The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 30071**

July 25, 2016

# Significant Changes Proposed for Form 5500 and Annual Reporting Requirements

[30071]

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TO: PENSION MEMBERS No. 20-16
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 22-16 RE: SIGNIFICANT CHANGES PROPOSED FOR FORM 5500 AND ANNUAL REPORTING REQUIREMENTS

Last week, the Department of Labor (DOL), the Internal Revenue Service, and the Pension Benefit Guaranty Association (collectively, the Agencies) released proposed changes to the Form 5500. The package includes proposed revisions to the Form 5500 and the Form 5500-SF (short form for small plans) and proposed regulations modifying the reporting rules (collectively, the Proposal). [1] If implemented as proposed, the changes would significantly increase the reporting obligations for all retirement and welfare plans.

According to the Agencies, the changes are designed to foster monitoring of benefit plans by employers, fiduciaries, participants, and (of course) the Agencies themselves; collect more data about health and welfare plans; enhance data mineability; provide more information about service provider fees to help fiduciaries evaluate their service arrangements; and enhance reporting on plan compliance.

The changes to the Form 5500 are proposed in conjunction with a "recompete" of the EFAST2 contract (i.e., the procurement process to retain a private-sector contractor to operate the electronic filing system). The Agencies contemplate that the changes generally would be effective for plan years beginning on or after January 1, 2019, with processing of the 2019 plan year forms under the new EFAST2 contract beginning in 2020—although certain changes may be implemented earlier. Comments on the Proposal are due on October 4, 2016. We encourage feedback from ICI members on comments that ICI should submit.

## Changes Affecting Health and Welfare Plans

The Proposal includes significant changes impacting health and welfare plan reporting, including, perhaps most significantly, the elimination of the exemption from the Form 5500 filing requirement for certain small (fewer than 100 participants) health and welfare plans. Other changes, however, would affect large plans as well. For example, a new Schedule J

would require reporting on claims' payment policies and practices, enrollment data, financial disclosures, denied claims information, cost sharing, and wellness activities. These changes are intended to enhance DOL's ability to enforce the Affordable Care Act and the Mental Health Parity and Addiction Equity Act.

## Changes Affecting Retirement Plans

Reflecting the shift from defined benefit to defined contribution pension plans, many of the proposed changes relate to defined contribution plans' investment offerings. As proposed, Form 5500 will include new questions for such plans, including whether a plan offers a default investment alternative, investment education, and Roth contributions.

Several new questions, however, will apply to all qualified retirement plans. For example, plans must specifically indicate whether they are invested in hard-to-value investments, such as derivatives, limited partnerships, hedge funds, private equity, real estate, and other alternative investments. Additional information regarding distributions to terminated participants will also be required. Similar changes will apply to Form 5500-SF for small plans.

New questions are also proposed for the schedules to Form 5500. For example, Schedule R will include new questions about participation rates and employer matching contributions to defined contribution plans, as well as compliance questions relating to nondiscrimination testing. Additionally, Schedule E for employee stock ownership plans, which was removed in 2009, will be reinstated. Perhaps most significantly, as described in greater detail below, Schedule C will require reporting of all indirect compensation received by covered service providers, and revisions to Schedule H include greater reporting granularity as well as a series of new compliance questions. The Agencies note that having access to this information in a data mineable format may be used for the Agencies' enforcement efforts and may enable them to target plans with likely compliance issues. We have described certain of the more consequential changes below.

### 1. Schedule C (Service Provider Information)

Proposed changes to the Schedule C are aimed at harmonizing the Schedule C reporting with the DOL's disclosure requirements under the 408b-2 regulations (fee disclosure from service providers to plan fiduciaries).

The Proposal would require a separate Schedule C for each service provider. The Proposal eliminates the concept of "eligible indirect compensation" used in the current Schedule C. [2] The Proposal would instead use the definition of "covered service provider" from the 408b-2 regulations, requiring a Schedule C for "(1) each covered service provider who received $1,000 or more in total direct and indirect compensation" during the plan year and "(2) other persons who received $5,000 or more in direct compensation in connection with services rendered to the plan or the person's position with the plan during the plan year, including payments from participants' accounts." This change will likely be helpful. For example, an advisor to a mutual fund that is solely an investment option under the plan and that is not providing other services such as recordkeeping would not need to report compensation on the Schedule C. [3] A number of new questions have been added to the form regarding the service provider arrangement. For example, it must be indicated for each service provider whether or not the provider was an ERISA fiduciary at any time during the plan year. [4] There are also new questions on whether the service provider arrangement included use of an ERISA recapture, ERISA budget, or similar account during the plan year, and whether the service arrangement involved any related party

compensation. [5]

Currently, indirect compensation can be disclosed on the Schedule C by describing the formula used to calculate the compensation. However, under the Proposal, a specific dollar amount must be reported. The change "would essentially require the pension plan administrator to report the actual compensation paid to or received by covered service providers based on the expected compensation included in the 408b-2 disclosures that the service provider furnished to the plan as part of the process of establishing and maintaining the service contract or arrangement with the plan." [6] The Proposal would allow any reasonable method of allocation to be used to estimate plan level fees for the Schedule C, provided the method is disclosed to the plan administrator. [7] While flexibility is appreciated, we would note that in some cases (for example in disclosing an amount of float) an actual estimated dollar amount will not be as meaningful as a formula in conveying the amount that will be received.

**2. Schedule H (Financial Information)**

The structure of the Schedule H is not changed by the Proposal, however, existing categories are proposed to be broken out into numerous subcategories, providing an extraordinary amount of detail about plan assets and investments. [8] The income statement in Part II, for example, is proposed to require a breakout of the administrative expenses, to list the total amount paid by the plan and the total amount charged directly against participant account (including details about how amounts are charged and apportioned). Fortunately, on the balance sheet in Part I, the current category for mutual funds ("value of interest in registered investment companies (e.g., mutual funds)") is not proposed to be further broken out, and is proposed to be listed as "Registered investment companies (Mutual funds, Unit Investment Trusts, Closed End Funds)."

Like the current Schedule H, the proposed Schedule H would include a schedule of assets held for investment at the end of the year (4i(1)) and a schedule of assets disposed of during the plan year (4i(2)). Currently, a number a number of assets are not required to be reported in this section, including interests issued by a company registered under the Investment Company Act of 1940. However, under the Proposal, the only assets excluded from the 4i(1) schedule are cash and cash equivalents. Like the breakouts in Parts I and II described above, this too will result in reporting of much greater detail of plan investments. Note that the comparative chart for fee disclosure required by DOL regulation 404a-5 must be attached to the Schedule H (or to the Form 5500-SF, if applicable).

The Proposal solicits new information about brokerage windows. A new category is added to the balance sheet in Part I of Schedule H to report the value of assets held in participant-directed brokerage accounts (with subcategories (A) through (G)). In addition, a new question is added regarding whether a brokerage window is made available and the number of participants that utilized the arrangement.

The compliance questions included in Part IV of the Schedule H have also been expanded. For example, the Schedule H asks a number of questions about checks to participants that remain uncashed, including the number and total value of the checks and the procedures followed by the plan relating to uncashed checks and "missing" participants.

**3. Small Plans**

Under current rules, small plans covering fewer than 100 participants: (1) may be eligible to

file the Form 5500-SF (Short Form Annual Return/Report of Small Employee Benefit Plan); (2) may file the simpler Schedule I (Financial Information – Small Plan); and (3) are not required to complete the Schedule C. The Proposal would eliminate the Schedule I, moving certain information from that schedule to the Form 5500-SF. However, any small plan that is not eligible to submit the Form 5500-SF [9] would be required to complete both the Schedule H and Schedule C.

**4. Limited Scope Audit**

Changes are also proposed to the "limited scope audit" rules, which impact the requirement that an opinion of the plan by an Independent Qualified Public Accountant be attached to the Schedule H. Under the statutorily provided "limited scope audit" rule, the auditor of the plan may rely on a certified statement "prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency". [10]

Under current rules, the Form 5500 includes a box that must be checked if the accountant performed a limited scope audit. DOL proposes to amend its regulations regarding limited scope audits by adding additional requirements and requiring the attachment of a certification created by the bank or insurance company. Under the Proposal, if the current value is not being certified for all assets covered by the certification, then the submission must include a caution "that the certification is not certifying current value information and the asset values provided by the bank or insurance company may not be suitable for use in satisfying the plan's obligation to report current value information on the Form 5500 Annual Return/Report." In addition, a new statement would be required "certifying that the person providing the certification is an authorized agent acting on behalf of the bank or insurance company and affirming that the bank or insurance company is taking responsibility for the accuracy and completeness of the certification and the underlying records used as a basis for the information being certified." [11]

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The Proposal, which would significantly increase Form 5500 reporting obligations for many employers, will have a significant impact on service providers tasked with providing the needed information—not to mention those who offer Form 5500 compliance services as part of their service offerings. In order to provide pertinent comments, which are due by October 4, 2016, we would appreciate receiving information on a variety of issues, such as the cost and feasibility of providing the detailed data required under the Proposal and the burdens associated with the proposed changes to the limited scope audit rules.

Shannon Salinas
Assistant General Counsel - Retirement Policy

**endnotes**

[1] The proposed regulation is available here: https://www.gpo.gov/fdsys/pkg/FR-2016-07-21/pdf/2016-14892.pdf. The proposed changes to the forms are available here: https://www.gpo.gov/fdsys/pkg/FR-2016-07-21/pdf/2016-14893.pdf. See also the DOL's fact sheet (available here:

https://www.dol.gov/ebsa/pdf/fs-proposal-to-modernize-and-improve-the-form-5500-filed-by-employee-benefit-plans.pdf), press release (available here: https://www.dol.gov/newsroom/releases/ebsa/ebsa20160711), and Technical Appendix describing the methodology used to calculate the burden of the proposed changes (available here: https://www.dol.gov/ebsa/pdf/documentation-of-the-methodology-used-to-calculate-the-burden-associated-with-the-proposed-form-5500-21st-century-initiative.pdf).

[2] Only a name and EIN or address is currently required for any service provider who received only eligible indirect compensation.

[3] See Section (c)(1)(iii)(D)(2) of the 408b-2 regulations, which explicitly excludes such individuals or entities from the definition of "covered service provider." 77 Fed. Reg. at 5655 (February 3, 2012).

[4] See question 1(d) of the Schedule C. Another new question related to the DOL fiduciary rule requires defined contribution plans to indicate whether they provide financial education and/or financial advice for participants. See question 9(a)(9) of the Form 5500.

[5] See line 1f and lines 4a and 4b.

[6] 81 Fed. Reg. 47534 (July 21, 2016) at 47551.

[7] A separate question (line 1(g)(1) and (2)) relates to recordkeeping services that are provided without an explicit compensation amount. For these arrangements, the same estimate used for the 408b-2 disclosure must be reported on the Schedule C, in order to "better enable a cost comparison in an environment where there are different fee structures and methods of calculating compensation."

[8] For example, the category in the current form, "Real estate (other than employer real property)" is proposed to be broken out into the following subcategories: (A) Developed real property (other than employer real property); (B) Undeveloped real property (other than employer real property; (C) Publicly traded Real Estate Investment Trusts; (D) Non-Publicly Traded Real Estate Investment Trusts; (E) Mortgage-Backed Securities (Including Collateralized Mortgage Obligations); (F) Real Estate Operating Company; and (G) Other real estate related investment (Describe). [47581

[9] According to proposed instructions for the Form 5500-SF in Attachment C, "To be eligible to use the Form 5500–SF, the plan must:

- Be a small plan (i.e., generally have fewer than 100 participants at the beginning of the plan year);
- Meet the conditions for being exempt from the requirement that the plan's books and records be audited by an independent qualified public accountant (IQPA);
- Have 100% of its assets invested in certain secure investments with a readily determinable fair value;
- Hold no employer securities;
- Not be a multiemployer plan; and
- Not provide health benefits."

[10] Note that the term "similar institution" as used here does not extend to securities brokerage firms (see DOL Advisory Opinion 93-21A).

[11] Additional requirements for this certification under new subsection (d) of the proposed regulation include the following:

1. Appear on a separate document from the list of plan assets covered by the certification;
2. Identify the bank or insurance company holding the plan's assets;
3. Describe the manner in which the bank or insurance company is holding the assets covered by the certification;
4. State whether the bank or insurance company is providing current value information regarding the assets covered by the certification in accordance with 2520.103–5, and if so, state that the assets for which current value is being certified are separately identified in the list of assets covered by the certification.

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