Settle Down Now: Understanding Settlor Functions, Plan Expenses, and Who Can Pay What

Adrienne I. Moore

A company decides to set up a retirement plan. You may not need the U.S. Department of Labor (DOL) to tell you that establishing a new plan must be paid by the would-be plan sponsor and not with plan assets. After all, how can a plan not yet in existence and with no assets pay for anything?

This is only the first – and perhaps the easiest – of a long line of issues relating to the payment of retirement plan expenses by the plan, itself, rather than by the plan sponsor. Once the plan is created and the trust established, the determination of what can be paid for by the plan only gets more nuanced.

For example, let’s look at amendments that are required by law. Suppose a new Treasury Regulation is issued that necessitates the adoption of an interim amendment (e.g., the new hardship changes)? The amendment is required for the plan to maintain its tax-favored status (which benefits the plan sponsor, to be sure, but also the employees who now participate). Can the plan pay to have this amendment drafted? Yes! If it’s a legal requirement, the plan can pay! The plan owners meet with the plan’s retained third party administrator (TPA), who customarily is paid from plan assets for providing its services to the plan necessary for the plan’s operations. The TPA walks the owners through the discretionary options within the new amendment and has them select their preferred provisions from the set choices. The TPA bills hourly for this meeting. Can this meeting be paid for by the plan? Nope. The discretionary aspects of the amendment add a new twist.

If your head is spinning, just settle down. While much of the guidance is informal, the DOL has provided plenty of instruction to plan fiduciaries to help them determine what fees may be paid by the plan and what fees must be paid by the plan sponsor.

The Basic Rules.

ERISA Sections 403 and 404 generally provide the basis for the ability to pay fees from plan assets. Section 403(c)(1) states that the assets of the plan are held for the exclusive benefit of the participants and beneficiaries (yes, yes, this we know), as well as "defraying reasonable expenses of administering the plan." It is this language, repeated in Section 404(a)(1)(A)(ii), that demonstrates that plan assets may be used for reasonable administrative expenses. Defining what is reasonable and what is administrative proves to be trickier.

The DOL guidance on this subject generally classifies expenses as being related to either (1) plan administration, or (2) settlor functions. In this context, the word "settlor" should not evoke visions of Conestoga wagons and little houses on the prairie. "Settlor" is an old trust term meaning the person or entity who creates or sets up the trust. In the context of retirement plans, the settlor is usually the employer/plan sponsor. It could also be a union or an association that sponsors a plan.

The general rule. Plan administrative expenses may be paid by the plan, but expenses arising from settlor functions must be borne by the plan sponsor. A fair amount of guidance on this distinction can be found on the DOL's website (www.dol.gov/agencies/ebsa) and in DOL Advisory Opinion 2001-01A. The DOL often considers whether an expense is ultimately beneficial to participants in deciding if it may be paid by the plan, and this understanding can help to categorize and anticipate the remaining (or potentially additional) appropriate expenses.

But, what does the plan say? Before you get there, however, it is important to remember that, as is so often the case, the plan document controls and should be reviewed first. The plan document may dictate that all expenses are borne by the plan sponsor. This is not common, but it is possible. Alternatively, the plan document may allow that such reasonable administrative expenses be paid from plan assets. Many documents direct that forfeitures may be used for the payment of such expenses, which permits these amounts to be paid without a direct effect on participants' accounts. The document, however, may not shift responsibility of expenses from the plan sponsor to the plan beyond those anticipated and allowed by ERISA. If the plan document is silent on the issue of expenses, DOL rules permit the plan fiduciaries to reasonably interpret this to mean that the plan assets may be used to pay reasonable administrative expenses. All of this leads us to the most important advice on all plan-related issues: Read. Your. Document.

What Must Be Paid by the Plan Sponsor?

Settlor expenses must be paid by the plan sponsor. The DOL considers settlor functions to be "decisions relating to the establishment, design and termination of plans." (See DOL Advisory Opinion 2001-01A.)

Why are these considered settlor functions? The decision to set up a retirement plan or to later terminate a retirement plan are business decisions, not plan fiduciary actions. The employer makes these decisions in its capacity as an employer. Those expenses that an employer would reasonably expect to bear in the course of its business operations are generally considered settlor functions. For a related reason, costs associated with FASB Statement No. 88, which relates to the plan sponsor's financial statements, must also be borne by the plan sponsor.

Plan Amendments and Terminations. Consider the decision to terminate a plan. Is it being made because it is in the best interests of the plan or the plan sponsor? If the plan sponsor finds itself unable to properly administer or support the plan, the decision to terminate is a business decision made for the benefit of the plan sponsor. The design of the plan is also related to the plan sponsor's business goals in carrying on the plan. For example, the decision to adopt a safe harbor matching contribution would likely be based on the plan sponsor's desire to avoid nondiscrimination testing and encourage employee deferrals. The decision would also be dependent on the plan sponsor's financial ability to make such a required contribution year-to-year. Payments for a plan design study, no surprise, would also be settlor expenses.

Discretionary amendments are always plan sponsor decisions, whereas any analysis of possible options for amending a plan pursuant to a required plan amendment (like costs for the above meeting with the TPA) would also be up to the plan sponsor to cover.

Once the settlor decision is made, carrying out that decision is generally administrative in nature. Therefore, the actual drafting of a required amendment may be paid by the plan. Calculations to carry out a plan termination or the impact of an amendment are also administrative in nature.

Amendments to spin off a portion of the plan pursuant to a corporate reorganization is, of course, related to a business decision and therefore a settlor expense. Any negotiations with unions about such spin-off are also settlor functions. On the other hand, the plan may pay for any expenses related to determining the amount of plan assets to be transferred as the result of a spin-off and implementing the decision to spin off certain participants, such as a calculation of benefits.

On the other hand, as is mentioned above, the DOL has specifically authorized plans to pay the expenses related to amending a plan to conform to legal requirements. The drafting of required amendments, which are necessary to maintain the plan's tax-qualified status, may be paid by the plan. The plan may also pay for expenses related to obtaining an IRS determination letter.

Correction of Plan Failures, Filing Failures, and Fiduciary Breaches. Plan sponsors must also cover any expenses incurred as a result of issues with the plan that require correction. Costs associated with obtaining advice about plan failures and submitting these issues to the DOL's Voluntary Fiduciary Correction Program (VFCP) or Delinquent Filers Voluntary Correction Program (DFVCP), or to the IRS's Voluntary Compliance Program (VCP), and the payment of any filing fees or sanctions in connection with such corrections cannot come from plan assets.

What May Be Paid by the Plan?

The phrase "reasonable administrative fees" is not terribly descriptive or helpful. It is up to the plan's fiduciary to determine what is reasonable. Commonly, this is done as part of the review of the contracts with those who service the plan (often called the "408(b)(2) Disclosures" after the ERISA section requiring that service contracts have reasonable fees).

With that out of the way, we can focus on what is "administrative." There is no clear guidance from the DOL on this, but it has provided many examples over the years. Expenses that we would typically consider administrative in nature, and which may be paid by the plan, include those associated with: nondiscrimination testing; hardship withdrawals or other benefit distributions determinations and processing (including calculation of benefits); reviewing Qualified Domestic Relations Orders (QDROs) and Qualified Medical Child Support Orders (QMCSOs); recordkeeping, accounting, legal, and trustee services that are necessary for administering the plan as a whole; legally-required reporting (e.g., Form 5500) and the related plan auditing; claims processing; processing and administering plan loans; custodial expenses; expenses related to compliance with ERISA's disclosure requirements (e.g., the Summary Annual Report or Summary Plan Description); and the payment of PBGC premiums.

The DOL guidance also generally allows the plan to pay investment expenses. Such expenses could include fees for investment advice, expenses associated with participant self-direction of investments, fees for brokerage windows, commissions, front- or back-end loans or sales charges, redemption fees, transfer fees, transfer agent expenses, and optional rider charges in annuity contracts. Many times, these fees will be charged directly against the respective participant's account, which is acceptable. The DOL goes even further and allows the plan to pay for retirement planning software and investment advice, likely because it is beneficial to participants.

The plan may also pay for educational seminars (like a meeting between a professional enroller and employees to explain plan provisions and how to make a deferral election) and for communications of plan information to participants and their beneficiaries, even where not required by ERISA. Finally, insurance helps to protect the participants' assets in the plan. For this reason, the plan may pay such reasonable insurance and bonding costs to cover individuals handling funds or assets in the plan and protecting against losses due to fiduciary breach.

Even though the plan *may* pay for these expenses, the plan sponsor may still choose to cover any or all of these fees or other extraordinary expenses. For example, you might see a plan sponsor pay for any back-end charges on investments incurred when the plan sponsor has chosen to transfer the plan to a new recordkeeper, to minimize the impact of the transfer on the plan's participants.

Time to Settle Up.

While certain of the above distinctions will be easy to memorize, it can be difficult to distill the DOL's approach into a clear or concise rule. When a new situation arises, it is worth reviewing the DOL's (and IRS's, to a lesser degree) published guidance for assistance. For those unclear situations, ask yourself: For whose benefit is the expense being incurred: the plan sponsor or the participant? Protecting and prioritizing the participants is always the correct route. If you're not sure, you can't go wrong by having the plan sponsor settle the debts.

For more guidance on payment of fees, see the below references:

DOL Advisory Opinion 2001-01A

DOL Field Assistance Bulletin 2003-3

DOL Guidance on Settlor v. Plan Expenses (https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/advisory-opinions/guidance-on-settlor-v-plan-expenses)

EBSA Publication: Understanding Retirement Plan Fees and Expenses (https://www.dol.gov/sites/dolgov/files/legacy-files/ebsa/about-ebsa/our-activities/resource-center/publications/understanding-retirement-plan-fees-and-expenses.pdf)

VFCP: 71 Federal Register 20261

ERISA §410(b)

Labor Regulation 2550.404a-5

PBGC Advisory Opinion 94-6

Revenue Procedure 2019-19

Revenue Procedure 2019-4

FERENCZY
BENEFITS LAW CENTER
We are your ERISA solution™

Ilene Ferenczy • ilene@ferenczylaw.com | Alison Cohen • acohen@ferenczylaw.com
Adrienne Moore • amoore@ferenczylaw.com | Adriana Starr • astarr@ferenczylaw.com
Tia Thornton • tthornton@ferenczylaw.com | Leah Dean • ldean@ferenczylaw.com

2635 Century Parkway Suite 200, Atlanta, GA 30345
T 404.320.1100 | F 404.320.1105 | www.ferenczylaw.com