

Form 5500/ERISA 408(b)(2) Proposed Regulations Webcast

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Introduction

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- To aid plan fiduciaries and participants in assessing reasonableness of compensation paid to service providers and potential conflicts of interest, DOL has finalized/proposed the following:
 - Form 5500 Schedule C rules - [FINAL]
 - Regs under ERISA Section 408(b)(2) - [PROPOSED]
 - Regs with respect to self-directed individual account plan fees – [PROPOSED]
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Form 5500 Schedule C Fee Disclosure

Background: Before & After

- *BEFORE:* Direct compensation reporting; not indirect compensation
- *AFTER:* *Both direct & indirect compensation reporting*

- *BEFORE:* Disclose fees concerning plan's 40 highest-paid service providers
- *AFTER:* *Persons receiving \$5,000 or more in reportable compensation for a particular transaction or service*

- *BEFORE:* Discretionary brokerage commissions
- *AFTER:* *Both discretionary and non-discretionary brokerage commissions*

- *AFTER:* *Identify service providers who fail to provide necessary information*

Background: New Rules

- What this all means:
 - Obligation on plan administrators to collect information from service providers
 - Greater burden on plan administrators and plan service providers
 - Potential follow-up by DOL with respect to service providers listed as not providing necessary information

Background: Timing

- New Schedule C requirements begin for the 2009 plan year (2010 filings)
- Service providers need to address ability to comply
 - *Service provider good faith effort grace period (FAQ 40)*
 - Statement that made a good faith effort, and
 - Despite such effort, unable to make necessary changes to systems

What Is Considered “Reportable Compensation” under the New Rules?

DOL Definitions

- “Reportable compensation” includes money and any other thing of value that a service provider receives directly or indirectly from the plan.
- What is a service provider under the rules?
 - Initially, considered to be broad but DOL tried to limit it with guidance under FAQs
 - Certain investment service providers excluded (FAQ 4)
 - Operating company fees excluded (FAQ 7)

Examples

- Direct compensation (i.e., payments made directly by the plan for services rendered to the plan)
- Indirect compensation includes:
 - Gifts, awards, trips
 - Investment management fees
 - Custody fees
 - Rule 12b-1 fees
 - Finder's Fees
 - Float income (FAQ 11)
 - Brokerage commissions
 - Soft dollars
 - All transaction-based fees received in connection with transactions or services involving the plan, whether or not capitalized as investment costs
- Payments by plan sponsor excluded (FAQ 37)

“Open Brokerage” Windows

- “Open brokerage” windows allow plan participants to invest in multiple investments through a designated broker for the brokerage window.
 - Schedule C reporting can be limited to direct and indirect compensation received by the designated broker(s) and other brokerage window providers (FAQ 5)
 - Each investment purchased through the window does not have to be analyzed

Gifts, Meals & Entertainment

- Gifts, meals, and entertainment are considered indirect compensation for plan reporting purposes
 - \$50/\$100 *de minimis* threshold (FAQ 34)
- Allocations between ERISA/non-ERISA accounts (FAQ 35)
- Educational conferences (FAQ 33)
- DOL treats these disclosures seriously

Service Provider Estimates

- Service providers may use a formula for reporting indirect compensation to plan administrators (FAQ 24)
 - Including indirect compensation that is not “eligible indirect compensation”
- Service providers that provide an estimate of their indirect compensation may use any reasonable method, as long as the method is disclosed along with the estimate (FAQ 27)



Special Reporting Rules



Special Reporting Rules

- Final instructions to new Schedule C provided reporting relief for:
 - Bundled Service Arrangements
 - Eligible Indirect Compensation
- Applicability and scope of rules were uncertain
- FAQs address a wide range of questions about complying with these new requirements

Bundled Service Arrangements

- Bundled service arrangements include any service arrangements where the plan hires one company (the “bundle provider”) to provide a range of services directly from the company, through affiliates or subcontractors, or through a combination, which are priced to the plan as a single package (FAQ 13)
- May include proprietary and certain alliance arrangements
- Generally only need to report amounts paid to the bundle provider, with certain exceptions
- Two major exceptions include (FAQ 14):
 - Separate fees charged against the plan’s investment (e.g., commissions, soft dollars, float income)
 - Certain compensation received by providers in the bundle who are conflict-of-interest sensitive

“Eligible Indirect Compensation”

- Plans are permitted to report less information on Schedule C for “eligible indirect compensation”
- “Eligible indirect compensation” may include:
 - Distribution fees
 - Investment management fees
 - Recordkeeping or shareholder service fees
 - Finder’s fees
 - Float income
 - Brokerage commissions
 - Soft dollars (proprietary and non-proprietary research) (FAQ 39)
 - Investment funds and separately managed investment accounts of a single plan (FAQ 3)

“Eligible Indirect Compensation” (Cont.)

- Must satisfy certain written disclosure requirements
- Disclosure need not be made by the recipient of the eligible indirect compensation (FAQ 18)
- Can use separate disclosures from multiple parties, including investment management agreements, SEC Form ADVs or prospectuses (FAQ 29)
- Electronic disclosure can satisfy the “written” requirement (FAQ 30)

Investment Funds

Investment Funds

- Not all fees and expenses charged against an investment fund are considered indirect compensation (FAQ 4)
 - Includes:
 - Investment advisers' asset-based fee
 - Fees related to the purchase/sale of interest in investment fund (such as 12b-1 fees, finder's fees and brokerage)
 - Participant communication materials
 - Excludes (other operating expenses):
 - Legal/accounting fees
 - Printers' fees

- Fees received by third parties from "operating companies" in connection with managing or operating the company are generally not reportable as indirect compensation (FAQ 7)
 - Venture Capital Operating Company (VCOC)
 - Real Estate Operating Company (REOC)

Proposed Rules under ERISA Section 408(b)(2)

ERISA Section 408(b)(2)

- Broad exemption
- Proposed Regs: No contract for services will be considered “reasonable” unless it is in writing and requires the service provider to make specific disclosures to the plan
- Still in Flux

408(b)(2) Disclosures

- Compensation & Services Disclosures
 - Specific compensation/services
 - Fee calculation/method
 - Representation that disclosure is complete/accurate

- Service Provider Relationship Disclosures
 - “Fiduciary” identification
 - Financial or other interest in any transaction that the plan will be involved with in connection with the contract or arrangement
 - Relationships with other parties that may result in a conflict of interest
 - Identification as to whether the service provider can alter its receivables from the plan without the prior approval of the plan fiduciary (e.g., float income) as well as a description of the nature of this compensation
 - Indication as to whether the service provider possesses any processes to manage real or potential conflicts of interest

Other Implications

- Service providers to non-plan asset vehicles are not ERISA “parties in interest.”
- IRAs and Keoghs not subject to 408(b)(2).

Recent DOL and SEC Guidance

Gifts and Gratuities/ DOL Enforcement Guidelines

- Receipt by a fiduciary of gifts/gratuities and other consideration in connection with plan transactions could violate ERISA Section 406(b)(3)
- 406(b)(3) does not have a *de minimis* factor
- DOL Enforcement Guidelines provide some baseline rules for:
 - Receipt of certain payments by a fiduciary
 - Reimbursement of certain expenses to a plan
- Of note, it appears that plans should maintain a written policy for gifts/gratuities and plan fiduciaries will need to monitor

SEC & DOL Communication

- Memorandum of Understanding between SEC & DOL
- Signals greater communication between regulatory agencies
- Of note, the exchange of SEC examination-related information concerning investment advisers



Questions?

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