Compensation for MEP Sponsors, Part 2

Tips on how a MEP sponsor can get paid without violating the prohibited transaction rules.

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In Part 1 of this article, we explained what a MEP is and the different types of MEPs. We also discussed some legal principles that apply to MEP sponsor compensation and reimbursement of expenses. Here in Part 2, we apply those principles to how a MEP sponsor can get paid without violating the prohibited transaction rules of ERISA or the federal Tax Code.

REASONABLE COMPENSATION

The determination of reasonableness is a facts-and-circumstances test, so we can't provide a bright line description on how to meet this requirement… other than to say that a MEP sponsor should assess, through benchmarking or other comparative means, whether its compensation and that of any affiliates is reasonable. However, the obligation to determine whether the MEP sponsor's compensation is reasonable rests with the participating employers. On the other hand, the MEP sponsor generally is responsible for determining whether the compensation of the MEP's other service providers is reasonable.

The initial decision to join the MEP is made by each participating employer. And the participating employers retain the responsibility to periodically monitor the sponsor's performance and compensation to determine if they continue to be reasonable and whether to continue to participate in the MEP.

Inherent in the oversight obligation of participating employers to monitor and approve changes in services or fees is the fact that the employers do not have a material financial interest in the MEP sponsor that would affect their judgment. In some MEPs – most often an Association MEP – an oversight board is appointed from among the participating employers. This board takes on the oversight role. We refer to this as a "MEP board."

CHANGING THE SPONSOR'S COMPENSATION

Since the MEP sponsor serves as a fiduciary of the MEP, it cannot set or unilaterally change its own compensation. Approving a change will require approval by the participating employers or a MEP board.

There are a couple of ways the sponsor can seek that approval. Where the responsibility is retained by the participating employers, the sponsor typically would send out a proposed amendment with the new fee structure and seek affirmative or "deemed" approval using the "Aetna Opinion" process discussed in Part 1. In plans with a MEP board, the process is

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simplified, since only the board will need to consent to the change.

PROFITING FROM THE MEP

One of the concerns of potential MEP sponsors is whether they can earn a "profit" from the MEP. For example, suppose a local builders association sponsors a MEP. Can it charge a per head fee that comes from plan assets and creates a profit? Or if a TPA is the MEP sponsor, can it make a profit paid from plan assets?

The answer to both questions is "yes," so long as the amount paid is:

- for a necessary service (i.e., "appropriate and helpful to the plan … in carrying out the purposes for which the plan is established or maintained"[1]);
- reasonable relative to the services rendered; and
- adequately disclosed under 408(b)(2).

In the builders association example, if the association takes on the fiduciary and administrative roles of a sponsor, it can build the per head charge into its fee for serving as the MEP sponsor. So long as the fee meets the requirements described in the prior paragraph, the fact that there is profit built into the fee is not an issue.

But if the association's role is limited to making the MEP available to its members, so that the fee is essentially an "access" fee, the answer is murkier. In that situation, the safer course would be for the fee to be paid by the entity engaged as sponsor of the MEP rather than be paid out of plan assets. The sponsor would need to ensure legal compliance. Having the fee paid out of MEP assets as compensation for a service rendered by the association would be even more difficult, in light of the requirement under the 408(b)(2) exemption that a service be "necessary."

The TPA example is clearer in that, when a TPA is a MEP sponsor, the TPA is performing the fiduciary and administrative roles we discussed earlier. To the extent it performs significant administrative services, its fees could be higher than if it served only in an oversight role over other service providers. Either way, it could build a profit element into its fee without violating the prohibited transaction rules so long as its compensation overall is reasonable and is approved by each participating employer.

REIMBURSEMENT OF EXPENSES

Under ERISA, while a fiduciary cannot cause itself to receive additional compensation from a plan, it is permitted to receive reimbursement for certain direct expenses. In this section, we address the following questions:

- Can a MEP sponsor be reimbursed for its expenses?
- Can it be reimbursed for marketing, salary for employees providing education, and support staff to answer questions?
- If it can be reimbursed, what expenses and what best practices should be adopted to document the reimbursement?

The sponsor of a MEP, whether it is an Association, Open or PEO MEP, can be reimbursed out of plan assets for direct out-of-pocket expenses. The DOL has addressed the reimbursement issue in several contexts. First, DOL regulations make clear that even though a fiduciary cannot set or approve its own compensation, it can receive "reimbursement of direct expenses properly and actually incurred in the performance of such services."[2]

The next question is whether an expense can be paid out of the plan or must be paid by the employer/ sponsor. In Advisory Opinion 2001-01A, the DOL said that generally, reasonable expenses of administering a plan, including direct expenses properly and actually incurred in the performance of a fiduciary's duties to the plan, can be paid out of the plan. However, the establishment, design and termination, rather than the management, of a plan, is generally not a fiduciary activity, such that related costs are considered settlor

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expenses that may not be paid out of plan assets.

The DOL also issued a series of examples to help identify settlor as opposed to permissible plan expenses.[3] In general, expenses of running the plan may be paid out of the plan, while the expense of setting up the plan, assessing various design alternatives and amending the plan would be considered settlor or employer expenses. The DOL recognizes an exception, indicating that the cost of amending a plan to maintain its tax qualification is a valid plan expense.[4]

On the "reimbursement" issue, the DOL has issued a number of Advisory Opinions on plan sponsors reimbursing themselves for out-of-pocket expenses from the assets of the plan they sponsor. In Advisory Opinion 1993-06A, the "Allied Signal" Opinion, the DOL said that a sponsor may be reimbursed for direct expenses, but not for general overhead such as rent, utilities, employee or other expenses that would have been incurred regardless of whether the plan existed.

Though the Opinion addressed reimbursement to a single employer and not a MEP, by analogy, the concepts should apply to MEPs. It may be possible under this Opinion to seek reimbursement for the salaries of employees who provide education or of support staff who answer questions, but the DOL generally is skeptical of this practice. In the MEP context, where the only function of the sponsor's employees is to serve the needs of the MEP, this skepticism may be surmountable, but we think the safer approach is to charge a specified fee for the participant education service and pay the employee costs out of that fee.

Another common question is whether a MEP sponsor can be reimbursed for travel, document production and similar costs incurred in "marketing" the MEP and the benefits of participation to new employer-members. This is a difficult question. On one hand, encouraging further MEP participation could help enhance economies of scale, which potentially could benefit participants or participating employers by reducing plan costs. On the other hand, this activity is arguably not a "service" to the MEP and its existing participants and could be seen as a settlor function, such that the costs could not be paid out of the MEP. The safer course would be for the sponsor to bear these costs out of its revenues and include them in its calculation of its fee.

CONCLUSION

MEP sponsors cannot approve or modify their own compensation, but must instead look to the participating employers or a MEP board established by those employers. That said, the compensation can include a profit element so long as the compensation is for a necessary service, is reasonable and is adequately disclosed. MEP sponsors may also be reimbursed out of plan assets for proper plan expenses – generally those related to the management and administration of the MEP rather than the design or establishment of the MEP. PC

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FOOTNOTES

[1] ERISA Reg. §2550.408b-2(b).

[2] 29 CFR §2550.408b-2(e)(3).

[3] See "Guidance on Settlor v. Plan Expenses" at https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/advisory-opinions/guidance-on-settlor-v-plan-expenses.

[4] Advisory Opinion 2001-01A.

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