

Employee Benefits Briefing

A bulletin designed to keep clients and other friends informed on employee benefits law matters

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DEPARTMENT OF LABOR ISSUES NEW GUIDANCE ON CHARGING EXPENSES TO PARTICIPANT ACCOUNTS

The Department of Labor (DOL) recently issued new guidance addressing the allocation of expenses in 401(k) and other defined contribution plans. Field Assistance Bulletin 2003-3 confirms that plan sponsors and fiduciaries have considerable discretion in determining how plan expenses, including recordkeeping, investment management, accounting and legal fees, will be allocated among plan participants and beneficiaries. In doing so, the DOL also reversed its long-standing position that expenses incurred in processing a qualified domestic relations order (QDRO) may not be charged to an individual participant's account.

In light of this new guidance, plan sponsors and fiduciaries should review which administrative expenses are being charged to the plan and the procedures being used for allocating those expenses to determine if any changes are required or desirable.

Field Assistance Bulletin 2003-3 addresses two principal defined contribution plan expense allocation issues:

- (1) what types of plan expenses generally must be allocated on a *pro rata*, rather than a *per capita*, basis; and
- (2) when plan expenses may properly be charged to the account of an individual participant or beneficiary, rather than treated as a general plan expense.

Allocating Expenses Among All Participants — *Per capita v. Pro rata*

Two general methods exist for allocating plan administration expenses. The *per capita* method allocates expenses equally to each account in the plan without regard to the size of the account. The *pro rata* method, in contrast, allocates expenses on the basis of the assets in the individual account – the larger the account balance, the larger the share of expenses allocated to it.

Since ERISA generally does not specifically address the allocation of expenses in defined contribution plans, plan sponsors have considerable discretion in selecting the method of allocation. If the method is specified in the plan document and communicated to employees in the summary plan description (SPD), plan fiduciaries are required to act in accordance with the document.

In contrast, when the plan document is silent, a fiduciary must exercise prudence in selecting a method, weighing the interests of various classes of participants and the effects of different allocation methods on those interests. If the method selected has no reasonable relationship to the services furnished or available to an individual account, the guidance cautions, a case might be made that the plan fiduciaries breached their fiduciary duties in selecting the allocation method.

Applying these principles, the DOL guidance states that a *pro rata* method in most cases will be an equitable method of allocation of expenses among participants. This is particularly true, according to the

guidance, in the case of investment management fees. However, the guidance states, the *per capita* method may provide a reasonable basis for allocating certain fixed administrative expenses, such as recordkeeping, legal, auditing, annual reporting, and claims processing.

Allocating Expenses to an Individual Account

When determining whether it is permissible to charge an individual participant's account with specific expenses, as opposed to allocating those expenses across the accounts of all participants either *pro rata* or *per capita*, the same principles apply. According to the guidance, the following specific plan expenses may be charged to an individual's account so long as notice is included in the SPD, thereby ensuring that participants and beneficiaries are apprised of the possibility of such charges.

- ✓ **QDRO Determinations.** Reasonable expenses incurred in processing a QDRO may be charged to the account of the affected participant. This constitutes a reversal of the DOL's long-standing position on this issue.
- ✓ **Hardship Withdrawals.** Administrative expenses for processing hardship withdrawals may be assessed to the account of the participant requesting the distribution.
- ✓ **Benefit Calculations.** Charges for calculations of benefits payable under various alternative payment options available under the plan may be assessed to the account of the participant or beneficiary requesting the calculations.

- ✓ **Benefit Distribution Charges.** If a participant or beneficiary receives payment of his or her account in installments or as an annuity, rather than in a lump sum, monthly check issuance and related expenses may be assessed to the account.
- ✓ **Account Maintenance Expenses of Separated Vested Participants.** A plan may charge the accounts of vested separated participants with the account's share of reasonable plan expenses, even if the plan does not charge the accounts of active participants, according to the DOL. However, it is not clear whether the IRS would consider this charge to be a "significant detriment" to those who choose to defer distribution upon termination of employment and therefore not permitted under its regulations. It is also unclear whether "separate benefit, right or feature" testing would be required under IRS regulations if an annual account maintenance fee is charged only to separated participants.

In light of this new guidance, plan sponsors and fiduciaries should review current plan expense allocation practices and determine whether any plan amendments or changes in administrative practice are necessary or desirable. In addition, SPDs should be reviewed to ensure that they include a description of any expenses that will be charged to individual accounts.

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