EBSA Reverses Its Position On QDRO Expenses!

By Marty Heming, Esq.

In Field Assistance Bulletin 2003-3 (“FAB 2003-3”), issued May 19, 2003, the DOL’s Employee Benefits Security Administration (“EBSA”) provided new guidance on the allocation of plan expenses among the participants in defined contribution plans. The new guidance reverses the position taken in Advisory Opinion 94-32A, that an individual participant or alternate payee could not be charged with the cost of administration of the QDRO.

Original Rationale

The rationale of 94-32 was that Section 206(d) of ERISA expressly grants an alternate payee the right to receive pension plan benefits payable under a QDRO. It was the DOL’s view that a plan may not encumber the exercise of a right mandated by Title I of ERISA by imposing conditions on the exercise of the right that are not contemplated by the statute.

Nothing in ERISA permits a plan to impose any separate fees (other than appropriate allocation of reasonable expenses of the plan as a whole) in connection with the status of a domestic relations order or administration of a QDRO. In short, imposing fees on a participant or an alternate payee in connection with the determination of the status of a domestic relations order, or administration of a QDRO, would constitute an impermissible encumbrance on the exercise of the alternate payee’s right to receive a QDRO mandated by ERISA.

Reversal

Subsequent DOL opinions expanded this rationale to encompass the general principal that if ERISA mandated a right of a participant, then that right could not be compromised by imposing per capita fees on the exercise of such right. This new guidance not only reverses 94-32, but sweeps away the entire rationale underlying the ruling.

FAB 2003-3 emphasizes that ERISA generally contains no provisions addressing how plan expenses may be allocated among participants and beneficiaries.

In that context, FAB 2003-3 establishes a two-tier structure for allocation of administrative expenses. If the terms of the plan document specifically set forth how the expenses are to be allocated among the participants, then fiduciaries administering the plan must follow the terms of the plan document, unless it would be a violation of ERISA to do so. See Section 404(a)(1)(D).

What this means is that if the allocation method is specifically set forth, in the document, it would be extremely difficult for any allocation scheme to violate ERISA, because the statute is silent as to the allocation method to be used. The only caveat set forth in the FAB is that if the plan is to be a tax qualified plan under IRC Section 401(a), then the method of allocation must not violate the IRC.

What if the plan doesn’t set forth the method for allocation of plan expenses, but leaves it to the discretion of the fiduciary administering the plan? In this case, the FAB provides that fiduciaries must act as prudent experts when selecting a method of allocation and they must act solely in the interest of all participants.

Accordingly, if one class of participant is favored over another, then there must be a rational basis for selecting the allocation method. In addition, when the plan document leaves the allocation method to the fiduciary administering the plan, there is possibility that such fiduciary could use his authority as a fiduciary to benefit himself, thus causing a prohibited transaction.

Finally, the DOL reminds us that under ERISA Reg. 2520.102-3(l), plans are required to include in the summary plan description a synopsis of any provisions that may result in the imposition of a fee or charge reducing a participant’s account or benefit. This is true whether or not the method for allocation of fees is set forth in the plan document.

What about the IRS?

When Paul Shultz, IRS Director, Rulings and Agreements was asked what was the IRS position on the EBSA FAB 2003-3, he advised that the IRS received no advance notice that the FAB would be issued. Accordingly, the IRS is not yet ready to take an official position with respect thereto. He indicated that his own personal reaction was that certain per capita allocations could violate IRC Section 411(a)(11).

Specifically, the FAB states that under ERISA it would be permissible to charge vested separated participant accounts their fair share of the reasonable plan expenses, either per capita or pro-rata, but elect not to charge the active participants for any portion of the expenses. This would be true regardless of whether the vested separated participant was afforded the option of withdrawing the funds from his or her account, or the option to roll the funds over to another plan or and individual retirement account.

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I Hear You, but I'm Not Listening *continued from page 5*

Furthermore, you may not even have your client's attention when you speak—your phone call may come between two other important meetings your client must attend and much of what you have communicated to your client may be forgotten in all of the excitement of the day's other tasks. (Sorry, but we have to face the fact that most of the world does not consider an ERISA conversation riveting.) Having a detailed letter that the client can review at leisure and think about may be very valuable. This is particularly true if your contact is not the ultimate decision maker.

Last but not least, don't be afraid to call your client and say, "I have something really important to discuss with you, but it's a little complicated. I've drafted a letter and I want you to read it and call me when you're done so that we can talk." This primes the client to do what is needed and shows that you care that he or she understands what you're trying to say.

The most important lesson really is: put yourself in your client's shoes, and think about how you can tell the client what you have to say in a way that permits him or her to hear the message. Clients want to do business with people that are helpful to them. They don't want to deal with people who can't talk in a language that they can understand. By communicating more clearly, you increase your chances of having a happy client who will stay with you for years. ✷

The Importance of a SAS 70 Report *continued from page 8*

- There is proper reporting to the plan administrator and participants; and
- Computer controls and data disaster recovery plans are in place.

The independent auditor must assess if controls documented in the SAS 70 report are relevant to the independent audit and adequate to reduce audit test work. In addition, the independent auditor is concerned with whether or not the relevant controls have been tested and if the service auditor noted any exceptions.

Compliance and Risk

The independent auditor typically focuses on the instances of noncompliance with the controls that are of concern. When the service organization is not in compliance with a control, the auditor must consider whether this will affect the risk of the financial statements being materially misstated, or increases the chance that the plan is not operating in accordance with the plan document.

In instances when the service organization is not in compliance with controls that could materially effect the financial statements or the reporting of the plan, the independent auditor will most likely perform additional audit procedures to conclude on the areas of noncompliance at the service provider.

The Type II SAS 70 report allows the auditor of an employee benefit plan to assess how the controls at a service organization affect portions of the financial statement audit. If the risks are mitigated because the SAS 70 report covers the applicable controls and the service auditor noted no significant exceptions, the independent auditor may reduce audit test work. Conversely, the absence of a Type II SAS 70 report increases the amount of time spent by both the independent auditor and the service organization during the course of the independent audit. ✷

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Under IRC Section 411(a)(11), terminated participants whose accounts are in excess of $5,000 must be given an election to keep their account in the plan rather than take an immediate distribution. Moreover, no "significant detriment," must be placed on that choice. If the price one paid for keeping his account in the plan was the imposition of administrative costs not imposed on active participants, this arguably could be a "significant detriment" in violation of Section IRC 411.

Because of the breadth of the possible types of expense allocation permitted by FAB 2003-3, after the IRS has an opportunity to analyze all possible types of expense allocations, they may find other potential violations. Nevertheless, plan sponsors may not want to wait until the IRS has issued its guidance before they act.

A Practical Solution

If a plan sponsor is anxious to change the method of allocation of plan expenses without waiting for IRS guidance, the best course of action would be to amend the plan document to set forth the expense allocation method and submit the plan for a favorable determination letter. This will have the advantage of assuring that whatever expense allocation method is selected, it won't violate ERISA, and, assuming a favorable determination letter is issued by the IRS, will assure that the plan can't be disqualified. ✷