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The Time Is Now: Are You Ready for the New LM-10 Reporting Requirements?

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Investment advisory firms that provide financial or other services to Taft-Hartley funds¹ should be well aware of the industry backlash at guidance issued last year by the Department of Labor (DOL) that requires service providers to make annual reports of the types of expenditures traditionally made to court and maintain relationships with unions and union-affiliated pension and welfare trusts. The news is that the guidance was confirmed late last year, and there are steps toward compliance that firms should take right now.

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For advisory firms that operate on a calendar year, the LM-10 report for fiscal year 2005 must be filed by March 31, 2006, meaning that by the time this article goes to press, about half of the time allotted to collect and compile the report will have passed, and there are no extensions. The good news is that the DOL has relaxed some of the requirements for new filers for a timely filing for 2005, so it is still possible to make a reasonable good faith effort to comply with the relaxed reporting requirements in the time that remains. Advisory firms with fiscal years other than the calendar year will have 90 days from the end of the fiscal year that began in 2005 to file the applicable LM-10 report.

The dilemma that remains is that advisory firms that operate on a calendar year are already well into their 2006 fiscal year, still without procedures in place to track and maintain records relevant to the Form LM-10. It is unlikely that the DOL will make further transition relief available for the 2006 filing. Therefore, a decision needs to be made quickly to assess and gain control of current expenditures, balancing legal risk and client relations, and to establish appropriate policies and procedures going forward.

The time is now; read on to see what is required to comply with the new LM-10 reporting requirements.

Is This Really a New Requirement?

The LM-10 reporting requirements are not really new at all, but their application to financial and other service providers is certainly in the news. The Labor-Management Reporting and Disclosure Act (LMRDA), also known as the Landrum-Griffin Act, requires employers to make annual disclosures to the DOL's Office of Labor-Management Standards (OLMS) of nearly all payments they make to unions, union officials, union employees, union agents, and labor relations

consultants, using Form LM-10.² While this reporting requirement has been in place for employers for over 40 years, the DOL has not historically taken an aggressive approach to enforcement.

More recently, the DOL issued guidance confirming the broader meaning of the term “employer” under the LMRDA that includes financial and other service providers with at least one employee. This is true regardless of whether the service provider has employees represented by the union in question or, for that matter, any union. Under this broader application, a covered service provider must file an LM-10 if it has given any “thing of value” to a union, union official, union employee or union agent, *including trustees of Taft-Hartley funds* who are also union officials.

What Payments Must Be Reported?

A broad range of payments are potentially covered by the LM-10 reporting requirements, including:

- Meals (*e.g.*, lunches and dinners)
- Travel expenses and/or reimbursements
- Gifts
- Tickets to sporting or other entertainment events
- Products or services
- Social events/parties
- Fees paid to attend union-sponsored events
- Payments to charities (other than direct payments to organizations qualified under section 501(c)(3) of the Internal Revenue Code (Code))

With the exception of certain payments or loans in the regular course of business by an insurance company or credit institution, payments to unions or union officials are reportable unless they fall within a newly formulated *de minimis* exception. The new *de minimis* test is twofold, requiring both that (i) the total value of payments provided to any one union, union officer, union agent, or union employee is \$250 or less in any fiscal year and (ii) the payment is unrelated to the recipient’s status in the labor organization (generally depending on whether or not the advisory firm normally provides such payments to similarly situated individuals who are not union officials). All covered payments are reportable if the \$250 threshold is exceeded.

The good news is that the \$250 limit applies separately to each union official. The bad news is

that a separate running total will have to be kept for each union official. It is noted that the new rule raised the *de minimis* amount from \$25 to \$250, which offers advisory firms some leeway to make small expenditures and offer hospitality not subject to reporting, such as providing coffee and donuts at monthly meetings. The new rule also eliminated the requirement that payments only be made occasionally.

Because there is no single right way to calculate the value of meals and other reportable events, it is important to establish defensible procedures for how payments or benefits are estimated and/or allocated to each individual. Note that certain overhead costs, such as use of a conference room or audio visual equipment for a presentation, are not reportable.

What if Payments Are Made Out of an Employee’s Personal Funds?

In limited circumstances, payments out of an employee’s personal funds are not reportable. However, if the answer to any of the following questions is yes, the gift or expenditure is reportable: (1) does the employee hold a key position in the advisory firm, such as a manager; (2) is it within the employee’s job responsibilities to generate or maintain business relationships with unions or affiliated trusts; or (3) is the employee acting, directly or indirectly, for the advisory firm in making the payment (*i.e.*, could he have received reimbursement for the payment, even if he did not)?

What Is Required to Comply for 2005?

LM-10 reports for fiscal years beginning on or after January 1, 2005, are due within 90 days of the close of the fiscal year. This means that for service providers operating on a calendar year basis, the LM-10 report for 2005 is due on March 31, 2006. But, even with the impending deadline, there is still time to comply—the consequences for non-compliance are considerable.

Consider assigning the task of LM-10 compliance to an individual or group already familiar with existing procedures for the internal processing of business expenditures. Applicable records that should be collected include vouchers, worksheets, receipts, and applicable resolutions. Also consider searching electronic data bases and using communications to managers and supervisors to solicit additional information. Applicable records

must be retained for a period of at least five (5) years after the relevant report has been filed.

When actual records are not available, procedures should be established for making good faith estimates. In compiling the report, the responsible parties should use the explanatory language section on the LM-10 report to explain and caveat any such estimates, as appropriate. Any estimates should be based on consistent, defensible positions. It may make sense to involve internal or external legal counsel in collecting and reviewing information concerning potentially reportable payments, to make sure that any privileges that may attach to such information are protected.

Finally, respective unions or union officials should be apprised of the expenditures to be reported, particularly with respect to any good faith estimates that advisory firms have made, so that they can make a corresponding report of the payments on their Form LM-30.³

Special Transition Rules for 2005

Under a special enforcement policy and grace period, new filers of Form LM-10 can take advantage of modified signature and attestation requirements and are not required to submit reports for fiscal years beginning prior to January 1, 2005 (absent what the OLMS refers to as “extraordinary circumstances”), provided that their reports for the first fiscal year beginning on or after January 1, 2005, are *filed on time*. Otherwise, the DOL may seek reports for the five prior years. “Extraordinary circumstances” under which the OLMS may require a new filer to submit reports covering the same financial interest for previous years include the existence of an ongoing investigation relating to the financial interest and evidence of egregious conflicts of interest or outright attempts to purchase official favors.

Ordinarily, the Form LM-10 must be signed under penalty of perjury by the president and treasurer of the advisory firm. For initial reports for the first fiscal year that began in 2005, the DOL will accept the advisory firm’s diligent and good faith attempt to identify and disclose covered transactions, and will permit the signatories to strike out the “under-penalty-of-perjury” attestation and substitute modified language provided by the DOL. In addition, the advisory firms may authorize the key officials who supervised or conducted the good faith search to sign the Form LM-10, in lieu of the president and treasurer.

What Is Needed to “Catch Up” for 2006?

The key to 2006 is to quickly assess and gain control of current expenditures, while the advisory firm establishes appropriate policies and procedures. To begin with, firms may wish to place a moratorium on all covered payments and gratuities, or require internal approval of covered expenditures, at least until appropriate recordkeeping systems have been devised. For many advisers, however, this type of business entertainment expenditure is a crucial component in attracting and retaining union business. Thus, depending on how the union officials react to the new appreciation of these rules, it may be necessary for the advisory firm to allow payments and gratuities to continue, but with certain considerations in mind.

The information contained on the LM-10 report implicates other statutes with potential penalties, including federal criminal provisions and prohibited transactions under the Employee Retirement Income Security Act (ERISA). For example, Section 406(b)(3) of ERISA and Code Section 4975 preclude fiduciaries of plans from receiving payments from third parties in connection with transactions involving assets of the plan. Although liability generally falls on the fiduciary, applicable case law allows for non-fiduciaries who participate in a prohibited transaction to be subject to enforcement, such as rescission of the transaction. Another example can be found under Section 302 of the Labor-Management Relations Act (LMRA), which prohibits payments to union officials, except where specifically allowed by the statute. Lastly, Section 18 U.S.C. 1954 makes it unlawful to make payments to or confer benefits on employee benefit plan officials, including Taft-Hartley funds, if the intent is to influence the decisions of the plan official.⁴ While the advisory firm should already have policies and procedures in place to ensure that its business entertainment expenditures comply with applicable law, the added LM-10 reporting requirement makes imperative a review of existing policies.

Furthermore, LM-10 disclosures are available to the public and may be compared to LM-30 union reports. Some union trustees may not be entirely comfortable with their business lunches and outings becoming a matter of public record. It is important to know the client, and prohibit or cap expenditures accordingly.

Regardless of the approach selected, it makes sense to implement tighter controls and authorization requirements for union-related business entertainment expenditures, and to implement

good recordkeeping practices. In developing a strategy for 2006 and beyond, consider the following suggestions:

1. *Build on Existing Systems.* In developing a tracking system, consider how existing electronic or paper expense tracking systems might be modified, to gain efficiency and economy.
2. *Create an LM-10 Task Force.* Assign responsibility for collecting the data and compiling the report to individuals or a group already familiar with the advisory firm's procedures for processing business expenditures. Provide the task force with the authority and resources to investigate potentially problematic expenditures, as well as access to legal counsel.
3. *Collect Data Frequently.* Determine how often expense information is collected. It may facilitate year end reporting to gather expense information quarterly, or even monthly, depending on the volume. Periodic data collection would also provide the opportunity to evaluate any potentially problematic expenditures in a timely fashion, and increase the chances that valuable supporting documentation will not have been discarded.
4. *Communicate.* Once established, new policies and procedures must be communicated to sales representatives, and other affected employees, as well as to clients, including any union-specific prohibitions or caps.
5. *Evaluate.* Finally, conduct periodic internal audits of recordkeeping policies and procedures, to ensure and document compliance. Remember that applicable records must be retained for a period of at least five (5) years, and there is always the potential for a DOL audit.

There remains the dilemma that calendar year 2006 is already well underway and reports for fiscal years commencing on or after January 1, 2006, are required to be signed with an unaltered attestation by the advisory firm's president and treasurer or corresponding principal officers, despite the fact that records may not have been contemporaneously maintained for the first part of the year. How to resolve this problem largely will depend on the ability to compile accurate and actual records for that time period.

What Happens if We Miss the Filing Deadline?

The failure to comply with the LMRDA's reporting requirements can result in criminal penalties, including personal liability for the advisory firm's president and treasurer (or other corresponding principal officers), both of whom are required to sign LM-10 reports. The statutory penalty is a maximum fine of \$10,000 or imprisonment for not more than one year, or both.

What Should Be Done Now?

The best course of action for fiscal years beginning in 2005 is to: (1) delegate responsibility for collecting and compiling information; (2) compile actual data if possible and otherwise make good faith estimates; (3) develop consistent defensible positions regarding any estimates; (4) make good use of the explanatory language section on the LM-10 report; (5) consider privilege issues; and (6) communicate with clients.

For fiscal years beginning in 2006 and beyond, it is important to: (1) assess and gain control of current expenditures; (2) establish policies and procedures for record collection, compilation, and retention; (3) determine what, or to what extent, covered payments and gratuities will be permitted; (4) communicate new policies and procedures to sales representatives, other affected employees, and clients; and (5) conduct periodic internal reporting audits.

Above all, for any fiscal year for which a report is required, be certain to file the LM-10 *on time*. Remember, a timely initial filing for fiscal years beginning in 2005 can effectively eliminate filing obligations for prior years.

No one really knows at this point what the DOL is planning to do with these reports, or how closely they will be examining the 2005 reports. In addition, further rulemaking is expected with regard to the LM-30 requirements which, for example, do not include the new \$250 *de minimis* exception applicable to the LM-10. Nevertheless, the expectation among practitioners in this area is that the DOL will continue to zealously enforce reporting obligations under the LMRDA, and that service providers can anticipate heightened compliance expectations in future years. Therefore, it makes sense to dedicate the time and resources necessary to develop comprehensive policies and procedures *now*.

Notes

1. A Taft-Hartley Fund is an employee pension or welfare benefit trust fund sponsored by a joint board of employer (management) and employee (union) trustees, the name of which is derived from the Taft-Hartley Act (also known as the Labor-Management Relations Act of 1947.)
2. The DOL has noted on its Web site that the LMRDA covers unions representing US Postal Service employees, and is applied to unions representing employees in most agencies of the executive branch of the federal government. The LMRDA does not cover unions comprised solely of state and local government employees.
3. Union officers and union employees who receive “things of value” from an employer must disclose covered payments on Form LM-30. The LM-30 report must be filed with the OLMS within 90 days of the close of the union’s fiscal year. Thus, for unions operating on a calendar year basis, the LM-30 report for fiscal year 2005 is due by March 31, 2006. While the DOL offered a grace period for new LM-30 filers with respect to fiscal years beginning in 2004, no such extensions are being made available to LM-30 filers for 2005.
4. *See also*, U.S. v. Kirkland, 330 F.Supp. 2d 1151 (D. Ore. 2004).

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