
Payment Options for Plan Expenses

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Qualified retirement plans provide tax deductible benefits for employers and employees, as well as an opportunity for significant savings for the post-retirement years. But these plans require adherence to numerous governmental regulations, and there are costs involved in the establishment and ongoing maintenance of the plan.

The list of expenses includes the preparation of plan documents, recordkeeping and government reporting, to name just a few. It is important that these functions be carried out by trained professionals who are familiar with the Internal Revenue Service (IRS) and Department of Labor (DOL) rules and regulations for qualified plans.

Many of these expenses are permitted to be paid from the assets of the plan, although certain expenses must be paid by the sponsoring employer. In hard economic times, employers who have been footing the bill for administrative expenses may choose to reconsider and have some of the fees paid from the plan assets.

Expenses Borne By Employer

The DOL does not permit expenses which relate to "settlor functions" to be paid from the plan assets. A "settlor function" is an independent business activity or decision of the employer. These activities are thought to primarily benefit the employer.

Expenses such as the following cannot be paid from plan assets, although they are deductible as ordinary business expenses:

- Plan design expenses, such as studies of the plan's feasibility and projections;
- Preparation of the initial plan document;
- Preparation of voluntary plan amendments (required amendments due to law changes may be paid from plan assets); and
- Certain plan termination fees.

Example: The XYZ Company established a 401(k) plan effective January 1, 2006. The cost for preparation of the documents to establish the plan is a business expense that must be paid by the employer and not the plan. In 2009 the company was informed that the plan had to be restated for EGTRRA (the Economic Growth and Tax Relief Reconciliation Act) which was enacted in 2001 and other laws that were passed since that time. Because the restated document is required by a change in the law and not a voluntary amendment instituted by the employer, the restatement fee can be charged to participants' accounts under the plan if the employer chooses not to pay that cost.

Administrative Expenses Payable From Plan Assets

If the employer wishes, fees related to the administration of the plan can generally be paid by the plan if they are prudent and reasonable and permitted under the plan document. Reasonable administrative costs that may be charged to plan participants include the following:

- Participant recordkeeping;

- Nondiscrimination and top heavy testing;
- Preparation and distribution of benefit statements;
- Preparation of Form 5500 and schedules;
- Accountant's audit report required for large plans (those with over 100 participants);
- Summary Annual Reports;
- Notices for automatic enrollment, default investments and safe harbor 401(k) plans (where applicable);
- Expenses for computing benefit payments and processing loans;
- Plan amendments/restatements required by law changes or new regulations;
- IRS determination letter requests;
- Purchase of trustees' fidelity bond;
- Trustee fees;
- Investment management fees; and
- Fees to process participant enrollment and investment elections.

One issue to consider when deciding if a fee should be paid from the plan assets is the size of the plan relative to the amount of the fee. Allocating a \$1,500 fee among 100 participants with total plan assets of \$1,000,000 will have much less of an impact than if the plan has only 10 participants with assets of \$100,000.

The employer, as a fiduciary of the plan, is required to monitor plan expenses to insure that they are reasonable and prudent.

Allocation Methods

Once it's been established that a fee can properly be paid by the plan, the method of allocating the fee must be determined. There are several alternatives outlined below.

Allocate Fee to Specific Participant

The fairest method for allocating certain service fees is to charge them against the account of the participant involved in the transaction or service, although such fees can be allocated to the entire plan. Participants should be informed of the amount of the fee in advance. The following fees are typically charged to the affected participant's account:

- Fees to prepare distribution election and consent forms;
- Hardship withdrawal expenses;
- Fees to prepare participant loan documents and the annual loan administration expenses; and
- Qualified Domestic Relation Order (QDRO) determination and processing fees.

Pro Rata or Per Capita Allocation

Plan expenses that are not being charged to a specific participant's account can be allocated to all plan participants on either a "pro rata" or a "per capita" basis.

A pro rata allocation is done proportionately based on account balances. Per capita means that the amount is allocated equally based on the number of participants in the plan. Here is an example of how a \$1,000 fee would be allocated under each method:

| Participant | Account Balance | Pro Rata Allocation | Per Capita Allocation |
|-------------|-----------------|---------------------|-----------------------|
| A | \$60,000 | \$600 | \$250 |
| B | 20,000 | 200 | 250 |
| C | 15,000 | 150 | 250 |
| D | 5,000 | 50 | 250 |
| Total | \$100,000 | \$1,000 | \$1,000 |

As you can see, the participant with the highest account balance would have the largest fee deducted under the pro rata method.

DOL rules require that the allocation method chosen be prudent and solely in the interest of all participants. It must have a rational basis, with some reasonable relationship to the services provided. It may be more appropriate to allocate certain

investment fees pro rata based on account balances, while some administrative fees may be more appropriately allocated per capita, where each participant pays the same amount. It depends on the facts and circumstances of each situation, with prudence and reasonableness being the primary considerations.

The DOL has stated that it could be reasonable to treat terminated employees differently than active employees when it comes to the allocation of plan expenses. This may be more easily justified where the terminated employee had a choice and elected to remain in the plan, as compared to the situation where terminees cannot receive a distribution until reaching normal retirement age.

Using Forfeitures to Pay Expenses

Some plans provide that allowable expenses may be paid from the forfeiture account (accumulated from employees who terminated employment without full vesting). The impact that this will have depends on how forfeitures are treated under the terms of the plan. If forfeitures are used to offset employer contributions, such as matching contributions in a 401(k) plan, it's as if the employer were paying the expense because the reduced forfeitures will likely result in additional employer contributions. But if the forfeitures are allocated to remaining participants, then it's as if the participants are paying the fee, due to the reduced forfeiture allocation.

Defined Benefit Plans

Defined benefit plans may also pay expenses from plan assets, but participants' benefits will not be reduced as a result. That's because the benefits are stipulated under the terms of the plan, and paying expenses from the plan would only reduce the assets available to pay benefits, which could increase the employer's funding obligation. However, where investments have outperformed actuarial assumptions creating overfunding, paying expenses from the plan may be desirable.

Plan Document and Disclosure Requirements

Expenses may only be paid from the plan assets if the plan document authorizes plan expense payments or is silent on the payment of expenses. The document may contain specific details for the payment and allocation of plan expenses, although it is not required to provide such detail. Plan documents that specifically prohibit the payment of expenses by the plan may be amended prospectively to remove this provision and allow the plan to pay expenses in the future. However, the expenses of this amendment must be paid by the employer as a voluntary amendment.

Participants need to be informed if plan expenses can be deducted from their accounts. Such information should be included in the Summary Plan Description (SPD) which is required to be distributed to each employee upon entering the plan. Specific details including the amount of and method for allocating the various types of expenses should be included.

DOL Proposals

Last year the DOL proposed fiduciary disclosure requirements for participant-directed accounts which would require additional information to be provided about investment options and more detailed information about fees. The rules were supposed to have been effective January 1, 2009, but it is now uncertain when, or if, this regulation will be finalized.

Another DOL proposed regulation concerns the contracts or arrangements between the plan fiduciary and a service provider. Under the proposal, in order for a service provider's fee to be paid by the plan without resulting in a prohibited transaction, the contract must be in writing and disclose the fees to be paid. In addition, the service provider must disclose any relationship it has with other parties that could create a conflict of interest.

Although it is unclear when, or if, this regulation will be finalized, it may be advisable to adhere to a service provider disclosure policy to prevent violations of the fiduciary and prohibited transaction rules under ERISA.

One DOL change that has been finalized is the increased reporting of fees paid to service providers on Schedule C of Form 5500 for large plans, effective for plan years beginning in 2009.

Conclusion

Employers have the option of paying certain expenses of a qualified plan from the business or from the assets of the plan,

in which case the plan participants share the burden of such costs. The DOL has provided rules to determine which expenses may be paid by the plan and the allowable allocation methods among participants' accounts.

The plan document must allow the plan to pay reasonable expenses in order for it to take place, and the expense policy must be communicated to employees through the SPD. Recent DOL proposals seek to increase disclosure of plan expense information to participants, fiduciaries and the DOL.

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