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Client Alert

A report for clients and friends of the firm May 2003

DOL Issues Field Assistance Bulletin Addressing Allocation of Expenses in a Defined Contribution Plan

The U.S. Department of Labor (the "DOL") has changed its position regarding the allocation of plan expenses to participants in defined contribution plans, such as 401(k) plans and profit sharing plans. In a major shift from prior guidance, the DOL issued guidance to its field investigators in Field Assistance Bulletin 2003-3 ("FAB") stating that plan sponsors and fiduciaries have considerable discretion in determining, either as a matter of plan design or as a matter of plan administration, how plan expenses will be allocated among participants and beneficiaries. Most notably, in a complete reversal of its long-standing position, the DOL concluded that expenses associated with the determination of whether a domestic relations order constitutes a qualified domestic relations order, or "QDRO," can be charged to the account of the participant or beneficiary seeking the determination.

Plan Design versus Fiduciary Decision

The FAB distinguishes between plans that specifically address allocation of expenses and plans that are silent as to expense allocation.

Since ERISA contains no provisions specifically addressing how plan expenses may be allocated among participants and beneficiaries, where the method of allocating expenses is set forth in the plan documents, fiduciaries are required to follow the prescribed method of allocation. This obligation does not change merely because the allocation method favors a class (or classes) of participants.

Where plan documents are silent or ambiguous about expense allocation, plan fiduciaries must select the method for allocating plan expenses in accordance with their fiduciary duties under ERISA. Fiduciaries must be prudent in the selection of the allocation method and the decision must be made solely in the interest of participants. For example, prudence would require a fiduciary to utilize a deliberative process to evaluate the competing interests of the plan's various classes of participants and the effects of various allocation methods on those interests. A method of allocating expenses will not fail to be "solely in the interest of participants" merely because the selected allocation method disfavors one class of participants, provided that a rational basis exists for the selected method. However, if a fiduciary selects an allocation method that has no reasonable relationship to services furnished or available to an individual account or in contemplation of an expense that could affect the fiduciary as a participant in the plan, the fiduciary will be breaching his or her fiduciary duty.

Surprisingly, the FAB states that both pro rata and per capita methods of allocating expenses may be permissible under ERISA. Whether an allocation method is permissible in a specific instance depends on the particular facts involved and whether the method chosen is reasonable under the circumstances. For example, a per capita method of allocating expenses, where expenses are charged equally to each account without regard to the amount of assets in the individual account, may provide a reasonable method of allocating certain fixed administrative expenses of the plan. These fixed expenses would include recordkeeping, legal, auditing, annual reporting, claims processing and similar administrative expenses. However, where a third-party imposes fees on a plan on the basis of the size of the plan's assets, such as investment management fees, a per capita method may be arbitrary.

Allocating Expenses to an Individual versus General Plan Expense

The FAB provides examples of certain administrative expenses which may be charged to the accounts of specific participants rather than be borne by the plan as a whole, including expenses associated with the determination of whether orders constitute qualified domestic relations orders ("QDROs") or qualified medical child support orders ("QMCSOs").

QDROs and QMCSOs

In 1994, the DOL issued Advisory Opinion 94-32A in which it concluded that the imposition of a separate fee or cost on a participant or alternate payee in connection with a determination of whether a domestic relations order constitutes a QDRO was not permitted by ERISA. The DOL's rationale was that the fee constituted an impermissible encumbrance on an alternate payee's exercise of the right to receive benefits under a QDRO pursuant to ERISA. In reversing this position, the DOL explained that neither the analyses or conclusions set forth in Opinion 94-32A are legally compelled by ERISA. As a result, the same principles applicable to determination of the method of allocating expenses among all participants are also applicable to determining how specific expenses should be allocated. Therefore, plans may now impose fees or costs on the account of the participant or beneficiary seeking the determination of QDROs or QMCSOs.

Other Examples

The FAB also gives four other examples of administrative expenses that may be allocated to the accounts of participants.

The most interesting example involves the assessment of greater administrative expenses against the accounts of terminated participants. The DOL reasoned that it is generally permissible for a plan to charge reasonable plan administration expenses to the individual accounts of plan participants and beneficiaries. In addition, nothing in ERISA limits the ability of a plan sponsor to pay only certain plan expenses or only expenses on behalf of certain plan participants. Accordingly, the terms of a plan may provide for the assessment of reasonable plan expenses to the accounts of terminated participants (either on a pro rata or per capita basis) that are greater or different than those of employed participants. This is true regardless of whether the accounts of active participants are assessed such expenses or whether the terminated participant had the option of withdrawing or rolling over the funds from his or her account.

Similarly, the FAB specifically stated that the terms of a plan may provide for the assessment of administrative fees to participant accounts for charges in connection with:

- hardship distributions;
- the calculation of benefits under a plan's various distribution options (*e.g.,* joint and survivor annuity, single life annuity, lump sum, et cetera); and
- benefit distributions (*e.g.,* check writing fees).

Planning Considerations

Plan sponsors may want to consider amending their plans to take advantage of the new flexibility FAB 2003-3 offers. If expense allocation methods are incorporated in a plan, it appears that the plan administrator and fiduciaries will be required to enforce them.

Any plan amendment that addresses the allocation of plan expenses should be evaluated in the context of the non-discrimination provisions of the Internal Revenue Code. Merely because an expense allocation method is permitted under ERISA's fiduciary requirements does not mean that it will necessarily be permissible under the Internal Revenue Code. In addition, ERISA requires that a summary of any fees or charges that may be imposed on a participant or beneficiary (or their individual account) be described in the plan's summary plan description. ERISA also requires that SPDs include a statement identifying the circumstances that may result in the offset or reduction of any benefits that a participant or beneficiary might otherwise reasonably expect the plan to provide on the basis of the description of benefits.

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Client Alert

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