providers do not constitute "plan assets." The identification of "plan assets" is critical under ERISA, because the existence of "plan assets" not only triggers ERISA's trust requirement and prohibited transaction restrictions, but they also help identify the plan's fiduciaries.

DOL Advisory Opinion 2013-03

Consistent with prior guidance analyzing similar plan assets questions, the DOL noted that the assets of a plan are to be identified on the basis of ordinary notions of property rights. *See* DOL Adv. Op. 94-31A (Sept. 9, 1994). DOL has determined that under this analysis, the assets of a plan include any tangible or intangible property in which the plan has a beneficial ownership interest. Applying its "ordinary notions of property rights" analysis, the DOL concluded that the revenue sharing payments as described are not plan assets for purposes of ERISA where the plan itself does not actually receive the revenue sharing payments, but receives credits which are calculated by reference to the amounts received by the plan's service provider. Importantly, based on DOL's analysis, any credits that are actually paid into the plan's account would become plan assets once placed in the plan's trust account.

While the revenue sharing amounts themselves are not plan assets, the DOL concluded that the plan's contractual right to benefit from the revenue sharing payments would be a plan asset. Thus, in any case that Principal failed to pay amounts as required under the contract, the plan's claim for credits or expense payments would be an asset of the plan.

Implications for Service Providers

The Advisory Opinion provides recordkeepers of ERISA plans with significant comfort that they are not holding plan assets when they make arrangements to cover certain plan expenses out of revenue sharing payments received from third parties. The Department highlighted, however, that these types of arrangements would be subject to section 406(a)(1)(C) of ERISA, which generally prohibits the furnishing of services between a plan and a party in interest, including a service provider. However, ERISA section 408(b)(2) provides relief from this prohibition in instances where the contract or arrangement is "reasonable, the services are necessary for the establishment and operation of the plan, and no more than reasonable compensation is paid for the services." Plan recordkeepers that make investment options available to participant-directed plans are subject to ERISA section 408(b)(2)'s recently enhanced disclosure requirements for certain service providers. Those regulations generally require recordkeepers to provide detailed disclosures describing the compensation that they receive from plans and third parties as well as the services they provide.

We note that the DOL's 408(b)(2) regulations would likely require a recordkeeper that receives revenue sharing payments from third parties to disclose all of the compensation it receives from third parties, regardless of whether and how that compensation is credited back to the plan. Nonetheless, service providers generally want their disclosures to make clear the amount of revenue that is credited back to the plan so that their retained compensation is not overstated.

Implications for Plan Sponsors

The DOL also explained that ERISA's general prudence requirements apply to revenue sharing arrangements with recordkeepers. In this regard, DOL indicated that plan sponsors must continue to act prudently and in the best interests of plan participants and beneficiaries in the negotiation of these types of agreements with service providers. The DOL specified that "[p]rudence requires that a plan fiduciary, prior to entering into such an arrangement, []

understand the formula, methodology and assumptions used" by the service provider in crediting the plan with revenue sharing payments. Moreover, DOL indicated that plan sponsors must be capable of periodically monitoring the arrangement, including the amounts credited to the plan as well as amounts applied toward the payment of plan expenses.