The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 21966

November 20, 2007

Department of Labor Releases Final Form 5500; Conference Call Scheduled for December 5 at 3:30 PM ET

[21966]

November 20, 2007

TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 51-07 RE: DEPARTMENT OF LABOR RELEASES FINAL FORM 5500; CONFERENCE CALL SCHEDULED FOR DECEMBER 5 AT 3:30 PM ET

The Department of Labor released final revisions to Form 5500, which employee benefit plans use to file the annual report required by ERISA and the Internal Revenue Code. [1] The revisions include changes to Schedule C on which plans report compensation paid to service providers. As described in more detail below, DOL's revision will require plans to report with respect to certain service providers to mutual funds in which the plan invests, including the mutual fund's investment adviser and brokers.

The Institute has scheduled a conference call for Wednesday, December 5 at 3:30 PM Eastern time to discuss Form 5500 revisions. If you would like to participate in the call, please complete the attached response form and fax or e-mail it to Brenda Turner at 202/326-5841 or bturner@ici.org by noon on Tuesday, December 4. To participate, please dial 1-888-709-9420 and enter passcode 37379. As a reminder, because all lines are open to facilitate discussion, please remember to place your line on mute when not speaking and do not place the call on hold. If you would like to discuss Form 5500 revisions in advance of the call, please feel free to contact the undersigned (202/326-5810 or mhadley@ici.org) or Mary Podesta (202/326-5826 or podesta@ici.org).

This memorandum describes the changes to Form 5500 of most relevance to defined contribution plans that invest in mutual funds. There are other changes relevant to defined benefit plans and welfare plans.

Effective Date

As requested by the Institute and others, DOL delayed the effective date for most of the Form 5500 revisions by one year. In general most of the revisions, including revisions to Schedule C, are effective for plan years beginning on or after January 1, 2009. [2] DOL also postponed mandated electronic filing.

Schedule C

In general terms, the final revised Schedule C follows the proposal, requiring reporting of persons [3] who rendered services to or had transactions with the plan if the person received, directly or indirectly, $5,000 or more in compensation. Final Schedule C also requires detailed reporting of indirect compensation that exceeds $1,000. The Department provided a simplified reporting exception for persons who receive only "eligible indirect compensation."

Covered service providers

DOL retained the requirement that a service provider is covered if direct and indirect compensation received "in connection with services to or their position with the plan" equal or exceed $5,000. This eliminates a prior rule requiring reporting of only the top 40 service providers by total compensation.

The Instructions to Schedule C provide that the investment of plan assets is not by itself payment for services but that persons that provide investment management, recordkeeping, claims processing, participant communication, brokerage and other services to the plan "as part of an investment contract" are considered to be providing services to the plan. Accordingly, DOL views service providers to a mutual fund in which a plan invests as service providers to the plan for purposes of Form 5500. [4]

Direct and indirect compensation

Subject to the exceptions for “eligible indirect compensation,” insubstantial non-monetary payments, and certain bundled services described below, plans must separately report for each covered service provider the amount of direct and indirect compensation paid during the year. [5] “Indirect” compensation includes any compensation not charged directly from the trust or a plan or participant account but which was received “in connection with services rendered to the plan during the year or the person’s position with the plan.”

Compensation is considered to have been provided “in connection with” services if the person’s eligibility to receive the 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. Indirect compensation does not include compensation that would have been received if the services had not been rendered or the transaction had not taken place and that cannot be reasonably allocated to the services performed or the transactions with the plan. The Instructions specifically mention as examples of covered indirect compensation the following:

- Fees and expense reimbursement received from a person from mutual funds and similar financial products that are charged against the fund and reflected in the value of the plan’s investment, including 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
- Brokerage commissions, regardless of whether the broker has discretion
- Float revenue
- Research or other products or services, other than execution, received from a broker dealer or other third party in connection with securities transactions (i.e. soft dollars)
- Other transaction-based fees received in connection with transactions or services involving the plan (whether or not capitalized as investment costs).

For each person receiving $1,000 or more in indirect compensation and who is a fiduciary or who provides one of an enumerated list of services (contract administrator, consulting, investment advisory (plan or participant), investment management, securities brokerage, or recordkeeping,) the plan must provide the following additional information:

- The identity, EIN, and address of the recipient
- The amount of the indirect compensation
- An associated service code [6]
- A description of the indirect compensation, including any formula to determine the recipient’s eligibility for or the amount of the indirect compensation

This special reporting for indirect compensation is also required even if the indirect compensation does not equal or exceed $1,000, but the plan was given a formula or other description of the method used to determine the indirect compensation rather than an amount or estimate.

Simplified reporting of "eligible indirect compensation"

Final Schedule C includes simplified reporting for persons who received during the year only "eligible indirect compensation" and who provided the plan administrator certain written disclosures. In lieu of the detailed reporting described above, these persons need only be identified by name and either EIN or address. The amount of the indirect compensation does not need to be reported.

"Eligible indirect compensation" means fees or expense reimbursement payments charged to investment funds and reflected in the value or return of the investment and for one of the following: [7]

- Distribution
- Investment management
- Recordkeeping or shareholder services
- Commissions and finder's fees paid to persons providing direct or indirect services
- Float revenue
- Securities brokerage commissions and other transaction-based fees not paid by the plan or plan sponsor (whether or not they are capitalized as investment costs)
- Soft dollar revenue.

In order for the limited reporting for eligible indirect compensation to apply, the plan administrator must have received written materials that disclosed and described:

- 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
- The identity of the party or parties paying and receiving the compensation.

The written disclosures for a "bundled arrangement" (see below) must separately disclose and describe each element of indirect compensation that would be required to be separately reported absent the exception for eligible indirect compensation.

The preamble states that any written disclosure, whether regulatory, contractual, or voluntary, could be relied upon so long as all of the disclosures required are provided to the plan administrator, and that the requirements may be satisfied by multiple documents.

DOL states that, as an example, 12b-1 fees received by a party providing recordkeeping services to a plan would not have to be reported separately on Schedule C if the disclosures in the mutual fund prospectus together with disclosures in the service contract advised the plan administrator of the fact that 12b-1 fees were being received, what the fees were paid for, the amount or estimate of the fees received or the formula used to calculate the amount of the fees received, and the party from whom the recordkeeper was receiving the fees. The preamble also cites as an example "soft dollars" received in the form of research in connection with securities trades. The preamble states that because of the difficulty of providing a formula or estimate of certain types of soft dollar non-monetary compensation, a description of the eligibility conditions sufficient to allow a plan fiduciary to evaluate them for reasonableness and potential conflicts of interest would satisfy the "amount" requirement. [8]

Bundled service arrangements

As in the proposal, certain bundled service arrangements may be reported together, but DOL modified the definition and rules significantly. In final Form 5500, two types of arrangements qualify as bundled service arrangements:

- Any service arrangement in which 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
- 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.

Direct payments to a bundled service provider do not need to be allocated among affiliates or subcontractors unless the amount paid to the affiliate or subcontractor is set on a per transaction basis, such as commissions.

On the other hand, the Instructions provide two instances in which payments must be broken out from the "bundle":

- 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, and shareholder servicing fees must be treated as separate compensation by the person receiving the fee.
- For each person who is a fiduciary or who provides one of a list of enumerated services (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, are required to be reported even if those fees are paid from the mutual fund management fees or other fees charged to the plan's investment and reflected in the net value of the investment.

Insubstantial non-monetary compensation

DOL added a limited exception for reporting non-monetary compensation such as gifts or meals. To be excluded, the non-monetary compensation must be tax deductible for federal income tax purposes by the payor and not taxable income to the recipient. The value of the compensation cannot exceed $50, and the aggregate value in a calendar year must be less than $100. Gifts with a value of less than $10 do not need to be counted toward the $100 limit. If the $100 limit is exceeded, then the value of all gifts will be reportable. Gifts received from one person by multiple employees of an entity can be treated as separate compensation when calculating the $50 and $100 thresholds.

Allocation among multiple plans

In response to comments by the Institute and others, the Department removed a requirement that if reportable compensation is due to a person's position with or services rendered to more than one plan, the total amount of compensation should be reported if the compensation cannot be reasonably allocated. The final Instructions allow any reasonable method of allocating the compensation among multiple plans.

Revenue sharing payments that are not plan assets

The Department states that "revenue sharing" payments are subject to Schedule C even if they do not constitute plan assets. In response to comments, the Department states in the preamble that the fact that revenue sharing payments charged against the assets in an investment vehicle are required to be reported on Schedule C or disclosed under the alternative reporting option would not, by virtue of the reporting requirement alone, make those revenue sharing payments plan assets under the Department's plan asset regulation [9] or under ordinary notions of property rights.

Identification of service providers who fail or refuse to provide information

As in the proposal, Form 5500 includes a line for plans to identify any fiduciary or service provider that failed or refused to provide any of the information necessary to complete Schedule C. In response to comments, DOL added a reminder in the Instructions to plan administrators that they should contact the fiduciary or service provider before listing them on Schedule C as failing or refusing to provide information.

Reporting for 403(b) Plans

Currently, 403(b) plans are exempt from a number of Form 5500 requirements that apply to other defined contribution plans. [10] As in the proposal, final Form 5500 removes these reporting exceptions previously available for Section 403(b) plans. Effective for plan years beginning on or after January 1, 2009, 403(b) plans covered by ERISA will be subject to the same reporting rules as other defined contribution plans. The Department notes in the preamble that small 403(b) plans will be eligible to file new Short Form 5500.
Attachment

Short Form 5500

The Department adopted new Short Form 5500 (Form 5500-SF) largely as proposed. Form 5500-SF is generally available for plans with fewer than 100 participants. To use 5500-SF, the plan must be eligible for the small plan audit waiver [11] other than by virtue of enhanced bonding, must hold no employer securities, must not be a multiemployer plan, and must have 100% of its assets in investments with a readily determinable fair market value. [12]

Schedules H and I

Mutual fund dividends. In response to a comment, DOL modified line 2b of Schedule H to break out dividends of registered investment companies from other dividends reported as income on the plan's income and expense statement.

Readily determinable value. In response to comments, DOL modified the Instructions to Line 4g of Schedule H to make clear that certain types of common plan investments, such as mutual funds and insurance company contracts, may be treated as having a readily determinable value.

Indirect compensation. DOL confirmed that the plan does not need to report on Schedule H (or Schedule I for small plans) compensation that is not paid directly by the plan.

Delinquent contributions and blackouts. Final Form 5500 makes clarifying modifications to reporting of delinquent contributions and blackouts on Schedules H and I.

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Attachment

endnotes

[1] Final Form 5500 is available here: http://www.dol.gov/ebsa/regs/fedreg/notices/20071116.pdf. A copy of the associated changes to DOL's regulations is available here: http://www.dol.gov/ebsa/regs/fedreg/final/20071116.pdf. Revisions to Form 5500 were proposed in July 2006. See Memorandum to Pension Members No. 45-06 [20216], dated July 25, 2006. The Institute commented on the proposal. See Memorandum to Pension Members No. 56-06 [20383], dated September 20, 2006.

[2] A few changes to Form 5500 will apply earlier, including reporting required by the Pension Protection Act for defined benefit plans. The PPA also mandated simplified reporting for plans with fewer than 25 participants and DOL created transition rules for simplified reporting using existing forms for the 2007 and 2008 plan years for these plans, as explained in more detail in the preamble. New Short Form 5500 will be implemented for the 2009 plan year.

[3] "Person" includes individuals, trades and businesses, whether or not incorporated.

[4] The preamble to final Form 5500 states that DOL intends to capture reporting not only of indirect payments to persons providing services to the plan, but also reporting of payments to persons providing services "indirectly" to the plan.

[5] Payments made by the plan sponsor that are not reimbursed by the plan are not subject to Schedule C reporting.

[6] Final Form 5500 expands the list of service codes, listing codes not only for types of services (e.g. investment management), but also types of payments (e.g. shareholder servicing fees).

[7] In a possible typographical error, part of this list is missing from the Instructions. The full list appears in the explanation in the preamble.

[8] This special exception for soft dollar payments appears only in the preamble and is not reflected in the Instructions.

[9] See 29 C.F.R. § 2510.3-101.

[10] Currently, a plan administrator of a 403(b) plan is not required to (1) engage an independent qualified public accountant to conduct an audit of the plan, (2) attach an accountant's opinion to Form 5500, or (3) attach any schedules to Form 5500.

[11] See 29 C.F.R. § 2520.103-1(d).

[12] The Instructions to Form 5500-SF confirm that shares of mutual funds qualify.
