

Fund Revenue Equalization

The fiduciary implications



REVENUE-sharing payments from mutual funds are often retained by a recordkeeper as compensation for the services it provides, and are generally acknowledged to be permitted by the Employee Retirement Income Security Act (ERISA). There are a wide variety of revenue-sharing arrangements recordkeepers can utilize. However, such arrangements can make it more challenging for plan fiduciaries to satisfy their duties to their plans and participants.

No matter what arrangement is used, ERISA requires that plan fiduciaries both understand the fees a plan pays and evaluate their reasonableness. Since recordkeeping and administrative costs are often paid from participant accounts, any revenue sharing used to offset such costs affects participants. Under ERISA, the allocation of such expenses among plan participants' accounts is a fiduciary act that must be performed prudently and in the best interest of the participants. Here, I will focus on one form of revenue-sharing arrangement, sometimes referred to as "fund revenue equalization."

Fund revenue equalization is a type of "fee recapture account" that attempts to obtain, for the benefit of the plan, the revenue sharing that exceeds the fee charged by the recordkeeper. Fee recapture accounts can be set up as hypothetical bookkeeping accounts or as actual asset-backed plan accounts, and may be referred to as "bookkeeping spending accounts" or "ERISA budget accounts." However, these accounts do not take into consideration the fact that different investment funds within a plan can pay varying amounts of revenue sharing or none at all. As a result, participants who select more expensive funds that tend to pay greater revenue sharing effectively bear a larger portion of a plan's administrative fees.

Due to recent advancements in technology, recordkeepers have developed the new strategy of fund revenue equalization, which can charge each participant an equal share of the recordkeeping fee. For example, participants who invest in an option for which the revenue sharing exceeds the fixed rate will receive a credit, while participants who invest in options for which the revenue sharing falls below the fixed rate are assessed a fee to make up the difference.

Although the facts of Department of Labor (DOL) Advisory Opinion 2013-03A, issued last year, do not involve a fund revenue equalization arrangement, the opinion nevertheless contains language regarding a fiduciary's duties when applied to any type of revenue-sharing arrangement, be it a bookkeeping account or an actual asset under the plan's trust. The opinion says that the plan fiduciary must under-

stand the details of a fund revenue equalization arrangement, including the formula, methodology and assumptions that will be used to credit revenue sharing to participant accounts and to pay plan providers. In addition, the plan fiduciary should be capable of periodically monitoring the arrangement to assure that its terms are being carried out correctly and amounts are being calculated accurately.

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In allocating expenses among participants' accounts, DOL Field Assistance Bulletin (FAB) 2003-03 points out that ERISA does not contain a provision that specifically addresses how plan expenses are to be allocated among participants. Thus, plan fiduciaries have discretion in determining, as a matter of plan design or plan administration, how plan expenses will be allocated among participants. As required by ERISA, if the plan document contains a method for the allocation of plan expenses, then the plan document must be followed. Where the plan document is silent or ambiguous, the fiduciary is responsible for selecting the method of allocation, and must do so prudently and in the best interest of participants.

Where certain expenses—such as investment management fees—are concerned, a *pro rata* method based on the assets in individual accounts is given general approval, whereas a per capita allocation is prone to being viewed as arbitrary. While this seems to favor a fund revenue equalization approach, each situation must be evaluated on its own merits. Fund revenue equalization arrangements are just one of the many strategies that recordkeepers can use to handle revenue sharing payments, and it is important to note that there isn't any one "right" arrangement.

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