

ErisaALERT

November, 2008

Fee Transparency Part 3 –2009 Schedule C

As noted in Part 1 and Part 2 of our three part Fee Transparency series, there are three pieces of DOL guidance that Plan Sponsors should have on their list of “to dos”. Two are in the form of proposed guidance with the third in final form. This ErisaALERT is the third and final in a series dealing with the guidance and their implications for Plan Sponsors.

Recap of the Guidance

The combined guidance addresses:

- reporting plan expense information on Schedule C.
- information that must be disclosed to plan participants (Part 1 of our series <http://www.erisadiagnostics.com/erisaalerts.asp?articleID=3>)
- information which must be provided by the service provider to a responsible plan fiduciary especially where fees will be paid from plan assets (Part 2 of our series <http://www.erisadiagnostics.com/erisaalerts.asp?articleID=38>).

In this ErisaALERT we will discuss some of the key disclosures required for the 2009 Schedule C. While you may be thinking that you don’t have to worry about this until the 2010 filing date, you should know what the requirements will be and whether or not your vendors will be able to provide the information to you!

You may wish to have the following information available as you attempt to apply the new requirements to your particular situation - FAQs About the 2009 Form 5500 Schedule C (<http://www.dol.gov/ebsa/regs/fedreg/notices/20071116.pdf>) and the 2009 Form 5500 (<http://www.dol.gov/ebsa/regs/fedreg/notices/20071116.pdf>).

What it means to Plan Sponsors

There is good news and there is not so good news depending on how you look at it:

1. You will have to report more information than you have in the past but it will help you understand the details of the fees charged by your vendors (particularly in the case of defined contribution plans).
2. You will have to learn the distinction between
 - a. direct compensation (payments made directly by the plan for services rendered to the plan),

- b. indirect compensation (compensation received by providers from sources other than directly from the plan or plan sponsor in connection with services rendered to the plan) and
- c. eligible indirect compensation (indirect compensation for which the plan sponsor receives certain disclosures).

This distinction will impact the amount of information which must be reported.

- 3. The requirements are in effect for the 2009 Form 5500 filing. There is one year of breathing room if you are dependent on your service provider for the information necessary to complete the Schedule C and you receive a statement from your service provider indicating that the service provider made a good faith attempt to make whatever system changes were necessary to gather the information but was not able to complete the work for the 2009 filing.

The Basics of Schedule C

Schedule C must be attached to a Form 5500 for a large pension or welfare benefit plan, an MTIA, a 103-12IE or a GIA. Part I must be completed to report certain information concerning service providers who received, directly or indirectly from the plan, \$5,000 or more in reportable compensation in connection with services rendered to the plan or DFE or to report an accountant and/or actuary who has been terminated; there are limited exceptions.

Part II must be completed to report service providers who fail or refuse to provide the necessary information.

Part III must be completed to report the termination in the appointment of an accountant or actuary during the plan year.

Keep in mind that health and welfare plans that meet the conditions of the limited exemption of Technical Release 92-01 are not required to complete and file a Schedule C.

For the most part, sounds familiar, right? Remember that old adage “the devil is in the details”. We will now turn to some of the details and you will quickly discover the devil in the details.

The Changes

Part I of Schedule C – Service Provider Information

Plan Sponsors must report information for each person receiving \$5,000 or more in total direct or indirect compensation in connection with services rendered to the plan during the plan year. Reportable compensation includes money and any other things of value (for example, gifts, awards, trips) received by a person *directly or indirectly* from the plan (including fees charged as a percentage of assets and deducted from investment returns). The term “person” includes individuals, trades and businesses.

Direct Compensation

Direct compensation is *payments made by the plan* for services rendered to the plan or because of a person’s position with the plan. Direct payments made by the plan would include:

- Direct payments out of a plan account
- Charges to the forfeiture and fee recapture accounts
- Charges to the trust before allocations are made to participant accounts

- Direct charges to participant individual accounts

Reminder

Payments made by the plan sponsor, which are not reimbursed by the plan, are not subject to Schedule C reporting.

Indirect Compensation

Indirect compensation is compensation received from sources other than directly from the plan or plan sponsor if the compensation was received in connection with services rendered to the plan during the plan year or person's position with the plan. Examples of indirect compensation include:

- Fees and expense reimbursement payments received by a person from mutual funds, bank commingled trusts, insurance company pooled separate accounts, and other separately managed accounts and pooled investment funds in which the plan invests that are charged against the fund or account and reflected in the value of the plan's investment (such as management fees paid by a mutual fund to its investment adviser, sub-transfer agency fees, shareholder servicing fees, account maintenance fees and 12b-1 fees) (***this falls under the devil is in the details***)
- Finder's fees
- Float revenue
- Brokerage commissions (regardless of whether the broker is granted discretion)
- Research or other products or services, other than execution, received from a broker-dealer or other third party in connection with securities transactions (soft dollars) and
- Transactions based fees received in connection with transaction or services involving the plan whether or not they are capitalized as investment costs

Practical Implications

Expenses paid from the Plan - Plans Sponsors have struggled for years trying to understand all of the fees involved in the administration of their defined contribution plans. The DOL has tried to help with a sample disclosure form and some major mutual fund companies have tried to make it easier. Now, Plan Sponsors must understand exactly what is included in expenses charged to the plan. The second in our series of ErisaALERTs regarding fee transparency discussed the information that the government will require Plan Sponsors to obtain before entering into an agreement with a plan service provider. The ultimate goal is that Plan Sponsors understand their Plan fees, obtain the information they need to communicate to participants and report to the government.

"Eligible" indirect compensation

To be considered "eligible" indirect compensation, a Plan Sponsor must receive written materials which disclose the indirect compensation. This is important because it impacts how much information must be provided on the Schedule C. "Eligible" indirect compensation includes:

- Fees or expense reimbursement payments charged to investment funds and reflected in the value of the investment or return on investment of the participating plan or its participants
- Finder's fees
- Soft dollar revenue
- Float revenue and/or

- Brokerage commissions or other transaction based fees for transactions or services involving the plan that were not paid directly by the plan or plan sponsor.

Practical Implications

As you review the fees paid from your plan, remember to ask “are the fees/expenses reflected in the value of the investment or the investment earnings?” If the answer is no, then the fees are not “eligible” indirect compensation and must be reported as indirect compensation. Q&A 8, 9, 10 and 21 of the DOL’s FAQs About the 2009 Form 5500 Schedule C provide examples that represent common administrative arrangements and should help with your understanding of the new requirements.

Fully insured group health and similarly fully insured benefits

The 2009 Schedule C instructions provide that where benefits under a plan:

- are purchased from and guaranteed by an insurance company, insurance service, or other similar organization, and
- the contract or policy is reported on Schedule A

payments of monetary compensation by the insurer ***out of its general assets*** to persons for performing administrative activities necessary for the insurer to fulfill its contractual obligation to provide benefits, where there is no direct or indirect charge to the plan for the administrative services other than the insurance premium would not be treated as indirect compensation.

This would include compensation for services such as recordkeeping and claims processing services provided by a third party pursuant to a contract with the insurer to provide those services but would not include compensation provided by the insurer to the sale or renewal of a policy such as finder’s fees, insurance brokerage commissions and fees, or similar fees. **Insurance investment contracts are not eligible for this indirect compensation classification exception.**

Bundled service arrangements

The instructions to the 2009 Schedule C define a bundled service arrangement as an arrangement that includes any service arrangement where the plan hires one company to provide a range of services either directly from the company, through affiliates or subcontractors, or through a combination, which are priced to the plan as a single package rather than on a service-by-service basis. A bundled service arrangement would also include an investment transaction in which the plan receives a range of services either directly from the investment provider, through affiliates or subcontractors, or through a combination.

Now this is where things begin to get confusing – the instructions state that direct payments by the plan to the bundled service provider should be reported as direct compensation to the bundled service provider and do not need to be allocated among affiliates or subcontractors and reported as indirect compensation received by the affiliates or subcontractors ***unless*** the amount paid to the affiliate or subcontractor is set on a per transaction basis, e.g., brokerage fees and commissions.

The instructions go on to say that fees charged to the plan’s investment and reflected in the net value of the investment, such as management fees paid by mutual funds to their investment advisers, float revenue, commissions (including soft dollars), finder’s fees, 12b-1 distribution fees, account maintenance fees and shareholder servicing fees, must be treated as separate compensation by the person receiving for Schedule C reporting purposes.

For each person who is a fiduciary to the plan or provides one or more of the following services to the plan:

- Contract administrator
- Consulting
- Investment advisory (plan or participant)
- Investment management
- Securities brokerage or
- Recordkeeping

commissions and other transaction based fees, finder's fees, float revenue, soft dollar and other non-monetary compensation would also have to be reported as separate compensation even if those fees were paid from mutual fund management fees or other fees charged to the plan's investment and reflected in the net value of the investment.

FAQ 14 of the previously mentioned DOL FAQs clarifies that as a general rule, in the case of bundled service arrangements, revenue sharing within the bundled group ***generally*** does not need to be separately reported, with two exceptions.

The first exception is that any person in the bundle receiving separate fees charged against a plan's investment (e.g., investment management fees, float revenue, and other asset based fees such as shareholder servicing fees, 12b-1 fees, and wrap fees if charged in addition to the investment management fee) must be treated as receiving separately reportable compensation for Schedule C purposes. Examples provided include, revenue sharing payments for shareholder services, recordkeeping or compliance services that paid by an investment provider to a TPA if they are charged against the plan's investment as a ***separate*** amount or pursuant to a ***separate*** formula. If such fees were paid as part of an overall investment management or shareholder service charge, then they wouldn't be reportable because it is not a ***separate*** amount.

The second exception is that compensation must be separately reported if (1) the compensation is received by any person in the bundle who is one of the service providers enumerated on Line 3 of Schedule C (service provider information) and (2) the compensation received is "commissions and other transaction based fees, finders' fees, float revenue, soft dollars and other non-monetary compensation".

Bottom line – know and document the nitty gritty details of your fee arrangement! Understanding the new reporting requirements is not easy and will probably require practical application to your own situation to really understand the requirements. Talk to your providers and begin the learning process; it will be a learning process for all parties involved.

What should you do now?

1. As you approach year end, you may want to begin making a list of the service providers who receive more than \$5,000 in fees paid from the plan (remember it is expenses paid from the plan, not directly by the plan sponsor) and start thinking in terms of the 2009 reporting requirements.
2. Review the 2009 Schedule C instructions and become familiar with the requirements.
3. Categorize your expenses as direct, indirect or eligible indirect compensation. As you go through the indirect categorization ask yourself "are the fees/expenses reflected in the

- value of the investment or the investment earnings?” Confirm your understanding with your service providers and others in your Company.
4. Contact the providers and ask them how they are gearing up for the 2009 Schedule C disclosures.
 5. Understand what you are paying for!!! Continue to ask your providers for detailed information; document that you requested the information.
 6. Become familiar with other DOL related guidance on fee transparency and stay on top of any changes with respect to further clarification as well as the effective dates.

Note: This material is for the sole purpose of providing general information and does not under any circumstances constitute legal advice and should not be used as a substitute for legal advice. You should seek the advice of counsel when applying the requirements to your plans. For more information on this ErisaALERT, contact us by phone at 610-524-5351 and ask for Mary Andersen or 973-994-7539 and ask for Theresa Borzelli or 610-337-7270 and ask for Paul Protos.

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