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New Revenue Sharing Advisory Opinion = More Mud in Already Muddy Waters

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The new Advisory Opinion ("AO") 2013-03A is another step towards clarity on revenue sharing; yet, many questions remain.

How is revenue sharing properly contributed to a plan trust?

According to the AO, revenue sharing deposited into an account held in a trust on behalf of a plan is a plan asset. This validation supports standard operating procedures embraced by most in the industry. What the DOL did not address, in this AO, and what remains outstanding, is the legal basis for depositing revenue sharing into a retirement trust. The Internal Revenue Code identifies the specific types of permissible contributions into the trust but revenue sharing is not one of them. In fact, there is no provision established by the Treasury Department for a qualified plan trust to accept donations from third parties, interested or not. So, one thing that remains unclear is what is the legal basis for the DOL's position that depositing revenue sharing payments into a plan trust is permissible?

Is a 408(b)(2) disclosure a communication that causes revenue sharing to become a plan asset before it is received?

According to the AO, assets of an employee benefit plan generally are to be identified on the basis of "ordinary notions of property rights" which includes any property, tangible or intangible, that the plan has a beneficial ownership interest. The DOL emphasized the structure of the arrangement and communications with the plan would dictate whether there is a beneficial interest. Examples cited in the AO which dictate property is a plan asset include:

1. "any contract or legal instrument," or
2. the "actions and representations of the parties involved," or
3. "whether an intent has been expressed to grant such a beneficial interest," or
4. "a representation has been made sufficient to lead participants and beneficiaries of the plan reasonably to believe that such funds separately secure the promised benefits or are otherwise plan assets."

What the DOL did not specify with clarify but seems immutable is whether 408(b)(2) disclosures are communications with the responsible plan fiduciary that may cause revenue sharing to be a plan asset before it is received. Is it possible that 408(b)(2) disclosures are part of the governing plan documents which are relied upon to determine if fees are reasonable and conflicts are avoided and therefore inherently make indirect fees disclosed plan assets?

It is also clearly a regulatory obligation to provide these disclosures in advance of the date the contract or arrangement is entered into, extended or renewed thereby establishing precedence for a representation of the actions a party will take and the corresponding payment that party will receive. This conclusion finds support in the DOL's comment "the client plan's contractual right to receive the amounts agreed to with Principal, or to have them applied to plan expenses, would be an asset of the plan." Thus, does the fact that indirect fees are disclosed in advance and identified how they would be used cause revenue sharing to become a plan asset from inception?

If revenue sharing is always a plan asset, is returning those assets to the plan a prohibited transaction under ERISA 406(a)(1)(B), (D) and/or 406(b)?

Assuming a court would rule that 408(b)(2) disclosures provide the basis for making all revenue sharing a plan asset, is it possible that a return of excess revenue sharing by the service provider could be considered lending of money or an extension of credit? If the service provider receiving the excess revenue sharing is a fiduciary, is there a possible claim under 406(b)? Again, assuming the service provider is receiving advanced payments from revenue sharing during the term of the contract, is there any provision in ERISA that permits any party in interest to purposely withdraw more plan assets than they are due for services rendered if they return the excess at a later date?

If revenue sharing is deemed a plan asset, is structuring an arrangement to collect excessive fees for services from participant accounts on a disproportionate basis only to return the excess fees to participants in a disproportionate basis prudent?

It has been widely recognized that participants that invest in plan assets that have higher revenue sharing payments pay a higher percentage of the cost of a plan. This was legally acceptable; although morally debatable, because revenue sharing was not considered a plan asset but instead represented income collected by the investment manager that could choose to do with its profits as it saw fit. However, this AO is a game changer, if it implies revenue sharing or the promise of revenue sharing is always a plan asset based on the pre-engagement disclosures required under 408(b)(2). As such, is it prudent for a fiduciary to select plan assets that pay different amounts of revenue sharing thereby causing some participants to pay a disproportionate amount of the plan expense? Furthermore, if an excess is received and returned to the plan for allocation, is it prudent for a fiduciary to allocate revenue sharing to participants that did not generate the revenue sharing?

If a fiduciary can't monitor revenue sharing or calculate the amount, should they structure a plan with investments that pay revenue sharing?

Does the DOL expect a fiduciary to understand the formula, methodology and assumptions used by a service provider before entering into an agreement where revenue sharing exists? Could the DOL's comments in this AO be interpreted to emphasize that a fiduciary must be capable of monitoring the amounts of revenue sharing including the ability to calculate the amount expected to be paid? Is it possible this DOL directive is influenced by Judge Laughrey's position in Tussey v ABB that revenue sharing must be calculated in a dollar amount and compared to other revenue sharing platforms to determine if it is reasonable? If so, what is most challenging for a fiduciary is the obligation to calculate revenue sharing with any degree of accuracy. In order to calculate the amount, a plan sponsor must know the actual terms of the revenue sharing agreements which are rarely disclosed due to nondisclosure agreements between the investment company and the covered service provider. The fiduciary will also need the cash flow to determine the timing of deposits, withdrawals and transfers to properly calculate revenue sharing. Few, if any, fiduciaries have the technology in place to conduct this type of analysis.

If the DOL or the courts hold a fiduciary accountable to the monitoring standards outlined in this AO and the fiduciary lacks the data, technology, knowledge, experience and skill to properly monitor and calculate revenue sharing, should a fiduciary select any investment that pays revenue sharing? If not, there are a great many plans that will need to change their structure and adopt an investment platform that is entirely institutional.

Conclusion

This AO is an important step that moves us closer to understanding how revenue sharing is to be treated. At the same time, this AO has raised a number of new questions that we hope will be answered by the DOL before this all becomes the cannon fodder of litigation.