

CLIENT ACTION BULLETIN

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CAB 08-17

FAQs about Schedule C Fee Disclosures for Defined Contribution Plans

SUMMARY

The Department of Labor's Employee Benefits Security Administration recently issued new guidance for benefit plan sponsors—in the form of 40 frequently asked questions (FAQs)—about new fee disclosures that will have to be made on Schedule C of the annual Form 5500. The new Schedule C fee disclosure requirements apply to large pension and welfare benefit plans that pay their service providers at least \$5,000 (in direct or indirect compensation) and that have 100 or more plan participants. The new Form 5500, which was finalized in November of last year, is effective for 2009 plan years, which means it must be filed (electronically) by the end of July 2010 for calendar-year plans, or by the end of the seventh month after the plan year ends.

Although the Schedule C must be filed by large pension and welfare benefit plans, the FAQs address issues that will be of most interest to defined contribution plans, such as 401(k) and 403(b) plans, because such plans often have a variety of complex fee arrangements—both direct and indirect—with their service providers (e.g., asset managers, broker-dealers, and third-party administrators).

DISCUSSION

Background

Schedule C is designed to help plan fiduciaries ensure that they are acting in the best interests of their plan participants. One goal is for plan sponsors to understand the amounts they are paying to service providers out of the plan's assets (and therefore out of the retirement assets of their plan's participants). With the new Schedule C, plan sponsors should get a better idea of what the plan's investment options and plan services actually cost. In addition, plan sponsors should be better able to identify service providers whose recommendations are tainted by conflicts of interest. Nevertheless, even with the promise of greater fee transparency, plan sponsors face challenges in determining whether plan expenses are fair (or within acceptable parameters for particular services), because no central repository currently exists that pulls together this pricing information.

Defined contribution plan fee arrangements tend to be extensive, with service providers often having another set of fee arrangements among themselves and with their own service providers (or subcontractors). The new Schedule C requires plan sponsors to classify the fees they pay service providers as either "direct" or "indirect" fees. The FAQs provide examples and guidance so that plan sponsors can divide indirect payments into "eligible indirect payments" and "noneligible indirect payments." These definitions have added significance because plan sponsors that only make "eligible indirect payments" to service providers may submit a less exhaustive, alternative Schedule C report.

Direct and Indirect Service Provider Fees

Plan sponsors and their service providers need to determine whether the fees they pay and receive, respectively, are "direct" or "indirect" fees. They also must determine whether any indirect fees are "eligible" or "noneligible." Beginning with the 2009 plan year, service providers will be required to supply plan sponsors the fee information for alliance arrangements, where different providers jointly offer a package of multiple services. If they fail to do so, plan sponsors will be required to note on Schedule C the name of the service provider and the nature of the missing information.

- **Direct fees.** Plan payments made directly to a service provider for services rendered to the plan are considered direct fees or compensation.

- **Reportable indirect compensation.** This term is defined as a fee paid to a service provider from another plan fee source. According to the FAQs, a person will be considered to receive indirect compensation for Schedule C reporting purposes if his or her eligibility for a 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.

In the case of charges against an investment fund, reportable indirect compensation includes, for example: the fund's investment adviser's asset-based investment management fee from the fund; fees related to purchases and sales of interests in the fund (including 12b-1 fees); brokerage commissions and fees charged in connection with purchases and sales of interests in the fund; fees for providing services to plan investors or plan participants, such as communication and other shareholder services; and fees relating to the administration of the employee benefit plan, such as recordkeeping services, Form 5500 filing, and other compliance services. However, reporting for open-brokerage windows in self-directed 401(k) plans is limited to reporting transaction fees and compensation paid to brokers.

Moreover, indirect compensation is deemed "eligible" if it is a fee or expense reimbursement payment charged to an investment fund and is reflected in the value of the plan's investment or return on investment. To qualify as "eligible indirect compensation," the plan administrator must receive a separate written disclosure detailing the services provided, the indirect compensation arrangement's formula or dollar amount (or estimate), and the identity of the parties paying and receiving the compensation. (This disclosure can be provided by a third party.)

- **Nonreportable indirect compensation.** Amounts charged against the fund for ordinary operating expenses such as attorneys' fees, accountants' fees, and printers' fees, are not reportable indirect compensation for Schedule C purposes.

Alternative Schedule C Option for Some Service Providers

A simpler Schedule C disclosure is an option for any service provider that receives "eligible indirect compensation" *exclusively*. Plan sponsors only have to disclose the name, address, and EIN of these service providers, who in turn must furnish a separate fee disclosure to the plan sponsor. They are exempt from disclosing the more in-depth information required of service providers who receive either direct or noneligible indirect compensation.

Plan sponsors must explicitly disclose fees on the Schedule C paid to bundled service providers if: (i) persons are receiving asset-based fees, such as revenue sharing for recordkeeping or compliance services; or (ii) the compensation received is commission or transaction-based and directed to certain investment management or administration providers. If a mutual fund pays a fund agent exclusively eligible indirect compensation and the agent, in turn, pays fees to an unaffiliated recordkeeper for compliance services, the fees paid to the recordkeeper need to be disclosed on Schedule C. Similarly, broker-dealer alliances with recordkeeping services must be disclosed.

Service providers who receive *noneligible* indirect fees of \$1,000 or more for consulting, contract administration, custodial services, investment advice, investment management, brokerage, or recordkeeping services must disclose information for Schedule C regarding their type of service and amount of indirect compensation (or compensation formula).

ACTION

Plan administrators have a fiduciary duty to fully understand their plan's various fee arrangements so they can judge whether those arrangements are in the best interests of the plan participants. Plan sponsors and their asset managers and other service providers would be well advised to begin conferring now on how to capture and report their fee arrangements to lay the groundwork for Schedule C filings for the 2009 plan year and beyond.

For more information on the new Schedule C disclosures or Form 5500 filing requirements, please contact your Milliman consultant.