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ERISA Accounts

Are revenue-sharing payments plan assets under ERISA?

The Department of Labor (DOL) recently delivered welcome news in Advisory Opinion 2013-03A, addressing whether certain revenue-sharing payments constitute plan assets under the Employee Retirement Income Security Act (ERISA). The advisory opinion was issued on behalf of Principal Life Insurance Company (PLIC) and discusses so-called "ERISA budgets."

Principal typically makes available a variety of investment options to 401(k) and other participant-directed defined contribution (DC) 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—an ERISA budget.

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. In addition to offsetting the cost of plan expenses, a service provider may also contract with the plan to deposit amounts equal to those 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 latter to segregate any portion of the revenue-sharing payments for the benefit of the plan, nor do plan participants or plan beneficiaries receive any representation to that effect.

While these types of arrangements are common, the DOL's prior guidance on this issue was limited to a clarification the department added to the preamble to regulations implementing amended Form 5500 revisions. These indicated that such revenue-sharing payments are not treated as plan assets under the Form 5500. Principal asked the DOL to confirm the view that revenue-sharing payments received by plan service providers do not constitute plan assets.

Consistent with prior guidance analyzing similar plan asset questions, the DOL noted that the assets of a plan are to be identified on the basis of ordinary notions of property rights. 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 credits that are calculated by reference to the amounts received by the plan's service provider. Importantly, based on the 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.

The opinion clarifies a number of legal principles. First, the revenue-sharing amounts themselves are not plan assets. Second, the creation and administration of an ERISA budget account within a recordkeeper does not cause the revenue-sharing payments to become plan assets. However, the DOL did conclude that the plan's contractual right to benefit from the payments would be a plan asset. Thus, in any case where 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 Plan Sponsors

The DOL indicated that plan sponsors must continue to act prudently and in the best interests of plan participants and beneficiaries. It also specified that "[p]rudence requires that a plan fiduciary, prior to entering into such an arrangement, [] understand the formula, methodology and assumption used" by the service provider in crediting the plan with revenue-sharing payments. Moreover, the 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.

In addition, the DOL emphasized that the operation of the budget arrangement by a plan recordkeeper and the making of the revenue-sharing payments would need to be disclosed under the DOL's relatively new Section 408(b)(2) regulation. This would likely require recordkeepers to disclose their receipt of the revenue-sharing payments from mutual funds and other investments to their plan sponsor clients.

Stephen M. Saxon is a partner with the Washington, D.C.-based Groom Law Group. Groom is one of the pre-eminent employee benefits firms in the country. Steve and his colleagues have worked on every major legislative and regulatory initiative affecting employee benefits since the enactment of ERISA.

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