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U.S. Department of Labor Provides a Reminder to Plan Sponsors and Committees of Certain Fiduciary Responsibilities

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Some mutual funds (and possibly other funds) that are made available by a 401k plan for investment by its participants may make payments to the plan's record-keeper (and perhaps other service providers) for certain services in connection with the plan's investment. Advisory Opinion 2013-03A ("Opinion"), which was issued by the U.S. Department of Labor ("DOL") on July 3, 2013, addresses whether certain payments of this type might be deemed "plan assets" under the Employee Retirement Income Security Act ("ERISA"). Significantly, the DOL also points out obligations of plan sponsors and committees (and any other fiduciary responsible for making payment decisions) in choosing to approve and to continue such arrangements, since failure to do so could result in liability to these fiduciaries.

The Opinion

The Opinion was requested by a record-keeper for 401k plans that receives payments from some mutual funds as a result of investments by plans for which the record-keeper provided recordkeeping and administrative services. In the particular circumstances described in the Opinion, the record-keeper kept these payments unsegregated for its own account, but provided some client 401k plans with credits based on these amounts, which could then either be applied at the direction of the plan administrator to pay certain plan expenses, such as for legal, accounting, or consulting fees, or be deposited directly into participant accounts. This "revenue sharing" is a common arrangement and ultimately can result in certain service providers, typically third-party administrators, charging low or no direct fees to the plans for their services (because these entities derive income from the revenue share). The notional accounts maintained by the service providers to pay for expenses are sometimes referred to as "ERISA accounts" or "ERISA budgets."

The specific question in the Opinion related to whether amounts in the record-keeper's unsegregated "revenue sharing" bookkeeping account are "plan assets" for ERISA purposes when held by the record-keeper. The implications of being plan assets could be significant for plan sponsors, committees, and service providers, because any decision or transaction involving those amounts would have to be considered in light of

ERISA's fiduciary requirements. To the extent that "service providers," such as record-keepers, control plan assets, they may be considered fiduciaries to a plan even when this characterization was not intended. The DOL held that, under the particular facts presented in the Opinion, the amounts would not be plan assets unless and until the plan actually receives the monies. Whether this is true of other specific arrangements would depend on the particular facts.

Fiduciary Obligations

Regardless of whether and when payments to a plan's record-keeper might constitute plan assets, the DOL made the point that a plan sponsor's or committee's (or other responsible plan fiduciary's) decision to maintain an arrangement that provides payments to a plan service provider (as described above) is subject to ERISA's fiduciary rules. The Opinion cautions plan fiduciaries that they must understand and carefully evaluate the arrangement. The DOL noted specifically that plan administrators (such as committees) responsible for making those decisions need to consider whether an arrangement under which a service provider earns fees in connection with a plan's investment (including revenue sharing) might result in any nonexempt prohibited transactions (including under Section 406(b) of ERISA (rules against "self-dealing" and conflicts of interest)). For example, there may be a violation of Section 406(b) if a service provider has authorities that may make it a fiduciary to a plan, such as where the service provider is viewed as providing "investment advice" to the sponsor, the committee, or plan participants, and the service provider uses its authority to cause the plan to invest in funds that pay it fees, even indirectly.

A fundamental requirement for sponsors and responsible committees, as fiduciaries to their plans, is to assure that the arrangements with, and the compensation received by, service providers as a result of their services to the plan are reasonable. Failure to do so could result in the engagement of the service provider being a prohibited transaction. Compensation paid to a service provider for services would include direct fees as well as all fees or other compensation received by the service provider as a result of its services to the plan (including revenue sharing). To fulfill this obligation, a fiduciary must obtain sufficient information about the arrangement and all compensation received (or to be received) by a service provider with respect to a plan, so that the fiduciary can make a prudent, informed decision as to whether to enter into and continue the arrangement. This is not necessarily an easy undertaking, although the recent fee disclosures that fiduciaries are required to receive from service providers pursuant to Section 408(b)(2) of ERISA (the first were required in July 2012) should provide substantial assistance in making prudent, informed decisions. To the extent a fiduciary, such as a plan committee, believes more information or an explanation is required, then the fiduciary should consider asking additional questions and requesting more information, particularly when negotiating a service provider's engagement. Taking it a step further, in negotiating or entering into arrangements involving revenue sharing, it is incumbent upon a committee (or other fiduciary responsible for such decisions) to make sure that it reasonably understands the method by which the amounts are determined, it is able to monitor the process periodically to determine whether those amounts are paid correctly, and the plan receives the amounts that it is entitled to receive so that the committee can continue to conclude that the arrangement is prudent and reasonable.

A sponsor's or committee's responsibilities to enter into reasonable and prudent arrangements is not new. However, the DOL's emphasis on fiduciary's duties regarding the selection and monitoring of arrangements involving revenue sharing emphasizes that these arrangements are not only the concern of service providers but have significant implications for those responsible for making decisions regarding the investment of a plan's assets and the hiring of those service providers. ERISA's fiduciary rules do not necessarily require a fiduciary to become an expert in the intricacies of revenue-sharing calculations, but, in evaluating such arrangements, among other things, fiduciaries should take into account disclosures by service providers of direct and indirect fees (as required under the DOL regulations), as well as other reasonably available information and the advice of experts. Additionally, plan sponsors must also consider the implications for reporting indirect fees received by service providers on the plan's annual Form 5500 Schedule C filing.

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