

# Are you Ready for Schedule C?

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The Department of Labor (DOL) is among those that have recently focused on the fees paid by 401(k) plans and plan participants. Plaintiff's attorneys and Congress are also interested in this topic. The concerns about fees include whether total fees paid under many 401(k) plans are unreasonable, a suspicion that plan fiduciaries and participants do not know the total fees nor understand how fees affect long-term investment returns, and a concern that fees paid to third parties may improperly influence advice from service providers to plan sponsors.

The DOL has recently introduced a revised Schedule C as part of the 2009 Form 5500, which requires new disclosures about fees paid to service providers of a plan. The schedule applies to all plans governed by ERISA, but the impact will be perhaps most visible for 401(k) plans, given the variety of ways that services to such plans are paid for with plan assets. The DOL considers this disclosure of fees as part of a fiduciary's ongoing responsibility to know, understand and monitor fees paid under a plan.

## *Why Does It Matter?*

Plan sponsors will likely find it more difficult than expected to gather information and determine how to report the necessary information. Sponsors who have previously relied on service providers to provide all of the necessary information for Form 5500 may need to be more involved with the Schedule C disclosures. Also, service providers will likely use a variety of methods to report information to plan sponsors and inconsistency should be expected. Some providers may cross reference fund prospectuses and service agreements as the source documents for fee disclosure. Given the significance of the changes to Schedule C, plan sponsors should start planning now for the information gathering and evaluation for the upcoming Form 5500. Finally, plan sponsors who do not receive the necessary information from service providers will need to decide whether the service provider has submitted sufficient information for the sponsor to rely on the transition rule for 2009 (discussed below under "Reporting of Unresponsive Providers").

## *Rules for Schedule C Reporting*

For reporting on Schedule C, plan sponsors will need to (1) identify each recipient of \$5,000 or more in direct or indirect compensation, and the total direct compensation received by such recipient during the year; and (2) list the amount of indirect compensation paid to such provider or state that the provider received eligible indirect compensation ("EIC"). The plans sponsor will also have to identify the relationship of any such service provider to the plan sponsor, a participating employer or to any other person who is a party in interest as defined under ERISA.

## *Reportable Direct or Indirect Compensation*

*Direct compensation* includes payments made by the plan for services rendered to the plan or associated with the plan and payments by a plan sponsor that are reimbursed by a plan. Included in direct compensation are payments from forfeiture accounts, fee recapture accounts, charges to the trust before allocations to participant accounts and charges to participant accounts.

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*Indirect compensation* includes compensation received from sources other than directly from the plan or plan sponsor. Indirect compensation should be included if the receipt of compensation is based in any way on transactions with the plan (revenue sharing, for example). If the compensation is EIC, the plan sponsor need not report the amount, although the plan sponsor must state that the provider received EIC. (Plan sponsors can check a box on Line 1 to use this alternative reporting for providers who receive only EIC.) EIC is fees or expense reimbursement payments charged to investment funds and reflected in the value or the plan's investment or the returns on the investment, finders' fees, soft dollar revenue, float revenue, brokerage commissions (including for self-directed brokerage windows) or other transaction based fees paid by the plan. Compensation is treated as EIC only if certain written disclosures are made to the plan. The plan sponsor must receive written disclosures identifying the indirect compensation, the services provided for or the purpose of the payment of indirect compensation, the amount (or estimate of) indirect compensation or formulas used to determinate the compensation, and the identity of the party paying and receiving the compensation. For a bundled arrangement, the disclosure must include separate disclosure and description of each element of indirect compensation that would otherwise be required to be reported absent this alternative reporting rule.

Specific reporting rules apply if a recipient of indirect compensation is included with the service providers listed as a recipient of \$5,000 or more of compensation from the plan, and such recipient is also a fiduciary to the plan or provides services to the plan as a contract administrator, consultant, investment management, securities brokerage or recordkeeping. Indirect compensation to such a provider must be reported if over \$1,000, or the plan was given a formula or other method used to determine the indirect compensation rather than the amount or an estimated amount of the indirect compensation.

Another area for plan sponsor attention is the indirect compensation provided to the employees of the plan sponsor due to such employee's position with the plan. If service providers to the plan in turn provide gifts, meals, free education conferences, etc. to an employee of the plan sponsor, such compensation is reportable if the employee's direct and indirect compensation related to the plan exceeds \$5,000 (compensation for this purpose does not include an employee's salary that is paid by the plan sponsor and not reimbursed by the plan). Plan sponsors will need to track such indirect compensation to ensure compliance. (If the plan sponsor is reimbursed by the plan for an employee's salary, such salary becomes direct compensation and, if over \$5,000, all indirect compensation received by the employee is reportable.)

### ***Bundled Arrangements***

The direct payments to a bundled service provider must be reported as such. The direct fees do not have to be allocated among affiliates or subcontractors. Revenue sharing within the bundled group is not separately reported with two exceptions. First, the fees charged to investments and reflected in the net value of the investment must be treated as separate reportable compensation to the person receiving the fees or under the reporting rule for EIC discussed above. Second, separate reporting is required for fees to fiduciaries or any of the following types of services providers: contract administrator, consulting investment advisory, investment management securities brokerage, or recordkeeping and the compensation is for commissions and other transaction fees, finder's fees, float, soft dollar and other non-monetary compensation.

### ***Reporting of Unresponsive Providers***

Plan sponsors must report all service providers who refuse to provide any of the information necessary to report the information under basic rules above. The DOL has provided a transition rule for 2009 if a plan sponsor is dependent on the service provider to obtain the required information. The transition rule delays the reporting of service providers who have not provided the necessary information for Schedule C for 2009 if the plan sponsor receives a statement from the service provider that states (1) good faith efforts were made by the provider to complete the

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necessary changes to its recordkeeping and information systems and (2) despite such efforts, the service provider was unable to complete the changes for the 2009 plan year and as a result the service provider was unable to provide the information necessary for Schedule C. The DOL requires service providers to share information it has available about reportable compensation with plan sponsors and provide plan sponsors with steps being taken to ensure that the required information will be provided for future Form 5500 filings.

### ***Additional Considerations***

Additional considerations affecting reporting fees received by service providers include:

- Plan sponsors must report insurance company fees netted against returns.
- Plan sponsors who receive estimates of fees or formulas to determine fees should consider assuming fees exceed \$5,000 and are included in Schedule C.
- A service provider's free attendance at a conference, payments for meals, hotel, transportation, tickets to events (sporting or entertainment) are all reportable indirect compensation. Such free attendance and educational expenses paid on behalf of a plan representative need not be reported if a plan fiduciary other than the attendee has approved the conference attendance consistent with the DOL rules (i.e. conference must be pre-approved as a prudence exercise, consistent with a written plan policy, etc. See Q/A 4, Supplemental FAQs About the 2009 Schedule C from the DOL.)
- Promotional gifts of little value generally need not be reported as indirect compensation (coffee mugs, calendars, etc.). Non-monetary gifts of less than \$50 in value (\$100 in the aggregate from one source) need not be reported. (Gifts valued at less than \$10 need not be considered.)
- A limited partnership's hedge fund is treated as an investment fund, even if plan assets are less than 25% of the hedge fund assets. Consequently, fees paid from the fund to the fund's advisor for managing the fund's investments are reportable indirect compensation.
- Contingent deferred sales charges and surrender/termination fees are reportable. Market value adjustments generally are not.

### ***Plan of Action***

Plan sponsors should begin discussions with all providers of services to ERISA covered plans and request information about what fee information can be expected from the provider and when. Sponsors should consider reviewing plan disbursements or reimbursements to identify recipients of direct compensation. Based on the Form 5500 filing date, plan sponsors should establish a deadline for receipt of fee information from providers and communicate that deadline to providers. Sponsors may want to develop a tracking system for providers who must provide fee information, what information is provided, what is outstanding and expected dates of receipt of information, including statements required to avoid reporting provider failures as discussed under the 2009 transition rule or for alternative reporting of eligible indirect compensation.

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