MEMORANDUM

TO: BOARD OF DEFERRED COMPENSATION ADMINISTRATION

FROM: CHARLES HONG
DEPUTY CITY ATTORNEY

SUBJECT: PAYMENT OF EXPENSES ASSOCIATED WITH THE IMPLEMENTATION OF A CITY EMPLOYER MATCH TO THE CITY'S DEFERRED COMPENSATION PLAN ("PLAN")

DATE: SEPTEMBER 23, 2022

A. Background

At its July 19, 2022 meeting, the Board of Deferred Compensation Administration (Board) asked the city attorney to report back on the use of participant contributions to pay for the costs associated with implementing an employer match to the City's Plan – an option which was discussed in Staff's report to the Board on July 19, 2022 (Report 22-40).

Specifically, the Board raised questions whether participant contributions, in whole or in part, should be used to pay for the costs incurred to implement or manage an employer match option for which not all plan participants may benefit or only a limited number of plan participants will benefit. Similarly, whether any expenses to be incurred for the employer match option would need to be covered by a funding source other than the Plan should such expenses not be considered a plan expense.

These thoughtful concerns, raised by the Board, touched upon important fiduciary and plan allowance questions. To address these concerns, given the potential significance of an employer match on the plan and its administration, our office discussed these issues with outside counsel – Ice Miller.

B. General Rule

As a starting point, the City's Deferred Compensation Plan exists for the exclusive benefit of its participants and beneficiaries as set forth under the federal Tax Code and general fiduciary principles. This "exclusive benefit rule" as commonly referred to, serves as the measure to which Board must value Plan assets. In doing so, the Board, as a fiduciary, is entrusted to hold and discharge its duties with the care, skill, prudence, and diligence of a prudent person in like capacity with respect to plan assets. This responsibility and judgment extends over to plan expenses and payment of plan expenses from plan assets.

C. Payment of Plan Expenses

Whether an expense is properly payable from plan assets - which may include participant contributions - is generally based upon all the relevant facts and circumstances. In assessing the facts and circumstances of said expense, guidance categorizes incurred expenses as either "settlor" type expenses or "plan" type expenses. Guidance provides that settlor type expenses should not be paid from plan assets while "plan" expenses, provided such expenses are reasonable, may be paid from plan assets. Settlor type expenses can be viewed as expenses to be incurred for employer's benefit or for services that the employer would otherwise incur in the normal course of business. And thus borne by the employer. Example of Settlor type expenses include, but not limited to, the following:

- expenses associated with making settlor decisions (*e.g.*, establishing, designing, or in deciding whether a plan should be terminated),
- design studies and cost projections,
- union negotiations,
- amendments to establish a loan program, and/or
- consulting to review alternatives for complying with changes in the law as part of any pre-planning of plan amendments.

Plan expenses are those incurred for the benefit of the plan and its participants. Examples of plan type expenses include, but not limited to, the following:

- management and custody of plan assets,
- plan administration,
- bonding,
- fiduciary liability insurance,
- payment for office space, legal, accounting, or other services necessary for the operation of the plan,
- expenses associated with the implementation of settlor decisions,
- benefit calculations,
- routine nondiscrimination testing,
- obtaining an IRS determination letter,
- amending the plan to comply with tax law changes, and/or
- certain communication costs.

1. Expenses for Implementation of Match Contribution

a. Can the expenses for implementation of the match contribution be allocated to all plan members and retirees even if those members or retirees are not eligible for the employer match?

Whether the expense of implementing a match element can be allocated to all plan members regardless of their expected benefit from the match will depend on the ultimate design of the match and, in part, whether the expenses allocated to all members are deemed negligible or significant. Certainly, if the expenses are significant, there is a strong argument that expense burden should not

be shared by members who are not eligible to benefit from the change. However, this may need to be balanced against the potential cost to be incurred to compute an allocation. If the cost to compute an allocation exceeds the actual costs incurred, further evaluation may need to be considered.

Regardless, the process and justification for the decision should be documented and subject to continued monitoring to ensure the expenses incurred are reasonable and necessary.

b. If a new 401(a) Plan is created to accept the employer matching contributions, how does the new plan pay for the expenses related to the start-up costs?

Should the design of the employer match include the creation of a new 401(a) plan, the new 401(a) plan can seek support from the City for the reasonable start-up or implementation costs. This support, if required, could then be repaid to the City, from 401(a) plan assets through an offset of the anticipatory employer matching contribution over an established period of time. Other options may also be potentially available to fund the start-up costs. However, this question will likely need to be further analyzed once the question of whether an employer match is to be implemented is resolved.