SHARING PLAN EXPENSES WITH SPONSORS/PARTIES IN INTEREST/RELATED PARTIES AND APPROPRIATE USES FOR PLAN ASSETS

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Ivelisse Berio LeBeau
Sugarman & Susskind
Miami, FL
Ivelisse@sugarmansusskind.com

James Craig
U.S. Dept. of Labor
Office of the Solicitor
Plan Benefits
Security Division
Washington, DC
craig.james@dol.gov

Sara Pikofsky
Steptoe & Johnson
Washington, DC
spikofsky@Steptoe.com
SETTLOR AND FIDUCIARY EXPENSES
Expenses related to plans fall into two broad categories:

- "Settlor expenses" are connected with plan establishment, design, termination and other activities that are not subject to ERISA’s fiduciary standards.
- "Fiduciary expenses" arise from the operation of the plan and compliance with government regulations.

Fiduciary expenses may be paid from plan assets. Settlor expenses may not.
“SETTLOR” VS. “FIDUCIARY” ACTIVITIES

The “settlor” vs. “fiduciary” dichotomy isn’t defined in ERISA but is implied by the text:

An employer acts as a fiduciary within the meaning of ERISA … only when fulfilling certain defined functions, including the exercise of discretionary authority or control over plan management or administration. [Lockheed Corp. v Spink, 517 US 882, 890 (1996)]
“SETTLOR” VS. “FIDUCIARY” ACTIVITIES

- The DOL took the same view before Spink:

[I]n light of the voluntary nature of the private pension system governed by ERISA, … there is a class of discretionary activities which relate to the formation, rather than the management, of plans. These so-called “settlor” functions include decisions relating to the establishment, termination and design of plans and are not fiduciary activities subject to Title I of ERISA. [Information letter, March 13, 1986]
A plan sponsor acts as a “settlor” when it –
- Decides to establish a plan
- Selects a plan design
- Amends the plan to alter the plan design
- Complies with non-ERISA financial reporting requirements
- Decides to terminate a plan

The costs of legal work, financial analysis, etc. related to those settlor activities may not be paid from plan assets.
“SETTLOR” VS. “FIDUCIARY” ACTIVITIES

- A plan sponsor acts as a “fiduciary” when it takes actions required to comply with ERISA, maintain the plan’s qualified status or to administer it, such as –
  - Determining eligibility to participate
  - Calculating and paying benefits
  - Adjudicating appeals of denied benefit claims
  - Investing plan assets
  - Communicating with participants about plan provisions and their benefit entitlements
  - Complying with government reporting requirements
  - Performing required nondiscrimination testing
  - Implementing plan amendments or termination

- Costs of these activities may be paid from plan assets.
The DOL’s general principle:

Expenses incurred in connection with the performance of settlor functions would not be reasonable expenses of a plan as they would be incurred for the benefit of the employer and would involve services for which an employer could reasonably be expected to bear the cost in the normal course of its business operations. However, reasonable expenses incurred in connection with the implementation of a settlor decision would generally be payable by the plan. [ERISA Adv. Op. 2001-01A (Jan. 18, 2001)]
DOL GUIDANCE

- But “incidental benefits by virtue of offering an employee benefit plan” do not convert an activity into a settlor function. *Id.*
DOL GUIDANCE: PRINCIPLES

▪ Key issue is how to distinguish the cost of arriving at a settlor decision (not payable from plan assets) from the cost of implementing it (plan may pay).

▪ In general, activities leading up to establishment of a plan, adoption of a discretionary amendment or initiation of a plan termination are “settlor” in nature.

▪ Activities after that are “fiduciary” to the extent that they relate to plan administration or to compliance with ERISA, IRC or other legal requirements applicable to the plan.
**DOL GUIDANCE: EXAMPLES**

- Plan is amended to add early retirement window:
  - Cost of study to evaluate window design alternatives is a settlor expense.
  - Cost of drafting plan amendment is a settlor expense.
  - Costs of notifying eligible employees, processing elections and paying benefits are plan expenses.
DB plan spins off assets and liabilities to purchaser of a division:
- Costs incurred during negotiations are settlor expenses.
- Cost of drafting plan amendment is a settlor expense.
- Cost of determining amount of assets to be transferred is a plan expense.
Plan must comply with a newly enacted qualification requirement. Several alternative ways to comply exist:

- DOL’s position is that cost of study to choose among methods of compliance is a settlor expense.
- The cost of drafting the plan amendment is a plan expense. The amendment is not discretionary; only the choice of which amendment to adopt is a settlor function.
DB plan is amended to “shift” nonqualified SERP benefits into plan by increasing benefits for HCE’s.

- The cost of designing the SERP shift is a settlor expense.
- The cost of nondiscrimination testing necessitated by the shift is a plan expense.
DOL GUIDANCE: OTHER PRINCIPLES

- The cost of applying for determination letters may be paid in full from plan assets.

- The cost of actuarial valuations for use in the employer’s financial reporting is a settlor expense.

- Communications regarding the plan may be paid from its assets, even if they provide more information than ERISA requires.
DOL GUIDANCE: OTHER PRINCIPLES

- Payment of expenses must be permitted by plan document.
- Employer may not pay expense, then retroactively assign it to the plan. Reimbursement by the plan is allowed only if the employer pays expenses on the explicit condition of repayment by the plan.
- If an expense benefits more than one plan, it must be reasonably allocated among them.
- As should go without saying, expenses must be reasonable.
DILEMMA FOR MULTIEMPLOYER PLANS

- Trustees make decisions about plan design, which is a settlor activity.
- Those decisions often require actuarial and other studies.
- The black letter rule is that cost of design studies should not be paid from plan assets.
- BUT a multiemployer plan has no source of funds except plan assets.
PAYING EXPENSES RELATED TO MULTIEMPLOYER PLANS
SETTLOR VS. FIDUCIARY ACTIONS

- The Board of Trustees of a multiemployer benefit fund is the sponsor of the benefit plan and is independent of both the union and participating employers

- **Question**: Can a multiemployer plan pay expenses for actions that are typically considered “settlor” functions?

- **Answer**: It depends– are the trustees acting as fiduciaries or settlors?
DOL considered whether trustees of a multiemployer plan acted in a fiduciary or settlor capacity when amending a plan. DOL noted that courts have concluded that multiemployer plan trustees can act in settlor functions and thus not be subject to fiduciary standards. "Where relevant documents … contemplate that the … trustees … will act as fiduciaries in carrying out activities which would otherwise be settlor in nature, such activities will be governed by the fiduciary provisions of ERISA.” However, if plan documents are silent, trustees can act in a settlor capacity that would not be governed by fiduciary standards.
DOL FIELD ASSISTANCE BULLETIN 2002-02

- It would NOT be appropriate for a multiemployer plan to pay for expenses related to the trustees’ settlor activities.
- See also Advisory Opinion 2006-04A (determining that trustees did not act in a fiduciary capacity when amending a plan and noting that settlor expenses are not appropriate plan expenses).
- 2007 Advisory Board: recommendation for DOL to issue regulations allowing multiemployer plans to pay for services that would generally be deemed to be settlor functions.
TRANSACTIONS AND SHARING EXPENSES AMONG RELATED FUNDS

- Unions typically bargain for pension/retirement, health, and other types of benefits for the same group of employees

- It is thus common for:
  - a union and an employer/employer association to jointly sponsor and administer different employee benefit funds that provide benefits to the same group of employees
  - related benefit plan funds, unions, or employers to lease property to each other
  - related benefit plan funds to have
    - common trustees
    - share space and/or services
The union, participating employers, trustees are all parties in interest to the benefit plans, and transactions between and among them raise prohibited transaction concerns.

Trustees, the union, employers may also have conflicts of interest because they could be acting on behalf of more than one party.

DOL issued a series of class Prohibited Transaction Exemptions in the 1970s that remain applicable today.
PTE EXEMPTION 76-1

- If listed conditions are met, PTE 76-1 exempts certain transactions from §406(a) prohibited party in interest transaction restrictions
- Applies where:
  - a multiemployer plan
  - leases office space, provides administration services, or sells/leases goods
  - to a participating union, employer, or employer association, or another multiemployer plan
PTE EXEMPTION 76-1

- Conditions include:
  - Plan must receive reasonable compensation for leasing of space or administrative services or sale/lease of goods
  - Arrangement can be terminated on short notice
  - Plan must maintain records for six years after transaction terminates
PTE Exemption 77-10

- Companion to PTE 76-1
- If listed conditions are met, PTE 77-10 exempts certain transactions from §406(b)(2) prohibitions on self-dealing/conflicts of interest
- Applies where:
  - a multiemployer plan
  - shares office space or administrative services or goods, leases office space, provides administrative services, or sells/leases of goods
  - to a participating union, employer, or employer association, or to another multiemployer plan
PTE Exemption 77-10

- Conditions include:
  - Costs of sharing office space, administrative services or goods must be assessed and paid on a pro rata basis with respect to each party’s use of space, services and goods
  - Plan must receive reasonable compensation for providing services or leasing office space or sale/lease of goods
  - Reasonable compensation does NOT need to include profit which would ordinarily be received in an arms length transaction but must reimburse costs
  - Arrangement can be terminated on short notice
  - Plan must maintain records for six years after transaction terminates
PTE EXEMPTION 78-6

- Limited to apprenticeship plans
- If listed conditions are met, PTE 78-6 exempts certain transactions from §406(a)(1)(A), (C), and (D) prohibited party in interest transaction restrictions

Applies where:
- an apprenticeship plan
- purchases or leases personal property from a contributing employer, or
- leases real property from a contributing employer or participating union, or
- leases personal property from a participating union
PTE EXEMPTION 78-6

- Conditions include:
  - Terms at least as favorable to plan as an arm's length transaction with unrelated party
  - Transaction is appropriate and helpful in carrying out purpose for which plan is established
  - Plan must maintain records for six years after transaction terminates
APPLYING EXEMPTIONS

- Must satisfy **ALL** listed conditions in order to benefit from class PTEs
  - Where plan provided service to union without compensation, PTE conditions not met and arrangement was a per se prohibited transaction. *Enright v. NY City Dist. Council of Carpenters Welfare Fund*, 2013 WL 3481358 (SDNY 2013).

- PTEs only exempt from specified prohibited transaction sections
  - Note that PTE 76-1 only applies to §406(a) PTs and PTE 77-10 only applies to §406(b)(2) PTs
  - Transactions may need to meet conditions of several statutory or class exemptions

- PTEs do not exempt from §404 fiduciary duties
DOL GUIDANCE: LEASING ARRANGEMENTS

- DOL issued FAQs on Multiemployer Plan Leasing Arrangements in October 2011
  - Identifies potential conflicts of interests in leasing arrangements between a plan, union, or contributing employer
  - Identifies exemptions that may be applicable to leasing arrangements involving plans, including §408(b)(2), §408(b)(17), and PTEs
- Provides examples of PTs in leasing arrangements
DOL GUIDANCE: LEASING ARRANGEMENTS

- Offers guidance on addressing PT issues in leasing arrangements:
  - Keep support demonstrating that reasonable compensation paid, including current real estate appraisals
  - Have written lease agreement signed at the start of a lease arrangement
  - Have trustees with conflicts of interest recuse themselves and not participate in making decisions related to conflict
  - Keep support demonstrating that an arrangement is as favorable as an arms’ length transaction
ALLOCATING SHARED EXPENSES

- Under PTE 77-10 shared expenses among plans must be assessed and paid on a pro rata basis with respect to each plan’s use of space, services and goods
- Plans must keep records to support assessment and payment of shared expenses
- Plans should use objective methods to measure use of space, services and goods, as appropriate under circumstances
- DOL has not offered specific guidance
ALLOCATING SHARED EXPENSES

- Potential methods for determining pro rata use in shared arrangements:
  - Measure use of space and divide lease based on use
  - Have employees keep time records and allocate accordingly
  - Keep specified work schedule for services to each plan and allocate based on scheduled hours
  - Allocate based on relative size of funds and related work
  - Pay expenses unique to each plan by each plan
  - Periodically update study and methodology, particularly if facts change
ALLOCATING SHARED EXPENSES: OPEN QUESTIONS

- How often should expenses be allocated and paid? Monthly? Quarterly? Annually?
- How often should property appraisals be done?
- How often should studies regarding comparable rent or comparable services be done?
- What types of documents required to meet exemptions?
- How often should arrangements be reviewed?
ALLOCATING SHARED EXPENSES: REMEMBER THAT...

- If more than one plan shares an expense it must allocated pro-rata, even if expense would be reasonable on its own for one plan in the absence of the other
  - *Ex: Welfare Plan rents meeting space with 4 hr minimum; Welfare Plan meeting is 2 hrs.; Pension Plan 1 hr.; Legal Fund ½ hr. Expense was reasonable for Welfare Fund. Still need to allocate meeting expenses pro rata with Pension and Legal Funds in order to meet exemption.*

- If a trustee is a full time salaried employee of union or employer and spends time doing work on behalf of a plan, likely can’t reimburse union or employer for share of wages because of salaried status; question is whether salary would be paid regardless of nature of work. 29 CFR §2550.408(c)-2(b)(2).
PRO-RATA VS PER-CAPITA EXPENSE ALLOCATION

Field Assistance Bulletin 2003-03
What rules apply to how expenses are allocated among plan participants in a defined contribution pension plan?

Supersedes AO 94-32A

Sponsors and fiduciaries have considerable discretion in how expenses will be allocated among participants and beneficiaries, both in plan design and administration.

- Pro-rata (based on size of account balance)
- Per-capita (charged equally to each account)
FAB 2003-03 (CONT’D)

- Plan documents are starting point – if settlor prescribed allocation method in plan docs, the fiduciary must follow per 404(a)(1)(D)
- Where plan documents silent or ambiguous, fiduciary “must be prudent in the selection of the method of allocation”
- Prudence requires fiduciary to weigh competing interests of various participant classes and effects of allocation methods on such interests
- Allocation method chosen by fiduciary must have rational basis or reasonable relationship to services furnished
FAB 2003-03 (CONT’D)

- Must also satisfy “solely in the interest” standard, but this standard is not failed merely because a class of participants is disfavored, so long as there is a rational basis for the chosen allocation method.

- Be careful that fiduciary is not conflicted in the decision, such as where a divorcing fiduciary (who is also a plan participant) decides on an allocation method for QDRO costs that benefits himself or herself.
While pro-rata method based on size of account balances appears reasonable in most cases, per-capita allocation may also be reasonable for certain fixed expenses such as recordkeeping, legal, auditing, annual reporting, and claims processing expenses.

However, where expense is based on account balance size (such as investment management fees), per-capita may appear arbitrary.

FAB discusses some specific examples.

Summary Plan Description must disclose plan provisions that may result in a fee or charge -- 29 CFR 2520.102-3(l)
VOLUNTARY FIDUCIARY CORRECTION PROGRAM (VFCP)

**BENEFITS OF USING VFCP**

- “No Action” letter (upon completion)
- Avoid DOL investigations
- Avoid ERISA §502(l) penalty
- Avoid potential litigation
- In some cases, avoid IRC §4975 excise tax
VFCP ELIGIBILITY

- See VFCP Sec. 3(b)(3), Sec. 4, 71 Fed. Reg. 20,270 (Apr. 19, 2006)

Among other things:

- Neither plan nor applicant “Under Investigation” (I.e., Plan has oral or written notice of EBSA, or IRS TE/GE EP audit, or IRS referral) If under investigation by PBGC or state, must disclose in application.

- Also, no evidence of criminal violations
VFCP CORRECTION

- All losses must be restored to plan, all PTs corrected
- No correction costs paid by plan
- 5500s amended when appropriate
- “Correction amount” varies based upon transaction type
- “Correction amount” usually includes “Principal Amount” (amount that would have been available for investment or distribution but for the breach) plus “Lost Earnings” calculated at §6621(a)(2) underpayment rate (or §6621(c)(1) rate if >$100,000)
VFCP CORRECTION FOR PLAN EXPENSES (SECTION 7.6)

- VFCP Sec. 7.6, 71 Fed.Reg. 20,280-81
- Duplicative, Excessive, Unnecessary Compensation
- Expenses Improperly Paid by Plan
  - In violation of plan provision
  - Settlor fees
- Dual Compensation to a Plan Fiduciary
**VFCP — EXCISE TAX RELIEF FOR SETTLOR EXPENSE PAYMENT**

- Exemption available once in 3 years
- Settlor fees
- Unless plan document prohibits
- “Arm’s length” terms
- Amount did not exceed lesser of $10,000 or 5% plan asset FMV
- Notice Requirement