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July 18, 2013

DOL Clarifies Revenue Sharing Fiduciary Responsibility Issues

Advisory opinion on "plan asset" issue lays out factors for fiduciary consideration.

On July 3, the U.S. Department of Labor (DOL) issued Advisory Opinion 2013-03A, which discusses whether a bookkeeping account for revenue sharing payments constitutes "plan assets" under the Employee Retirement Income Security Act (ERISA).[1] In the opinion, the DOL also takes the opportunity to outline the responsibilities of plan fiduciaries in deciding whether to approve revenue sharing arrangements on behalf of their plans. Sponsors and fiduciaries of plans that participate in revenue sharing arrangements should review the arrangements to confirm that the factors described by the DOL have been taken into account.

Background

"Revenue sharing" is a term generally used to describe payments that plan investment options (commonly mutual funds but also other types of funds) may make to plan trustees and recordkeepers. These payments typically include, for example, "12b-1" and "shareholder servicing" fees paid by mutual funds. Revenue sharing enables the plan trustees and recordkeepers that receive these payments to charge lower (or no) "direct" fees to the plans for their services.

The DOL's advisory opinion describes an insurer that received revenue sharing payments in connection with investments by plans to which the insurer provided recordkeeping and administrative services. While the insurer retained these payments for its own account, it agreed with some client plans to record bookkeeping credits based on these amounts, which could then be applied to pay certain plan expenses or be deposited directly into participant accounts. These types of accounts are sometimes referred to as "ERISA accounts" or "ERISA budgets."

Overview of the Advisory Opinion

The narrow issue in the advisory opinion is whether the insurer's bookkeeping accounts are to be treated as "plan assets" for ERISA purposes prior to their actual use for the benefit of the plan, which would raise various issues. The DOL states that, while this is an inherently factual inquiry, nothing described by the insurer would lead it to conclude that the amounts in the insurer's bookkeeping account would be assets of a client plan before the plan actually receives them. This should help to resolve an issue that, while technical, has been raised in litigation.

The DOL goes on to emphasize that, regardless of the plan asset issue, an arrangement involving the payment of revenue sharing to a plan service provider is subject to the ERISA's fiduciary rules and responsibilities. The DOL's discussion of these issues serves as a reminder to plan fiduciaries of the need to understand and evaluate revenue sharing arrangements. In particular, the DOL notes the following:

- Plan fiduciaries need to evaluate whether a service provider's revenue sharing or other fee arrangements involving the plan give rise to any nonexempt prohibited transactions under section 406(b) of ERISA, which prohibits fiduciary self-dealing and conflicts of interest. There could be such a violation if, for example, the service provider were a fiduciary to the plan (either with discretion or through providing fiduciary "investment

1. View the advisory opinion at http://www.dol.gov/ebsa/regs/AOs/ao2013-03a.html.

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advice") and able to use its authority as a plan fiduciary to cause the plan to invest in funds that pay it revenue sharing or other fees.

- To comply with ERISA's general standards of fiduciary conduct, plan fiduciaries must assure that the compensation the plan pays directly or indirectly to a service provider for services is reasonable, taking into account the services provided to the plan as well as all fees or compensation (including revenue sharing) received by the service provider in connection with the investment of plan assets. This requires that the fiduciaries obtain sufficient information about all fees and other compensation that the service provider receives with respect to the plan's investments to be able to make an informed evaluation.
- Plan fiduciaries must also act prudently and in the best interests of plan participants and beneficiaries in negotiating the specific formula and methodology under which revenue sharing will be credited to the plan and paid back to the plan or plan service providers. This requires the fiduciaries to understand the formula, methodology, and assumptions to be used and to have the ability to monitor periodically to ensure, among other things, that any amounts to which the plan may be entitled are correctly calculated and applied for the benefit of the plan.

Implications

Of the three considerations described by the DOL for plan fiduciaries with regard to revenue sharing, the first two have been covered in prior DOL guidance. The third point, however, is a more specific application of that guidance. The DOL's disclosure initiatives over the last four years, including the 408(b)(2) service provider disclosure regime, and recent informal comments from DOL officials highlight a focus on "indirect" sources of compensation, which the DOL views as having the potential to give rise to conflicts of interest and excessive fees. While the initial burdens of the 408(b)(2) disclosure rules were on the service providers, which were required to provide the disclosures, the burden is now on plan fiduciaries. The DOL guidance indicates an expectation the plan fiduciaries will be using that information to detect potential conflicts of interest and to monitor service provider compensation arrangements, including indirect compensation, to assure that overall compensation is reasonable.

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