

Strafford

Presenting a live 110-minute teleconference with interactive Q&A

Form 5500 Schedule C for 2010 Plan Years: Lessons Learned From First Filing

Navigating Rules to Accurately Report Service Provider Fees and Compensation

WEDNESDAY, MAY 18, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Linda Fisher, Owner, Linda T. Fisher 5500 Consulting, Buffalo Grove, Ill.

Linda Shore, Counsel, Mayer Brown, Washington, D.C.

Summer Conley, Counsel, Drinker Biddle, Los Angeles

For this program, attendees must listen to the audio over the telephone.

Please refer to the instructions emailed to the registrant for the dial-in information. Attendees can still view the presentation slides online. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Conference Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Continuing Education Credits

FOR LIVE EVENT ONLY

Attendees must listen to the audio over the telephone. Attendees can still view the presentation slides online but there is no online audio for this program.

Please refer to the instructions emailed to the registrant for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Tips for Optimal Quality

Sound Quality

For this program, you must listen via the telephone by dialing 1-866-869-6667 and entering your PIN when prompted. There will be no sound over the web connection.

If you dialed in and have any difficulties during the call, press *0 for assistance. You may also send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Form 5500 Schedule C for 2010 Plan Years: Lessons Learned From First Filing Seminar

May 18, 2011

Linda Fisher, Linda T. Fisher 5500 Consulting
info@form5500prep.com

Summer Conley, Drinker Biddle
summer.conley@dbr.com

Linda Shore, Mayer Brown
lshore@mayerbrown.com

Today's Program

Review Of Changes To 2009 Schedule C
[Linda Fisher]

Slide 7 - Slide 25

Key Compliance Issues That Have Already Arisen
[Summer Conley, Linda Fisher, Linda Shore]

Slide 26 - Slide 51

Linda Fisher, Linda T. Fisher 5500 Consulting

REVIEW OF CHANGES TO 2009 SCHEDULE C

Schedule C For 2010 Plan Years

Review Of Changes

- Effective with 2009 plan years, Schedule C was expanded to report indirect compensation.
- Report when service provider received \$5,000 or more from the plan, directly or indirectly
- Direct compensation paid by the plan must be reported based on the plan year.
- Report on either cash or accrual basis; however, you must be consistent with your method.

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

- No longer limited to top 40 service providers
- For Indirect compensation, report amount of compensation, unless alternative rule applies
- Service provider information can be “reasonably accurate” to be in compliance.

Schedule C For 2010 Plan Years

Review Of Changes (Cont.)

- **Direct** – payments made directly from the plan's trust; Part I, Line 2
 - Recordkeeping
 - Trustee
 - Investment management
 - Legal
 - Auditor
 - Claims processing

Note: For payments paid by a plan sponsor who is later reimbursed for such payments by the plan, these should be reported as direct compensation paid to the respective service provider(s).

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Indirect compensation – payments made *other than directly* from the plan's trust in connection with services rendered to the plan (*often based on a transaction with the plan*)

- Recordkeeping
- Trustee/custodian
- Investment management
- Mutual funds
- Insurance company
- Brokerage commissions
- Asset-based investment management fees
- Sub-transfer agency fees
- SEC Rule 12b-1 distribution fees
- Float revenue
- Research
- Finder's fees
- Other transaction-based fees not paid by plan or plan sponsor

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds and separately managed accounts

- Expense ratio
 - A measure of what it costs an investment company to operate a mutual fund. Determined annually by dividing a fund's operating expenses by the average dollar value of its assets under management.
 - Deducted out of fund's assets
 - Largest component is typically management fees.
 - Varies from fund to fund
 - Disclosed on fund prospectus

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds (Cont.)

- SEC Rule 12b-1 fees*
 - Fees charged by mutual funds for sales, promotion and marketing expenses
 - 1% of fund assets maximum allowable charge
 - Deducted from net assets
 - Part of exchange ratio
 - May be paid in lieu of loads

* Note: Many mutual funds return a portion of their 12b-1 fees back to the recordkeeper.

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds (Cont.)

- Soft-dollar arrangements
 - A component of commissions
 - Generally arise when an investment advisor places securities transactions with a broker-dealer in exchange for research or other services
- Finder's fees
 - One-time fees paid by mutual fund companies to brokers and investment advisors for new purchases of fund shares
 - May offset loads or 12b-1 fees

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds (Cont.)

- Commissions
 - Usually paid to a broker; transaction-based compensation paid to brokers for sale of securities, mutual fund shares and other investments
 - Called “loads” in mutual fund environment
 - Front-end
 - Contingent deferred sales charges (back-end)
 - Based on share class

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds (Cont.)

- Distribution fees
 - Fees paid for marketing and selling fund shares
 - Compensates brokers and others who sell fund shares
 - Pays for advertising, printing and mailing
- Sub-transfer agent fees
 - Compensation paid to sub-transfer agents for performing services including:
 - Shareholder recordkeeping
 - Daily activity pricing and recording
 - Issuing account statements and confirmations
 - Shareholder customer service functions

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Fees charged to investment funds (Cont.)

- Float revenue
 - Short-term investment income retained by financial service providers generated by amounts such as contributions, transfers and distributions that are held in accounts while plan transactions are pending (e.g., investment allocation instructions and check-clearing)
- Wrap fee
 - Fees that consolidate various expenses associated with managing a variable annuity, including:
 - Investment management
 - Operations
 - Administration
 - Marketing

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Alternative reporting option and rule

Plan administrator must have received written materials that disclosed and described the following items, in regard to indirect compensation received as a plan service provider:

1. Existence of indirect compensation
2. Services provided for the indirect compensation
3. Amount or estimate of compensation or a description of the formula used to calculate
4. Identity of parties paying and receiving compensation

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

- **Indirect compensation (Cont.)**
 - Report on Line 1 if support received includes all four required disclosure items to classify as “eligible indirect,” and no direct compensation was paid to the service provider.
 - Report on Line 2 if the service provider received both direct and indirect.
 - Non-monetary compensation (gifts, meals, entertainment, travel, etc.): Report on lines 2 and 3

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Line 2: To report direct and indirect compensation where a formula was provided for Indirect

- Enter “0” in element (g)
- Check “Yes” to element (h)
- Enter formula or other method used on Line 3(e) or attach a description of the formula or other method used
- Amount or formula to calculate indirect compensation may be based on service provider’s fiscal year that ends within the plan’s reporting year.

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

- Persons reported on Line 1b may also be reported on Line 2a, if they provided disclosures regarding service providers that only received EIC.

Example:

ABC Bank serves as plan trustee. It received direct payments from the plan's trust for trustee fees (Line 2a). Also, its annual ERISA trust statement package included a "Commissions Report" that lists broker commissions paid during the plan year. The plan sponsor received the required disclosures to treat these broker commissions as EIC. Since ABC Bank provided the disclosures for the brokers, it would also be reported on Line 1b.

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Line 3: Indirect compensation reporting (Cont.)

Report information from each source from whom the person received indirect compensation if:

- (1) The amount of the compensation was \$1,000 or more, or
- (2) The plan was given a formula or other description of the method used to determine the indirect compensation, rather than an amount or estimated amount of the indirect compensation.

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Special reporting for insurance contracts*

- Where payments of expenses ARE reported on a Schedule A:
 - They would not be reported on Schedule C.
 - Applicable to compensation like recordkeeping, and claims processing pursuant to a contract with the insurer

* Not applicable to insurance investment contracts

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Special reporting for insurance contracts (Cont.)

- Where payments ARE NOT reported on a Schedule A
 - They **would** be reported on Schedule C, if the total of compensation reported on Schedule A and Schedule C meet or exceed the \$5,000 threshold for each respective insurance company.
 - This would typically include:
 - Finder's fees
 - Insurance brokerage commissions
 - Other brokerage fees

Schedule C For 2010 Plan Years Review Of Changes (Cont.)

Special reporting for insurance contracts (Cont.)

Example

- MetLife guaranteed annuity contract, Schedule A reported fees paid to it of \$1,500.
- MetLife also received \$3,500 in direct compensation from the plan for investment advisory services.
- Since these two amounts total \$5,000 or more, Met Life must be reported on the plan's Schedule C for the \$3,500.

Summer Conley, Drinker Biddle

Linda Fisher, Linda T. Fisher 5500 Consulting

Linda Shore, Mayer Brown

KEY COMPLIANCE ISSUES THAT HAVE ALREADY ARISEN

New Disclosure Regime

- > Schedule C
 - Requires plan administrators to report service provider fees and other compensation
 - Became effective with 2009 plan year filings
- > DOL Reg. Sect. 2550.408b-2(c)
 - Requires covered service providers to disclose compensation to the responsible plan fiduciary
 - July 16, 2011 effective date extended to Jan. 1, 2012
- > Participant disclosures
 - Require plan administrators to disclose information, including fee and expense information, to participants
 - Effective Dec. 20, 2010
 - Applicable for plan years beginning on or after Nov. 1, 2011

New Disclosure Regime (Cont.)

- > While all part of an overall move toward increasing fee disclosures, it is important to note various distinctions
 - Disclosure responsibilities fall on different parties.
 - Plan administrator vs. service provider
 - Consequences for failures differ.
 - Penalties vs. prohibited transactions
 - What must be disclosed differs.

Schedule C Vs. 408b-2 Comparison

	Schedule C	408b-2
Service Providers	Must receive \$5,000 or more in reportable compensation during the reportable year.	Reasonably expect to receive \$1,000 or more in connection with covered services – over the life of the arrangement.
Plans	Large Pension or Welfare Plans	<u>Any</u> ERISA-governed pension plan. DOL is considering welfare plans.
Direct Compensation	Payments made directly by the plan for services or because of a person's position with the plan.	Payments the covered service provider, an affiliate or subcontractor reasonably expects to receive directly from the plan.
Indirect Compensation	Compensation received from other than the plan or plan sponsor for services rendered to the plan during the plan year or the person's position with the plan. Eligible v. Ineligible.	Compensation the covered service provider, an affiliate or subcontractor reasonably expects to receive from a source other than the plan, plan sponsor, an affiliate or subcontractor.
Related Party Compensation	Not addressed directly – will depend upon whether bundled service arrangement.	Compensation paid among covered service provider, an affiliate or subcontractor, if transaction-based or charged against investment.
Non-monetary Compensation	Exclude if excluded from taxable income and valued at less than \$50 and aggregate value from one source is less than \$100 (gifts under \$10 do not count).	Exclude if valued at \$250 or less, in aggregate, during the term of the arrangement.
Mutual Fund Manager Fees	Included as reportable indirect compensation	Manager is not a covered service provider.

Service Codes

Service codes beginning for 2009 plan years, expansion

- Services provided (codes 10 – 49)
- Types of compensation received (codes 50 – 99)

Expected to report codes from both number sequence sections

Service Codes (Cont.)

Example: Trustee who also manages one of the plan's mutual funds

- 21 – Trustee
- 27 or 28 – Investment advisory or Investment management
- 50 – Direction payment from the plan
- 52 – Investment management fees paid indirectly by plan
- 60 - Sub-transfer agency fees
- 63 – Distribution (12b-1) fees
- 62 – Float revenue

Best Practices, Service Provider Reports

- Best practice recommendations for Schedule C information collection process
 1. Create template e-mail with request for applicable indirect compensation; include definition of indirect compensation
 2. Obtain contacts from investment committee member
 3. Include plan name, plan year date range
 4. Provide listing of service codes (services and compensation types)
 5. Define indirect compensation
 6. Define four items needed to be considered EIC
 7. Provide a due date
 8. Perform timely follow-ups

Best Practices, Service Provider Reports (Cont.)

Schedule C information request sample

- Plan Name _____; Plan Number _____
- Service Provider Contact Name _____
- Signature of person providing information _____

Part I, Line 2

Service Provider or Fund Name	EIN or Address	Did you receive Indirect Compensation from this Plan?	Applicable Service Codes	\$ Amt. or Formula	EIC or IC *
ABC Equity Fund	98-7654321	Yes	28 52 59 60 63	XX Expense Ratio	EIC
Recordkeepers America	12-3456789	Yes	15 60 63 64	.25 basis pts.	IC

* Provide Line 3 information needs for all indirect compensation (IC)

Best Practices, Service Provider Reports (Cont.)

Additional information needs for indirect compensation (not EIC)
Part I, Line 3

Service Provider Name from Line 2	Applicable Service Codes	Source of Indirect Compensation: Name and EIN or Address	\$ Amt. or Formula	Description of Indirect Comp.
Recordkeepers America	15 60 63 64	ABC Equity Fund	.25 basis pts.	12b (1) Revenue Sharing

Best Practices, Service Provider Reports (Cont.)

Items to note

- There is no need to request “direct compensation” amounts from each service provider, since they need to match trust statements, +/- accruals.
- Plan sponsor may choose to not request indirect compensation from service providers that only receive direct compensation.
- Schedule C total direct compensation may not match Schedule H expenses, due to:
 - Cash vs. accrual differences in reporting
 - Expenses that were less than \$5,000 are not reported on Schedule C.
 - PBGC premiums are not reported on Schedule C.
 - Expenses are reported on Schedule A.

Best Practices, Service Provider Reports (Cont.)

Items to note (Cont.)

- Thousands of filings for 2009 plan year that appeared to require a Schedule C did not include one.
- 700 service providers were reported on Line 4 as failing or refusing to provide Schedule C information.
- The DOL expects to see indirect compensation reporting for plans with mutual funds.
- Service provider responses vary when reporting applicable service codes, due to so many to choose from.

Filing Deadline Approaching, Not All Info Has Been Provided: Now What?

- Many plan sponsors did not realize most plan service providers are not obligated to provide info necessary for schedule
 - Exception for banks and insurance companies
 - Building requirement into contract terms
- Following up with plan service providers
 - Whose fiscal year is relevant?
 - What leverage do plan sponsors have?
- Filing extensions
 - Automatic extension when corporate return deadline is extended
 - Extensions on request

Filing Deadline Approaching, Not All Info Has Been Provided: Now What? (Cont.)

- Filing Form 5500 with incomplete information
 - Edit test review procedures and notice of rejection
 - Brief overview of penalty procedures
- Filing amended Form 5500 under EFAST2
- Suggestions for future plan years
 - Build requirement to provide Schedule C data into contract terms, if feasible
 - Send written request to service providers
 - Keep track of information received from each service provider

Defining Key Service Provider

Key service providers

- A service provider that could be a plan fiduciary or provide:
 - Contract administration, consulting, custodial, investment management, securities brokerage or recordkeeping services
- If a "key" service provider reports its compensation by a formula, then the amount of indirect compensation is presumed to meet the \$5,000 reporting threshold.
- Key service provider rule applies to indirect compensation (not eligible indirect) and must be reported on Part I, Line 3.
- Common examples: 12b(1) fees, sub-transfer agent fees

Bundled Service Arrangements

- Service arrangement where plan hires one company to provide a range of services directly, through affiliates or subcontractors or a combination, but priced as one single package. Note: Flexibility in determining which services or providers are part of the bundle
- Normally report direct payments to bundled service provider as direct compensation to the bundled service provider (rather than indirect compensation to the affiliates or subcontractors)

Bundled Service Arrangements (Cont.)

- Exceptions to bundled service arrangement reporting; these require separate reporting:
 - Anyone in the bundle receives fees charged against a plan's investment (e.g. 12b-1 fees, float revenue, investment management fees)
 - Compensation is received by a fiduciary or one who provides administration, consulting, investment advisor, investment management, brokerage or recordkeeping services; and the compensation received is commissions or other transaction-based fees, finder's fees, float revenue, soft dollars or other non-monetary compensation.

Bundled Service Arrangements: Example

- Service provider provides third-party administrative services to a 401(k) plan. As part of the arrangement, service provider offers ancillary services offered by subcontractors as part of the annual fee.
- Plan sponsor provides written questionnaire asking whether the service provider has paid any indirect compensation in connection with services provided, to or transactions with, the plan to another party.

Indirect Compensation, Generally

- Indirect compensation includes compensation from sources other than directly from the plan or plan sponsor, if received in connection with services rendered to the plan or the person's position with the plan.
 - Compensation falls into this category “if the person's eligibility for a payment or the amount of the payment is based, in whole or in part, on services that were rendered to the plan or on a transaction or series of transactions with the plan.”
 - Finder's, placement and solicitation fees
 - Float revenue received by plan trustee or custodian
 - Brokerage commissions
 - Soft dollar research

Indirect Compensation, Generally (Cont.)

- Compensation does not fall into this category if it “would have been received had the service not been rendered or the transaction not taken place and that cannot be reasonably allocated to the services performed or transaction(s) with the plan.”
 - Distinguishing between compensation that can be “reasonably allocated” to plan services and compensation that cannot
- Allocation among plans for which compensation can be “reasonably allocated”
 - Gifts and entertainment
 - Plan and non-plan services/clients
 - Proprietary soft dollar research

Indirect Compensation, Generally (Cont.)

- Special rule for “investment funds”
 - Investment funds are broadly defined to include commingled investment funds and single-customer managed accounts
 - “Operating expenses” such as attorney’s fees, accountant’s fees, printer’s fees and brokerage costs; and other expenses associated with effecting transactions within investment fund portfolio are not reportable indirect compensation.
 - Does it matter whether fees are paid directly from an “investment fund”?

Reporting Indirect Compensation Of In-House Employees

- What is “indirect” compensation”
- When a plan sponsor provides services to the plan, who is the service provider?
 - Plan sponsor
 - Plan employees vs. employees of plan sponsor
- What is the reporting threshold?
 - Compensation is reportable when a “person” is paid or receives \$5,000 or more in direct or indirect compensation during a plan year in connection with services rendered to plan or the person’s position with the plan.
 - Who is a “person”?
 - Individuals, trades and businesses, regardless of whether they are incorporated

Reporting Indirect Compensation Of In-House Employees (Cont.)

- Identifying “person” who is recipient of “indirect compensation”
 - Travel, meals, lodging associated with plan business
 - Would expense be properly reimbursable by plan?
- Gifts and entertainment
 - *De minimis* rules
- How does reporting threshold apply to employees of plan sponsor?
 - \$5,000 threshold for each employee?
 - Allocation across plans?
- How should recipients of indirect compensation be identified on Schedule C?
- What records should plan sponsor require employees to maintain?

Special Issues For Welfare Plans

- Which welfare plans are required to complete Schedule C?
- FAQ guidance relating to pharmacy benefit manager (PBM) compensation
 - DOL characterizes PBMs as plan service providers
 - Compensation received by PBM from plan is reportable as direct compensation (even if fees are passed through a network pharmacy)
 - Reporting relief for manufacturer rebates and discounts
 - FAQ guidance limited to Schedule C compliance; no implications for prohibited transaction rules
- Does this guidance have implications for compensation of third-party administrators?

Special Issues For Welfare Plans (Cont.)

- Typical sources of compensation for TPAs
 - Claims-processing fees
 - Subrogation services
 - Fees for access to preferred provider networks
 - TPA may receive a portion of its compensation through discounts, rebates, etc.
- Welfare plan services may be eligible to be treated as a “bundled service arrangement.”
 - Special rules apply to transaction-based compensation.
- The Patient Protection and Affordable Care Act may encourage some employers to maintain retiree-only plans. Could this raise special concerns?
 - Does Technical Release 92-1 apply to retiree-only plans?

Contractual Obligations

- Add contractual language requiring information needed for Schedule C by a specified date?
- Add representation/clarification as to bundled service arrangement status?
- But, consider 408b-2 requirements

Compensation And Multiple Plans

- Allocating compensation among multiple plans
 - When compensation is received in connection with several plans or DFEs
 - Permitted to use “any reasonable method” to allocate among plans
 - When determining the \$5,000 threshold, use the amount attributable to the Plan or DFE.