COMPLIANCE BULLETIN

June 2003*

DOL Provides Guidance on Defined Contribution Plan Expenses

On May 19, 2003, the Department of Labor (DOL) published guidance for allocating plan expenses among participants in defined contribution plans. Field Assistance Bulletin (FAB) 2003-3 addresses two main issues:

- Acceptable expense allocation methods (e.g., pro-rata, per capita, per use);
- Circumstances in which "per use" expense allocations are appropriate.

Some of the conclusions reached in this guidance are a notable, and welcome, departure from previous DOL plan expense guidance.

Expense Allocation Methods

If plan documents specify the method of allocating plan expenses, the plan administrator must follow these document provisions. However, if plan documents are silent or unclear about expense allocation methods, the plan administrator may select the method or methods to be used. While the plan administrator must be prudent when making this selection, different expense allocation methods may be applied to different classes of participants, as long as there is a rational basis for this treatment. In situations where the plan administrator is also a plan participant, s/he must be careful to avoid prohibited transaction issues, where the benefit to the plan administrator, as a participant, of the application of a specific expense allocation method is more than incidental. *For example, a plan administrator who, in anticipation of his own divorce, changes the plan's treatment of QDRO expenses to benefit himself may violate ERISA's prohibition on self-dealing.*

In most cases, the ***pro-rata method*** of allocating expenses among individual accounts (i.e., expenses are allocated on the basis of assets in the individual account) would be acceptable. However, the ***per capita method*** (i.e., expenses are charged equally to each account, without regard to the assets in those accounts) may also be reasonable. *For example, the per capita method would be reasonable for allocating the plan's fixed administrative expenses, such as recordkeeping, legal, auditing, annual reporting, and claims processing. However, it would not be reasonable to use this method to allocate fees or charges that are determined on the basis of account balances, such as investment management fees.*

Certain expenses may also be charged to participants who use a specific service, where it is reasonable to do so. This is the ***per use method*** of allocating expenses. *For example, investment advice service fees and expenses may be charged only to participants who use that service.*

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

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Acceptable "Per Use" Expense Allocations

This new guidance draws very different conclusions from those expressed in DOL Advisory Opinion 94-32A (a.k.a., the Homer Elliott letter). That Opinion had concluded that the costs of determining whether a domestic relations order (DRO) is a Qualified DRO (QDRO) could *not* be charged to the account of the participant for whom the determination was being made. Instead, those costs had to be spread out among all plan participants, on a pro-rata or per capita basis. Based on this Opinion, we understand that the DOL had taken the position informally that plans could not charge per user fees for any transaction that is required by ERISA. For example, a per use fee could not be charged for a minimum required distribution, but a plan could charge the affected participant's account for a plan loan, which is not specifically required under ERISA. Because of the dubious basis under ERISA for this position, and the fact that DOL never formalized it outside the QDRO context, Prudential did not change its procedures to prevent plans from charging for ERISA required distributions on a per-use basis.

Under the new guidance, DOL has reversed its 1994 Opinion, acknowledging that its prior position was not required by ERISA. Plan sponsors are now explicitly permitted to allocate the expenses incurred in processing the following transactions to the account of the specific participant involved in the transaction:

- Hardship withdrawals.
- Calculation of benefits payable under different plan payment options.
- Benefit distributions (e.g., check writing expense).
- QDRO determinations.

The DOL no longer makes a distinction between distributions that are required under ERISA and voluntary distributions (e.g., in-service withdrawals, hardship withdrawals). However, if any fees are imposed on distributions, the plan's Summary Plan Description (SPD) must include a statement identifying those situations since they may result in the offset or reduction in benefits that a participant or beneficiary would otherwise expect to receive.

Account Maintenance Fees for Vested Separated Participants

In addition, plans may charge vested separated participant accounts the account's share of plan expenses, on a pro-rata or per capita basis, even if active participant accounts are not charged those expenses. These charges may be imposed even if the separated participants were not allowed to take distributions of their accounts.

Possible Plan Qualification Concerns

In reviewing this guidance, plan sponsors should keep in mind some related plan qualification issues. For example, while ERISA may permit a plan administrator to apply different expense allocation methods to different classes of participants, this type of action may give rise to separate benefits, rights or features that require nondiscrimination testing under the Internal Revenue Code. In addition, charging plan expenses only to vested separated participant accounts might be viewed as imposing a "significant detriment" on participants who do not take immediate distributions at separation from service. However, if only the reasonable expenses associated with administering the participant's account are charged, this seems unlikely to be deemed a significant detriment. It is up to the IRS to provide guidance on these issues.

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Next Steps

Plan sponsors should review plan documents to ensure that their methods of allocating plan expenses are consistent with plan provisions, and are adequately described in the related SPD. If changes are made to plan expense allocation methods, a plan amendment may not be required (if the existing plan language is broad enough to cover the new methods), but the plan administrator may need to distribute Summaries of Material Modifications (SMMs) to participants. If you use Prudential's Document Services, we will work with you to prepare the required documents.

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