REISH & REICHER
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW

BULLETIN

March 11, 2010

The 5500 Nightmare: Completing the Schedule C

By Fred Reish

Recordkeepers, bundled plan providers, third party administrators, broker-dealers, RIAs, investment managers, and mutual fund complexes are all struggling . . . with the new Schedule C.

We are doing a significant amount of work advising those clients on the need to gather . . . or provide . . . information about service provider compensation for the preparation of the Schedule C. The entities that prepare Forms 5500—like recordkeepers, bundled providers and TPAs (and, in some cases, plan sponsors)—are trying to gather the information, while broker-dealers, RIAs, investment managers and mutual fund complexes are trying to provide the information to plan sponsors and 5500 preparers.

Before explaining the issues, let me give you some background . . . the DOL has substantially revised Schedule C to the Form 5500, effective for the 2009 plan year. Basically, the DOL is requiring significantly more information for large plan filings on the Schedule C. The additional information focuses primarily on compensation to "service providers" for large plans. (A "large plan" is generally defined as a plan which covers 100 or more participants. But, for 401(k) purposes, the definition of participant includes all eligible employees, even if they are not deferring—and thus even if they do not have an account balance.)

When the new Schedule C was designed, it was contemplated that service providers would be giving detailed compensation information to plan sponsors . . . because of the requirements imposed by a new 408(b)(2) regulation. However, as we all now know, the 408(b)(2) regulation was effectively blocked by the Office of Management and Budget in the waning hours of the Bush Administration. But the new Schedule C was already in place. Thus, there is a disconnect. On the one hand, large plan sponsors are required to report compensation information, but their providers are not required to give the information to them. While that will be remedied at some point in the future—because ultimately there will be 408(b)(2) regulatory requirements—it creates a problem for plan sponsors for the 2009 plan year.

However, plan sponsors do have one "enforcement arrow" in their quiver. There is a box on the Schedule C to report those service providers who fail to provide the necessary information. Before reporting a provider, though, plan sponsors, and their agents, should formally request the information from the service provider . . . preferably in writing.

Since the deadline for the Form 5500 for calendar year 2009 plans is July 31, those requests should be made, at the latest, in the next 30 to 60 days in order for the provider to have time to furnish the information and for the preparer to complete the 5500. Thus, plan sponsors and 5500 preparers need to approach this with sense of urgency.

The Schedule C instructions divide reportable compensation into three categories: direct compensation; eligible indirect compensation; and "other" indirect compensation. The reporting requirements are different for each of the three categories. Thus, it is important for both the provider of the information and the preparer of the return to understand the definitions in order to properly categorize and report the compensation information. Of the three categories, "direct compensation" is the easiest to define . . . and, for that matter, the easiest to report. It covers compensation paid directly from the plan. As a result, the trustee should be able to provide the preparer of the 5500 with a report of all payments made directly from the plan,

Pre-Conference Session at ASPPA 401(k) Summit

The ASPPA 401(k) Summit Conference is nearly upon us. Join Fred Reish, Bruce Ashton and Jason Roberts as they present a pre-conference session, entitled "The Government's Focus on Accumulation and Distribution of Benefits: Target Date Funds and Guaranteed Payments." The session will be aimed at financial services professionals and will address issues and guidance surrounding target date funds and the emerging issue of guaranteed lifetime benefits. The session will be held at 9:00 am on Sunday, March 14, in the Canary room, section 2. It is open to all registrants at the Summit.

For more information, please visit http://www.asppa.org/main-menu/knowledge/conferences/2010/the-asppa-401k-summit/overview.aspx.

ASPPA 401(k) Summit Conference

Fred Reish and Jason Roberts are presenters at the 2010 ASPPA 401(k) Summit Conference, to be held at the Orlando World Center Marriott & Convention Center on March 14th through 16th. The conference is a unique, interactive environment for retirement professionals who actively sell, market, support or service 401(k) plans.

Fred will present the workshop "Hot Off the Press!" This session will address breaking news and its impact on retirement advisors. Fred will also be moderating a workshop on "Tools for Categorizing and Analyzing Target Date Funds."

Jason is a conference committee member and will present a workshop on "Legal Updates." This session will address recent legislative and regulatory activity and how it impacts service providers. He will also co-present a workshop on "Inadvertent Fiduciary Status: Common Pitfalls for Service Providers and Opportunities for Acknowledged Fiduciaries." This session will explore the various ways one can become a functional fiduciary and provide guidance on how to avoid fiduciary-related pitfalls.

For more information, please visit http://www.asppa.org/main-menu/knowledge/conferences/2010/the-asppa-401k-summit/overview.aspx.

including the payees and the amounts. Furthermore, the trustee (or the plan sponsor) should be able to report on the types of services provided in exchange for that compensation. In theory, at least, the plan committee reviewed all of the expenses before they were paid and approved the payments as reasonable, which includes both the fact that the services were rendered and the fact that the value of the services was equivalent to the amount paid.

If direct compensation covers amounts paid from a plan, then obviously indirect compensation refers to any amounts paid to service providers which are not paid from the plan. Indirect compensation includes, for example, revenue sharing, 12b-1 fees, subtransfer agency fees, administrative services fees, subsidies to TPAs, and so on. It is "indirect" because the expense was not paid from the plan.

The second category—eligible indirect compensation—includes, broadly defined, indirect compensation that directly reduces the value of the plan's investments. An easy example would be 12b-1 fees, which are subtracted directly from the value of the assets in a mutual fund. Eligible indirect compensation is an attractive reporting method for the recipient and for the 5500 preparer because it requires only a check-the-box reporting on the Schedule C. Unfortunately, for the rest of the world, it is woefully inadequate, since any person who later reviews the Schedule C will not see information about some of the largest expenses paid by the plan. That would include, for example, plan participants.

However, it is not enough to be the type of compensation that is eligible for that check-the-box reporting. The service provider must also give the plan sponsor four pieces of information in writing. Those are:

- The existence of the indirect compensation,
- The services provided for the indirect compensation or the purpose for payment of the indirect compensation;
- The amount (or estimate) of the compensation or a description of the formula used to calculate or determine the compensation; and
- The identity of the party or parties paying and receiving the compensation.

Note that the information must be provided to the plan sponsor and not to the preparer of the Schedule C. In other words, delivery of the information to a service provider is not enough. The required information must actually be delivered to the plan sponsor.

"Other" indirect compensation includes, as you might suspect, all reportable indirect compensation that is not eligible indirect compensation.

As explained earlier in this bulletin, each category—direct, eligible indirect and other indirect—requires that different information be reported. As a result, the preparers of the 5500 Forms have the burden of collecting the information from multiple service providers in order to prepare the Schedule C. Technically, the preparers do not have a legal obligation. The legal obligation is on the plan sponsor. But, as a practical matter, since they have agreed to prepare the Form 5500, they feel the necessity to make at least a reasonable effort to gather the information on behalf of the plan sponsor. Having said that, though, we see that recordkeepers, bundled providers and third party administrators (all of whom prepare 5500s) are making a significant number of assumptions about the information that they need and about the categorization of that information . . . many of which are not correct. As a result, it appears likely that many plan sponsors will be signing, under penalty of perjury, Forms 5500 with incorrect information on the Schedule C. We assume that, for at least the initial years of new Schedule C reporting, the DOL will be understanding in enforcing those reporting requirements.

In any event, the organizations that prepare the 5500s are making an effort to collect the information in a way that can most easily be used by them for preparing the Schedule C.

Meanwhile, service providers are receiving requests for information from large numbers of recordkeepers, bundled providers and third party administrators, all of which are using their own formats. In other words, the issue for the service providers who need to provide the information is that they are getting multiple sets of instructions (some of which differ) and they are being asked to report in multiple formats. Obviously, that is a significant administrative burden and is not cost effective from their perspective. Because of these issues, we are being engaged by both the preparers and the providers to assist

them in gathering and/or reporting the information. As a word of warning, the issues are complex, both with regard to the information that needs to be reported and with regard to the categorization of the compensation within the three categories. For example, in many cases, broker-dealers receive additional payments, or bonus payments, from mutual fund complexes. Those payments are above and beyond the 12b-1 fees and are not shared with the individual financial advisers. Nonetheless, they are compensation to the broker-dealer that needs to be reported. And, in the cases that we have examined, those payments fall into the category of other indirect compensation, which has a somewhat heavier reporting obligation. That is just one example of the kind of issues that 5500 preparers are encountering.

Another example is the payments made to compliance-only third party administrators (that is, TPAs who do not recordkeep) by providers and mutual fund complexes. We loosely refer to those payments as subsidies. They are reportable indirect compensation to the TPA (and usually will be considered other indirect compensation).

So, as a word of warning, now is the time to be requesting the information. As this bulletin makes clear, it is important to have a detailed understanding of the types of compensation that are paid and of the reportable categories for each types of payments.

GAO Study on Potential Conflicts of Interest in the Provision of Investment Advice to DC Plan Participants

Fred Reish was recently interviewed by the Government Accountability Office (GAO) concerning investment advice for plan participants.

Congressman George Miller, Chairman of the House Committee on Education and Labor, had requested that the GAO conduct a study on potential conflicts of interest that arise in the provision of investment advice to participants in plans where they can direct investments. To accomplish that study, the GAO established the following objectives:

1. What types of investment advice arrangements may pose conflicts of interest for advisers to defined contribution (DC) plan sponsors and participants?
2. To the extent that investment advice arrangements may pose conflicts of interest, what is the potential impact on plan participants?
3. What options are available to ensure that plan sponsors and participants have access to independent investment advice?

As the questions indicate, Congressman Miller has serious concerns about conflicts of interest for advisers and the potential impact of those conflicts on participants.

At this time, the GAO is actively conducting their study. In due course, the GAO will publish their findings on this subject.

Any tax advice contained in this communication (including any attachments) is neither intended nor written to be used, and cannot be used, to avoid penalties under the Internal Revenue Code or to promote, market or recommend to anyone a transaction or matter addressed herein.

©2010 Reish & Reicher, A Professional Corporation. All rights reserved. This bulletin is published as a general informational source. Articles are general in nature and are not intended to constitute legal advice in any particular matter. Transmission of this report does not create an attorney-client relationship. Reish & Reicher does not warrant and is not responsible for errors or omissions in the content of this report.