

# Plan v. Settlor Expenses under ERISA and Non-ERISA Defined Benefit and Defined Contribution Plans

## MassMutual's Regulatory Advisory Services

### **ERISA and Department of Labor Guidance Relating to Plan Expenses (and Comparable Internal Revenue Code Requirements for Non-ERISA Plans)**

*Plans Impacted - ERISA Plans, Non-ERISA Plans (including Governmental, Church, or Other Tax Exempt 403(b), 457(f) Plans) and Group Sponsored IRAs*

The rules discussed in this white paper apply to tax qualified defined benefit and defined contribution plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") and Department of Labor (DOL) Regulations. The rules also apply to other retirement plans that are not subject to ERISA and DOL Regulations but are subject to comparable provisions of the Internal Revenue Code (the Code). Plans that are not subject to ERISA are listed in a chart at the end of this document with references to the comparable provisions of the Code or Treasury Regulation that applies. In addition, the chart cites circumstances where state insurance department laws may apply. Please note that the Code contains provisions comparable to the ERISA provisions described below. Therefore, the DOL requirements described in the following paragraphs also apply to those non-ERISA plans listed in the

chart. The Treasury Department defers to the DOL on interpretations of these statutory requirements regarding the use of plan assets to pay settlor expenses and, therefore, non-ERISA plans should review and apply any DOL guidance on this subject.

Section 404(a)(1)(D) of ERISA requires that plan fiduciaries discharge their duties in accordance with the plan document(s). A plan document will typically include language that authorizes payment of reasonable plan administrative expenses from plan assets. The DOL has also clarified that even if the plan is silent regarding the payment of administrative expenses, plan assets may be used to pay reasonable administrative expenses.

The plan fiduciary is required by ERISA to determine whether payments for plan expenses is consistent with ERISA requirements, including general fiduciary responsibility provisions of sections 403 and 404 of ERISA. These sections provide that plan assets may only be used for the exclusive benefit of the participants and beneficiaries, and provide that plan fiduciaries must ensure that plan assets only be used to defray reasonable plan administrative expenses.

ERISA section 406 prohibits the plan fiduciary from dealing with plan assets for his or her own benefit, or engaging in a transaction that constitutes a direct or indirect furnishing of goods, services and facilities between the plan and a party in interest where the party in interest benefits from plan assets. However, ERISA section 408 provides an exemption from the prohibition of section 406 for those plan services that are necessary and are provided pursuant to a reasonable contract or arrangement for reasonable compensation.

#### ***Definitions of Plan and Settlor Expenses***

Expenses that “may” be paid by the plan are administrative “plan expenses” (the plan sponsor always has the option to pay these expenses rather than paying them from plan assets). Administrative plan expenses are those reasonable expenses referenced in sections 403 and 404 of ERISA which include direct expenses properly and actually incurred in the performance of a fiduciary’s duties to administer the plan.

Expenses that “must” be paid by the plan sponsor are known as settlor expenses. The DOL has, for a long time, taken the position that there is a class of discretionary activities which relate to the formation, rather than the management of plans. These activities are referred to as “settlor functions” and they generally include decisions relating to the establishment, design and termination of the plan.

The DOL has ruled that expenses incurred in connection with the performance of settlor functions will not be considered reasonable plan expenses because they are incurred for the benefit of the employer’s business and involve expenses for which the plan sponsor could reasonably be expected to bear the cost in the normal course of its business operations.

While the DOL prohibits the use of plan assets to pay settlor expenses, it has clarified that plan assets may be used to pay reasonable expenses to administer the plan, even if there is an incidental benefit to the plan sponsor. The United States Supreme Court has recognized that plan sponsors receive incidental benefits by offering an employee benefit plan, such as attracting and retaining employees, and the DOL has ruled that the mere receipt of such incidental benefits by plan sponsors does not convert a plan expense to a settlor expense.

#### ***Comparative Examples of Plan and Settlor Expenses***

When a plan sponsor establishes a retirement plan, it is a voluntary activity, and the plan sponsor must make the decision regarding what type of qualified plan to offer and what the plan provisions will be. In addition, this requires the drafting or adoption of a plan document and perhaps a request for an initial determination letter from the Internal Revenue Service (IRS). Expenses associated with all these “formation” activities are considered settlor expenses



that must be paid by the plan sponsor. However, implementation of the settlor's decision to establish a plan, which includes the set up, recordkeeping and other administrative functions, would generally be considered plan expenses that can be paid from plan assets.

An amendment to the plan may be either a settlor expense or a plan expense, depending on the particular circumstance. If it is a discretionary amendment where the plan sponsor initiates a change to plan provisions, such as the eligibility requirements, it is generally a settlor expense that cannot be paid from plan assets. However, if the amendment is required to comply with regulatory requirements in order to maintain the plan's tax qualified status, such as an amendment to comply with the Pension Protection Act of 2006, it is generally considered a plan administrative expense that can be paid from plan assets. If an analysis is required by the plan sponsor in order to make a choice of options available to comply with regulatory requirements, the expense incurred in analyzing the options may be considered a settlor expense. As you can see, facts and circumstances play an important role in this "settlor" versus "plan" expense determination.

Activities relating to ongoing plan operation, such as routine nondiscrimination testing, Form 5500, actuarial valuations, and participant statements, are generally considered plan

administrative expenses that can be paid from plan assets.

However, for defined benefit plans, some reports required by the Financial Accounting Standards Board, typically referred to as FASB Accounting Standards Codification, would be settlor expenses because this activity is driven by the plan sponsor's financial reporting needs.

Non-routine nondiscrimination testing done in advance of an anticipated or proposed plan change would generally be considered a settlor expense. In addition, government imposed fines or penalties on the plan, or fees for submission under the IRS corrections programs, would generally be settlor expenses.

When a plan is terminated, costs incurred in the analysis of the plan termination, or any required plan amendments, are generally considered settlor expenses. However, costs for IRS determination letters or Pension Benefit Guaranty Corporation premium payments (for qualified defined benefit plans), and costs for administrative work associated with the plan termination, such as final participant statements, are plan expenses that can be paid from plan assets.

There is a chart at the end of this document that provides more detailed examples of plan and settlor expenses.



### ***Plan Qualification and Other Issues***

In order to maintain the plan's favorable tax qualified status, a plan sponsor must ensure that the plan document agrees with the operation of the plan for paying plan administrative expenses, as well as ensuring that plan assets are not used to pay settlor expenses. An improper payment of expenses from plan assets can result in significant consequences, such as a breach of fiduciary duty, a prohibited transaction, or a violation of the exclusive benefit rule. This document is intended to provide an overview of plan expenses versus settlor expenses. Ultimately, it is the plan sponsor's ongoing fiduciary responsibility to determine whether a particular expense is properly characterized as a plan expense or a settlor expense. If there is a question as to the correct characterization of an expense, the plan sponsor should consult with their legal counsel to determine whether the expense can be paid from plan assets, or if the fee is a settlor expense that should not be paid from the plan's assets.

***Multiemployer Plans*** - In Field Assistance Bulletin 2002-2, the Department of Labor ruled that, where relevant documents, such as collective bargaining agreements or plan documents, specify that the trustees of a multiemployer plan will act as fiduciaries in carrying out activities which could otherwise be considered settlor functions, such activities could be considered plan expenses and could be paid from plan assets. If the documents

are silent, then the trustees' activities that are settlor in nature will generally be considered settlor expenses. Given the complexity of multiemployer plans, it is important for the plan sponsor to be aware of the provisions of the documents regarding trustee activities and for the plan sponsor's ERISA counsel to provide advice regarding which expenses can be paid from plan assets.

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Non-ERISA Retirement Plan Subject to Rules on Plan v. Settlor Expenses	Internal Revenue Code Section or Treasury Regulation Exclusive Benefit Rule Applies
401(a) Plan sponsored by Governmental, Church or other Tax Exempt entity	Code §401(a)(2)
403(b) Plan sponsored by Governmental, Church or other Tax Exempt entity	Treasury Regulation 1.403(b)-8(d)(2)(iii) imposes an exclusive benefit requirement on 403(b) assets held in a custodial account. State insurance laws typically require that an annuity contract contain an exclusive benefit provision.
457(b) Plan sponsored by Governmental entity	Code §457(g)(1)
457(b) Plan sponsored by Tax Exempt entity or 457(f) Plan	State insurance laws typically require that an annuity contract contain an exclusive benefit provision.
Group Sponsored Traditional IRA or Roth IRA	Code §408(c)



# Guidelines for Plan v. Settlor Expenses

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<i>TYPE OF PLAN ACTIVITY</i>	<i>EMPLOYER MUST PAY (FOR SETTLOR ACTIONS)</i>	<i>PLAN CAN PAY1 (FOR ACTIONS THAT RELATE TO PLAN ADMINISTRATION AND MAINTENANCE)</i>
<b>PLAN ESTABLISHMENT</b>		
	DETERMINING THE TYPE OF PLAN TO ESTABLISH	DRAFTING TRUST DOCUMENT (IF SEPARATE FROM PLAN DOCUMENT)
	COST ANALYSIS, DESIGN PROPOSALS	
	DRAFTING INITIAL PLAN DOCUMENT (WHICH MAY INCLUDE TRUST)	
	DRAFTING CORPORATE RESOLUTIONS	
	LEGAL FEES	
	CONSULTING FEES REGARDING PLAN DESIGN	
<b>PLAN DESIGN</b>		
	LEGAL FEES: PLAN DESIGN STUDIES, PROJECTED COST STUDIES	DETERMINATION LETTER REQUESTS FOR PLAN AMENDMENTS TO MAINTAIN QUALIFIED STATUS DUE TO CHANGES IN TAX LAW
	LEGAL FEES: BENEFIT FORMULA/ALLOCATION CHANGES	DETERMINING PLAN BENEFITS AFTER IMPLEMENTATION OF AMENDMENTS
	FINANCIAL IMPACT ANALYSIS OF PROPOSED CHANGES	AMENDING FOR CHANGES IN FIDUCIARY RESPONSIBILITIES
	PLAN BENEFIT STUDIES FOR POTENTIAL AMENDMENTS	AMENDING DUE TO ERISA TITLE I COMPLIANCE
	ACTUARIAL ANALYSES FOR PROPOSED PLAN DESIGN STUDIES	AMENDING FOR REGULATORY-MANDATED CHANGES (E.G., PPA RESTATEMENTS)
	CONSULTING FEES: ANALYSIS FOR PLAN AMENDMENTS AND RESTATEMENTS	
	PLAN DESIGN PROPOSALS (E.G., SPIN-OFF, CONVERSION TO CASH BALANCE)	
	AMENDING PLAN BENEFIT FORMULA	
	AMENDING PLAN TO PROVIDE FOR SPIN-OFF	
	AMENDING PLAN TO INCLUDE AN EARLY RETIREMENT WINDOW BENEFIT	
	ANY DISCRETIONARY AMENDMENT	
	UNION NEGOTIATIONS	



**GUIDELINES FOR PLAN V. SETTLOR EXPENSES**

<i>TYPE OF PLAN ACTIVITY</i>	<i>EMPLOYER MUST PAY (FOR SETTLOR ACTIONS)</i>	<i>PLAN CAN PAY1 (FOR ACTIONS THAT RELATE TO PLAN ADMINISTRATION AND MAINTENANCE)</i>
<b>PLAN ADMINISTRATION</b>		
	EARLY RETIREMENT WINDOW BENEFIT CALCULATIONS: MADE BEFORE PROPOSED AMENDMENT IS ADOPTED	EARLY RETIREMENT WINDOW BENEFIT CALCULATIONS: MADE AFTER AMENDMENT IS ADOPTED
	ESTABLISHING A PARTICIPANT LOAN PROGRAM	OPERATING AN ESTABLISHED PARTICIPANT LOAN PROGRAM
	OVERHEAD COSTS: OFFICE SPACE	OVERHEAD COSTS: SUPPLIES AND EQUIPMENT UTILIZED TO PROVIDE SERVICES TO THE PLAN (TELEPHONE VOICE RESPONSE SYSTEM, RETIREMENT PLANNING SOFTWARE)
	RECORDKEEPING FEES: SYSTEMS CHANGES DUE TO PLAN DESIGN CHANGE; COMPUTING ANNUAL DEDUCTION LIMITS	RECORDKEEPING FEES: ROUTINE EXPENSES AND SYSTEMS CHANGES DUE TO CHANGES IN THE LAW.
	DISCLOSURE DOCUMENTS: SPDS OR SMMS REVISED FOR PLAN DESIGN CHANGES	DISCLOSURE DOCUMENTS: INITIAL SPD, SUCCESSIVE SPDS, SMMS, SPDS AND SMMS REVISED FOR LAW CHANGES, AND OTHER PLAN-RELATED COMMUNICATIONS (I.E., ENROLLMENT, RMDS, RETIREMENT, PARTICIPANT EDUCATIONAL SEMINARS, ETC.)
	IF APPLICABLE, SUMMARY INFORMATION IN A BOOKLET THAT RELATES TO NON-PENSION PLAN MATTERS (E.G., VACATION POLICY, HOLIDAY SCHEDULE)	PRODUCE AND DISTRIBUTE SUMMARY INFORMATION ABOUT THE PENSION PLAN
		ON-GOING BENEFIT CALCULATIONS. (NOTE: BENEFIT CALCULATIONS FOR DIFFERENT DISTRIBUTION OPTIONS MAY BE BORNE BY THE PARTICIPANT, RATHER THAN PLAN.)
		SERVICE PROVIDER FEES (TRUSTEE, ACCOUNTING, CUSTODIAL, INVESTMENT MANAGEMENT, PARTICIPANT-LEVEL INVESTMENT ADVICE, LEGAL FEES RELATING TO PLAN ADMINISTRATIVE ISSUES [NON-SETTLOR ISSUES], AND REPORTING FEES)
		START-UP FEES ASSOCIATED WITH ADMINISTRATIVE OUTSOURCING
		DETERMINING DRO QUALIFIED STATUS (NOTE: FEES MAY BE CHARGED TO INDIVIDUAL PARTICIPANTS, AT PLAN FIDUCIARY'S DISCRETION)



**GUIDELINES FOR PLAN V. SETTLOR EXPENSES**

<i>TYPE OF PLAN ACTIVITY</i>	<i>EMPLOYER MUST PAY (FOR SETTLOR ACTIONS)</i>	<i>PLAN CAN PAY<sup>1</sup> (FOR ACTIONS THAT RELATE TO PLAN ADMINISTRATION AND MAINTENANCE)</i>
<b>PLAN MAINTENANCE</b>		
	FASB ACCOUNTING STANDARDS CODIFICATION INCLUDING ASC TOPICS 712 AND 715	FIDELITY BOND
	NON-ROUTINE NONDISCRIMINATION TESTING DONE IN ADVANCE OF A PLAN CHANGE (E.G., COVERAGE OR GENERAL TESTS DONE WITH PROPOSED EARLY RETIREMENT WINDOW BENEFIT AMENDMENT TO DB PLAN.)	ROUTINE NONDISCRIMINATION TESTING
		TRANSACTION FEES (HARDSHIPS, INSTALLMENTS, CHECKS, LOANS). (NOTE: EXPENSES FOR HARDSHIPS AND PROCESSING DISTRIBUTIONS MAY BE BORNE BY THE PARTICIPANT RECEIVING THE DISTRIBUTION.)
		RETIREMENT AND DISABILITY ANNUAL MAINTENANCE CHARGES
		ERISA-REQUIRED COMMUNICATIONS (E.G., SPDS, SARS, ANNUAL FUNDING NOTICE AND INDIVIDUAL BENEFIT STATEMENTS FOR INDIVIDUAL REQUESTS)
		FIDUCIARY INSURANCE
		PERIODIC VALUATION (DAILY, ANNUAL, ETC.)
		ACTUARIAL FEES: COSTS ASSOCIATED WITH CHANGING ACTUARIES
		PLAN-TO-PLAN TRANSFER COMPUTATIONS
		FEES INCURRED IN LOCATING "LOST" INDIVIDUALS FOR BENEFIT PAYMENTS (NOTE: SUCH EXPENSES MAY BE CHARGED TO THE MISSING PARTICIPANT)
		FORM 5500 SERIES PREPARATION AND AUDITED FINANCIALS INCLUDING ASC 960 (FORMERLY FAS 35) PREPARED BY CERTIFIED PUBLIC ACCOUNTANT
		PERIODIC COMPLIANCE AUDITING
<b>GOVERNMENT-IMPOSED FEES</b>		
	PLAN-RELATED PENALTIES AND FINES	DETERMINING PLAN SPIN-OFF BENEFITS (AMOUNT)
	COMPLIANCE PROGRAMS, INCLUDING IRS'S EPCRS COSTS, DOL'S 5500 LATE FILING PROGRAM	DETERMINATION LETTER REQUESTS FOR PROPOSED OR ADOPTED PLAN DESIGN AMENDMENTS
	EPCRS (AUDIT CAP SANCTION, VCP COMPLIANCE FEE)	PBGC PREMIUMS (PBGC ADVISORY LETTER 74-10)
	DOL CORRECTION PROGRAMS: VOLUNTARY FIDUCIARY CORRECTION PROGRAM AND DELINQUENT FILER VOLUNTARY COMPLIANCE PROGRAM	

<i>PLAN TERMINATION</i>		
	STUDY INCURRED BEFORE DECISION TO TERMINATE THE PLAN.	DETERMINATION LETTER REQUEST FOR TERMINATING PLAN
	ANALYSIS OF RECOVERABLE EXPENSES AFTER PLAN TERMINATION	PBGC TERMINATION FEES
	SUCCESSOR PLAN ANALYSIS AND CONSULTING FEES	CONTRACT TERMINATION CHARGES
	LEGAL FEES INCURRED IN DETERMINING TO TERMINATE THE PLAN	SERVICE PROVIDER TERMINATION CHARGES
		IMPLEMENTING PLAN TERMINATION (AUDITING THE PLAN, PREPARING/FILING ANNUAL REPORTS, PREPARING BENEFIT STATEMENTS, CALCULATING BENEFITS, NOTIFYING PARTICIPANTS OF BENEFITS UNDER THE PLAN)

1 Plan administrators must determine, as plan fiduciaries, whether an expense is payable from the plan. However, the plan sponsor may elect to pay for such expenses. Plan documents should be reviewed to determine if any provisions govern payment of plan administrative expenses. Each analysis is dependent on the particular facts and circumstances, and should be made prudently and in the interest of plan participants and beneficiaries. If it is determined that an expense is payable from plan assets, the fiduciary determines whether the expense is a reasonable expense. This Plan v. Settlor Expenses chart is not intended for use by multiemployer plans.

Please note that this list is not intended to be a comprehensive list. Rather, as expenses are incurred, a factual analysis should be made as to the nature of the services (e.g., proposed plan changes, statutory requirements). This document is intended to provide an overview of plan expenses versus settlor expenses. It is the plan administrator's ongoing fiduciary responsibility to determine whether a particular expense is properly characterized as a plan administrative expense or a settlor expense. In reviewing expenses, the plan administrator may determine that an expense represents both "settlor" (plan sponsor) fees and expenses that may be paid from plan assets. In such a situation, the expense may require further breakdown.

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