Guidance on Plan Expenses from the Department of Labor

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In conjunction with investigations involving reviews of plan expenses, a number of questions have been raised concerning the extent to which plans may pay certain expenses that might be viewed as conferring a benefit on the plan sponsor. In this regard, the Department has issued a number of letters which have attempted to lay out the fiduciary provisions, principles and considerations relevant to an analysis of this question.1 Nonetheless, it has been determined that further clarification and guidance will facilitate both compliance and enforcement efforts in this area.

In an effort to specifically address the most frequently raised questions, the Employee Benefits Security Administration has developed a set of six hypothetical fact patterns in which various plan expense issues are both presented and addressed.

Questions concerning this guidance may be addressed to the Office of Regulations and Interpretations (ORI), Employee Benefits Security Administration, Room N-5669, 200 Constitution Avenue, N.W., Washington, D.C. 20210, Attention: Settlor Expense Guidance or by calling Louis Campagna, Chief, Division of Fiduciary Interpretations, ORI, 202-219-8671 (this is not a toll-free number).

Hypothetical No. 1
During 1997, ACD Inc. agreed to sell a business segment to EFG Inc., a friendly competitor. The closing date for the sale was January 1, 1998. As a result of this sale, 1,600 participants and $180 million (the amount of accrued benefits attributable to the transferring employees) were to be transferred from the ACD defined benefit plan to the EFG defined benefit plan on the sale closing date. In December 1997, the companies were forced, through no fault of the parties, to postpone the sale closing date until May 1, 1998. The following expenses were paid by the ACD plan as a result of the business segment sale:

- $80,000 for a plan design study
- $30,000 to amend the ACD Plan to provide for the spin-off
- $75,000 to compute the amount necessary to implement the transfer of plan assets from the ACD Plan to the EFG Plan and an additional $75,000 to re-compute the amount of the asset transfer due to the changed closing date
- $25,000 for negotiations with various unions related to the transfer of assets and participants

Which of the above expenses, if otherwise reasonable, may be paid by the ACD Plan?

Hypothetical No. 1 - Answer
The Department has taken the position that there is a class of activities which relates to the formation, rather than the management, of plans. These activities, generally referred to as “settlor” functions, include decisions relating to the formation, design and termination of plans and, except in the context of multiemployer plans, generally are not activities subject to Title I of ERISA. Expenses incurred in connection with settlor functions would not be reasonable expenses of a plan. The Department also has taken the position that, while expenses attendant to settlor activities do not constitute reasonable plan expenses, expenses incurred in connection with the implementation of settlor decisions may constitute reasonable expenses of the plan. See Letters to Carl J. Stoney, Jr. (2001, Advisory Opinion 01-01A); Samuel Israel (1997, Advisory Opinion 97-03A); Kirk Maldonado (1987); and John Erlenborn (1986).

Applying the foregoing principles, the $80,000 for a plan design study clearly constitutes an expense for a settlor activity and, therefore, cannot be paid by the ACD Plan.The $30,000 to amend the ACD Plan to provide for the spinoff should, in the view of the Department, be treated as a settlor/plan design expense inasmuch as the plan fiduciary would have no implementation responsibilities under the plan until such time as the plan is actually amended

The $75,000 expense incurred to determine the amount of plan assets to be transferred to the EFG Plan would be a permissible plan expense if the expense is attendant to implementing ACD's decision to spin off certain participants, rather than for assisting ACD in formulating the spin-off. The second $75,000 expense incurred to recompute he amount of the asset transfer due to the changed closing date also may be a reasonable plan expense, where, for example, the delay in the closing date was through no fault of the sponsor and the plan was duly amended to accomplish the merger at the new closing date.

The $25,000 expense related to negotiations with various unions would be a settlor expense. The described union negotiations typically take place in advance of plan changes. Activities (such as union negotiations, benefit studies, actuarial analyses) that take place in advance of, or in preparation for, a plan change will almost always constitute settlor activities, the expenses for which would not constitute reasonable plan expenses.

Hypothetical No. 2

MNOP Corp., a Georgia gold mining company with pharmaceutical operations in the Miami area, decided to reduce its staff after several years of poor mining results, falling gold prices, and failed marketing projects in the Miami area. After exploring several other staff reduction options, MNOP decided to initiate an early retirement window (window) in their defined benefit plan (Plan) to induce older workers to retire. The Plan paid the following expenses related to the window:

- $150,000 for a plan design study to determine the components of the window
- $80,000 for cost projections and to determine the impact of the window on MNOP's financial statements in accordance with FASB Statement No. 87 ("Employer's Accounting for Pension")
- Following adoption of the early retirement window, $90,000 to compute potential benefits for those participants that would be eligible for the window
- $30,000 to communicate selected components of the window and the plan benefits under the window to encourage eligible participants to take advantage of the early retirement benefit offer
- $50,000 for benefit calculations for those opting to retire under the window
- $20,000 to communicate plan benefits to the participants that opted to retire under the window
- $10,000 for FASB Statement No. 88 ("Employer's Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination of Benefits") calculations, as the window resulted in a Plan curtailment

Which of the above expenses, if otherwise reasonable, may be paid by the Plan?

Hypothetical No. 2 - Answer

The expenses incurred in hypothetical No. 2 fall into three basic categories - plan design, benefit computation and communication expenses.

Plan design expenses clearly constitute settlor expenses and, therefore, are not payable by the plan. Typically, plan design expenses are incurred in advance of the adoption of the plan or a plan amendment. In the case at hand, the $150,000 for plan design study and the $80,000 for cost projections to determine financial impact of the plan change on the sponsor are settlor expenses and may not be paid by the Plan. Similarly, the $10,000 for FASB Statement No. 88 expense relate to the Plan sponsor's financial statements and are not payable by the Plan.

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Calculating the actual benefits to which a participant is entitled under the plan is an administrative function of the plan and, accordingly, reasonable expenses attendant to such calculations may be paid by the plan. Thus, the $50,000 expense for calculating the benefits of those opting for the retirement window may be a reasonable expense of the Plan. In addition, the $90,000 paid to compute the potential benefits for all eligible employees may be a reasonable expense of the Plan, if the fiduciary determines that such an expenditure is a prudent use of plan assets. Even though providing such information to all eligible employees might be viewed as furthering the objectives of the company, this benefit to the employer would not prevent the Plan from incurring the expense.

As suggested above, communicating plan information to participants and beneficiaries is an important plan activity and, therefore, expenses attendant to such communications will usually constitute permissible plan expenses, if the expenses are otherwise reasonable. In this regard, administrators and plan fiduciaries generally should be afforded substantial latitude in the method, form and style of their plan communications. Applying the foregoing, the $30,000 to communicate selected components of the window to all eligible participants and the $20,000 to communicate plan benefits to participants that opted for early retirement under the window may constitute reasonable expenses of the Plan, even though, like the above benefit calculations, the communication to all eligible participants might be viewed as furthering the objective of the company to induce employees to opt for early retirement.

Hypothetical No. 3

HIJ, Inc. is a major retailer in Boston, Chicago and San Francisco. During the last two years, it was determined that HIJ's defined benefit plan (Plan) was amended to offer a participant loan program and an early retirement window for management employees. The Plan is intended to be maintained as a tax-qualified plan. HIJ normally maximizes its tax-deductible contribution to the Plan. Upon review of the Plan's financial records, it was determined that the following expenses were paid by the Plan:

- $100,000 to amend the Plan to establish an early retirement window for management employees and to obtain an IRS determination letter
- $50,000 to amend the Plan to comply with tax law changes
- $25,000 to amend the Plan to establish a participant loan program
- $20,000 for routine nondiscrimination testing to ensure compliance with the tax qualification requirements

Which of the above expenses, if otherwise reasonable, may be paid by the Plan?

Hypothetical No. 3 - Answer

In Advisory Opinion 97-03A, the Department expressed the view that the tax-qualified status of a plan confers benefits upon both the plan sponsor and the plan and, therefore, in the case of a plan that is intended to be tax-qualified and that otherwise permits expenses to be paid from plan assets, a portion of the expenses attendant to tax qualification activities may be reasonable plan expenses. The Department further clarified its views on tax qualification expenses in Advisory Opinion No. 01-01. In that opinion, the Department expressed the view that a plan fiduciary is not required to take into account the benefits a plan's tax-qualified status confers on an employer in determining whether the expenses attendant to maintaining a plan's tax-qualified status constitute reasonable expenses of the plan. The Department further noted that any such benefit should be viewed as an integral component of the incidental benefits that flow to plan sponsors generally by virtue of offering a plan.

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In the context of tax qualification activities, it is the view of the Department that the design of a plan as a tax-qualified plan clearly involves settlor activities for which a plan may not pay. On the other hand, implementation of the settlor decision to maintain a tax-qualified plan would require plan fiduciaries to undertake activities relating to maintaining the plan's tax-qualified status for which a plan may pay reasonable expenses (i.e., reasonable in light of the services rendered). Implementation activities might include drafting plan amendments required to maintain tax-qualified status, nondiscrimination testing, requesting IRS determination letters.

Applying the above principles, the $50,000 to amend the Plan to comply with tax law changes and the $20,000 for routine nondiscrimination testing may constitute reasonable expenses of the Plan. The $25,000 to amend the Plan to establish a participant loan program would be a plan design/settlor expense inasmuch as the plan fiduciaries have no implementation obligations under the Plan until such time as the Plan is amended. Subsequent to the Plan amendment, however, expenses attendant to operating the established loan program would be implementation expenses with respect to which the Plan may pay reasonable expenses.

The single charge of $100,000 includes expenses for plan design/settlor activities (i.e., amending the plan to establish an early retirement window) and implementation activities (i.e., obtaining an IRS determination letter). In as much as fiduciaries may pay only reasonable expenses of administering the plan, the fiduciaries of the Plan would be required to obtain from the service provider a determination of the specific expense(s) attributable to the fiduciaries' implementation responsibilities (i.e., obtaining an IRS determination letter) prior to payment by the Plan.

Hypothetical No. 4

The QRS Corp. is a world-wide shoe manufacturer with plants in the Cincinnati and Detroit areas. A review of the financial records of the QRS Corp. defined benefit plan (the Plan) reflected the following expenses:

- $60,000 for consulting fees to analyze the company's options for compliance with Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) and Small Business Jobs Protection Act of 1996 (SBJPA)
- $5,000 to amend the Plan to comply with USERRA and SBJPA and $5,000 to obtain an IRS determination letter
- $50,000 in actuary fees to perform nondiscrimination testing due to a Plan amendment increasing benefits as a result of union negotiations
- $5,000 to amend the Plan to comply with the requirements of Title I of ERISA.

Which of the above expenses, if any, may be paid by the Plan?

Hypothetical No. 4 - Answer

The expenses presented in this hypothetical raise some of the same issues as those raised in hypothetical No. 3 - the extent to which expenses relating to maintenance of tax-qualification may constitute reasonable plan expenses. Applying the principles set forth in the answers to hypothetical No.3, the $5,000 expense to amend the Plan, the $5,000 expense for a determination letter and the $50,000 for nondiscrimination testing may be necessary to maintain the Plan's tax-qualified status and, therefore, may constitute reasonable Plan expenses. The fact that the $50,000 discrimination testing was necessary because of a union-negotiated plan amendment does not affect the expense being treated as a permissible plan expense. On the other hand, if the $50,000 was incurred as part of the Plan sponsor's negotiating with the union - in advance of adoption of the Plan amendment giving rise to the testing - the expense, as discussed in the Answer to hypothetical No. 1, would be viewed as a settlor, rather than plan, expense. The $60,000 for consulting fees to analyze the Company's options for compliance with USERRA and SBJPA would constitute plan design/settlor expenses that may not be paid by the Plan.

Similar to a fiduciary's implementation responsibility with regard to maintaining the tax-qualified status of a plan, fiduciaries have an obligation to ensure that administration of their plan comports with the requirements of ERISA, as well as other applicable Federal laws. Accordingly, the $5,000 expense to amend the Plan to comply with the requirements of Title I of ERISA would be a permissible plan expense, assuming that the amount is reasonable in light of the services rendered.

Hypothetical No. 5

The public relations firm, TUV (the Firm), has offices in Philadelphia, Dallas, Los Angeles and New York. The Firm operates a defined benefit plan (Plan). From 1993 to 1996, the Plan, in addition to distributing a Summary Annual Report (SAR), distributed an individual benefit statement to each participant. The total preparation and distribution costs for the benefit statements were approximately $50,000 annually.

In 1996, the Firm decided it would be a good idea to make sure its employees were aware of all of the benefits provided by the Firm. Accordingly, for 1996 and subsequent years, the individual benefit information was incorporated in a twelve page booklet that included summary information about all the Firm's benefit plans (health, dental, vision), as well as one full page devoted to other Firm benefits (e.g., the physical fitness center, limousine services) and activities (e.g., annual picnic, Holiday party, etc). The booklets are prepared by the Plan's actuarial consultant. The booklet costs approximately $125,000 to prepare and distribute annually.

What, if any, of these expenses may be paid by the Plan?

Hypothetical No. 5 - Answer

The issues presented by this hypothetical involve the extent to which a plan can pay expenses related to the disclosure of plan information. Clearly, plans may pay those expenses attendant to compliance with ERISA's disclosure requirements (e.g., furnishing and distributing summary plan descriptions, summary annual reports and individual benefit statements provided in response to individual requests). As indicated in the Answer to hypothetical No. 2, communicating plan information to participants and beneficiaries is an important plan activity. The Department notes that there is nothing in Title I of ERISA that precludes a plan fiduciary from providing more information than that specifically required by statute. Whether or not a particular communication related expense should be incurred by a plan is a fiduciary decision governed by the fiduciary responsibility provisions of Title I of ERISA.

Accordingly, the $50,000 to produce and distribute individual benefit statements would be a permissible plan expense to the extent that the actual costs of preparation and distribution are reasonable. Similarly, a portion of the $125,000 for preparation and distribution of the benefit booklets may also be a permissible plan expense. Clearly, the plan sponsor should pay that portion (1/12) of the costs of the booklet that relates to non-plan matters (i.e., physical fitness center, limousine services, picnic, etc.). In addition, a plan may pay only those reasonable expenses relating to that plan, and therefore, each of the plans should pay their proportionate share of the expenses of the booklet. While plan administrators and fiduciaries should be given considerable deference with regard to their disclosure decisions, plan administrators should be able to explain their disclosure decisions and justify the costs attendant thereto.

Hypothetical No. 6

The QT, P. C. (QT) is a law firm with satellite offices in most major U. S. cities. QT operates a defined benefit plan (Plan). Until 1997, the Plan was administered by a ten lawyer benefits committee. In 1997, the Plan fiduciaries decided to out-source the administration. Following an in-depth search, the Plan's fiduciaries selected Firm, Inc. and agreed to pay $1 million in start-up fees. The start-up fees were paid from the Plan and were used to set up data bases and transfer data to Firm that was necessary to administer the Plan. The new system operated by Firm provides Plan participants with a significantly enhanced level of service than was previously provided by the staff of ten lawyers. Once the Plan's administration was transferred to Firm, the Plan paid all of Firm's administration fees.

To what extent may the expenses associated with outsourcing the Plan's administration be paid by the Plan?

Hypothetical No. 6 - Answer

Section 404(a)(1)(A) specifically contemplates the payment of reasonable expenses by an employee benefit plan. Where a plan sponsor has assumed responsibility for the payment of plan expenses and later prospectively shifts that responsibility to the plan, the plan may pay those expenses to the extent reasonable and not otherwise precluded by the terms of the plan.

To the extent that the services provided by Firm are necessary for the administration of the Plan, the $1 million start-up fee and ongoing administrative fees may constitute reasonable expenses of the Plan if they are reasonable with respect to the services provided, and not otherwise precluded by the Plan.

FOOTNOTES

1. See Letters to Carl J. Stoney, Jr. from Robert J. Doyle (Advisory Opinion 01-01A, January 18, 2001); Samuel Israel from Robert J. Doyle (Advisory Opinion 97-03A, January 23, 1997); Kirk Maldonado from Elliot I. Daniel (March 2, 1987); John Erlenborn from Dennis M. Kass (March 13, 1986).
2. The expense information set forth in the following hypotheticals are for illustrative purposes only and are not intended to reflect a determination by the Department on the reasonableness of an expense.
3. The Supreme Court has recognized that plan sponsors receive a number of incidental benefits by virtue of offering an employee benefit plan, such as attracting and retaining employees, providing increased compensation without increasing wages, and reducing the likelihood of lawsuits by encouraging employees who would otherwise be laid off to depart voluntarily. The mere receipt of such benefits by plan sponsors does not convert a settlor activity into a fiduciary activity or convert an otherwise permissible plan expense into a settlor expense. See Lockheed Corp. v. Spink, 517 U.S. 882 (1996), Hughes Aircraft Company v. Jacobson, 525 U.S. 432 (1999).
4. See footnote no. 3.
5. The Department has taken the position that where a plan document is silent as to the payment of reasonable administrative expenses, the plan may pay reasonable administrative expenses. Where a plan document provides that the employer will pay any such expenses, and if the employer has reserved the right to amend the plan document, ERISA would not prevent the employer from amending the plan to require, prospectively, that the relevant expenses be paid by the plan. The Department believes that the prohibition against self- dealing in section 406(b)(1) precludes an employer from exercising fiduciary authority to use plan assets to pay for an amendment

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