Retirement Plan Update

What is a Legitimate Expense for a Plan to Pay?

The Department of Labor (DOL) has rules as to what types of expenses a plan sponsor can pay from a retirement plan. This Retirement Plan Update explains the rules.

Summary

The DOL divides plan expenses into two types. The first is "settlor expenses," which must be paid by the employer. In general, settlor expenses include the cost of any service provided to establish, terminate, or design the plan. The second category is administrative expenses, which, if they are reasonable under all the relevant facts and circumstance, may be paid from the plan, if the plan so allows.

The schedule provided with this Retirement Plan Update is an informal reference for identifying those expenses that can be paid from the plan.

Detailed Background

The assets of an ERISA plan may be used for two purposes: (1) to pay benefits, and (2) to pay the reasonable expenses of administering the plan. [ERISA §§403(c)(1) and 404(a)(1)(A)] The decision to pay expenses from the assets of a plan is a fiduciary decision subject to the fiduciary rules of ERISA.

If a fiduciary pays expenses from a plan in violation of the above rules, this constitutes a breach of fiduciary duty and the plan fiduciary could be required to restore the amount improperly paid. If the plan pays expenses which improperly benefit the sponsor or another party in interest, this may be a prohibited transaction, subjecting the plan fiduciaries to penalties and excise taxes.

A plan sponsor choosing to pay expenses from the plan must ensure that the plan document provides for the feature and that participants are timely notified by receiving an updated Summary Plan Description (SPD) and Plan Expense Addendum to the SPD (if participant transaction fees apply). Before implementing expense payments, the plan sponsor will also want to address any participant sensitivities and determine how such expenses will be charged to participant accounts.

Before paying an expense from plan assets, the plan fiduciary should be able to answer the following questions:

1. Is the expense related to the fiduciary's administration of the plan and not related to the plan sponsor's "settlor" function?
2. Is the expenditure prudent and the amount reasonable – in the aggregate or by participant?
3. Is the service being provided by a party in interest or by the plan fiduciary (e.g., the plan sponsor or an affiliate)?

"Settlor" expenses relate to the employer's business activities, are incurred for the benefit of the employer, and must be borne by the employer. In general, settlor expenses include the cost of any services provided to establish, terminate, or design the plan. However, reasonable expenses incurred in connection with implementing settlor decisions are generally payable by the plan.

The second step requires that fiduciaries determine what competitors are charging for the same service and whether the charges are appropriate in relation to the needs of the plan. This information has ideally been determined as part of the plan sponsor's periodic benchmarking of fees and services. The DOL has specific fee disclosure rules for plans [ERISA 408(b)(2) and, for participant directed accounts, ERISA 404(a)(5)]. The Plan Administrator of an ERISA-covered plan is responsible for collecting and reviewing the fee disclosures required of all of the Plan's service providers.

"Who is being paid" is the final step in the analysis of whether an expense can be paid from plan assets. In general, if it is a non-fiduciary (i.e., a third-party service provider) the expense can be paid by the plan. There is a specific exception for the payment of expenses associated with the provision of reasonable and necessary services to the plan. If, however, the expense relates to services provided by a plan fiduciary, the payment of the expense will more likely result in a prohibited transaction and the imposition of an excise tax unless the expense is approved by another fiduciary unrelated to the fiduciary providing the service.

Action Steps

As with all fiduciary decisions, plan fiduciaries should document the basis for the decision. Related procedures should then be developed and responsibility assigned for evaluating each expense for eligibility to be paid from the plan. If you would like assistance in establishing a plan expense policy, or have questions regarding the schedule accompanying this Retirement Plan Update, please contact Means & Associates, LLC at 619-696-7284 or updates@meansllc.com.

Schedule of Plan Administration Expenses

The following chart is intended to provide guidance regarding permissible plan expenses. The schedule may not be accurate for a particular circumstance or apply to all situations. In addition, considerations other than legal permissibility may bear on the advisability of paying expenses from Plan assets; these would include how costs may be allocated to participants, public relations issues, etc. Plan sponsors should consult with a qualified adviser with respect to the proper treatment of expenses in regard to their plans.

Expense Category	May be Paid by Plan?
A. Establishment of Plan	
Plan formation: legal or consulting services	No
Initial Plan Design	No
Plan Document	No
SPD	No
Creation of Plan Trust	No
IRS Filing for Initial Determination Letter	Yes
Participant Communication	No
B. Plan Amendments /Mergers / Conversions	
Plan Design Activities	No
Drafting IRS Discretionary Amendments	No
Drafting IRS-Required Amendments (including amendments required at plan termination)	Yes
Implementing Amendments	Yes
IRS Determination Letter	Yes
Participant Communications of Changes (SMMs)	Yes
Participant Communications (Sarbanes/Oxley)	Yes
C. IRS and DOL Correction Programs	
Application Fees	No
Consulting / Drafting of Correction Program Application	No
Qualification Error Correction (IRS EPCRS Programs - SCP, VCP)	No
Fiduciary Error Correction (DOL VFCP Program)	No
D. Sanctions/Penalties	
Imposed on the Plan	Yes
Audit-CAP sanction under EPCRS	No
E. Investment-Related Services	
Sales Charges (“loads” or commissions)	Yes
Asset Management	Yes
Contract termination charges	Yes
Product termination fees	Yes

Schedule of Plan Administration Expenses

Expense Category	May be Paid by Plan?
*F. Ongoing Administration of Plan**	
Plan Recordkeeping / Administration	Yes
Plan and Trust Accounting	Yes
Distribution Processing (e.g., loans, terminations, hardship withdrawals, check issuance)	Yes
1099-R / Government Reporting	Yes
Transaction Fees (e.g., loans, distributions, deferral of termination payout)	Yes
Claims Processing	Yes
Form 5500 Preparation	Yes
Audit Fees	Yes
Trustee / Custodian Fees	Yes
Ongoing Investment Review / Consulting	Yes
Participant Statements	Yes
Participant Location Search	Yes
QDRO Review / Qualification Cost	Yes
G. Communications	
SPD/SMM Updates	Yes
Participant Statements and Notices	Yes
Educational Seminars/Videos/Materials	Yes
Investment Guidance / Advice	Yes
Investment Material (Prospectuses)	Yes
Retirement Planning Software	Yes
Telephone Voice Response Systems	Yes
Electronic Access to Plan Information	Yes
H. Plan Termination / Freeze	
Consulting Service on Termination / Freeze Impact	No
Amendments to Terminate / Freeze	No
IRS filing for Determination on Termination	Yes
Final Valuation / Administrative Report	Yes
Final Valuation / Administrative Report	Yes
Distributions on Termination	Yes
Participant Location Search Fees	Yes
I. Insurance and Bonding	
Premiums for fidelity bond	Yes
Purchase of liability insurance	Yes

Schedule of Plan Administration Expenses

Expense Category	May be Paid by Plan?
J. Defined Benefit — Ongoing Administration of the Plan	
Financial Accounting Standards Reports (Financial Reporting)	No
Actuarial Fees	Yes
Benefit Calculation / Estimate Fees	Yes
PBGC Premiums	Yes
Consulting on Design / Freeze/ Termination	No
*Certain expenses related to plan administration and recordkeeping may be indirectly paid through investment –related fees in the form of "revenue sharing" agreements between the fund companies and the service providers	