

THE WAGNER LAW GROUP

A PROFESSIONAL CORPORATION

Legal Updates in the ERISA & Employee Benefits World

ERISA, Employee Benefits and Executive
Compensation Law

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This has been a very busy year for pension plan matters. This Newsletter is intended to provide you with a solid overview of the legal changes affecting tax-qualified and 403(b) plans, the new requirements, and how to properly address them.

If you have any questions or seek our counsel, please contact any of The Wagner Law Group attorneys, specialists in ERISA, employee benefits and executive compensation law.

To learn more about our team and practice, please visit our website at www.erisa-lawyers.com.

Best regards,

Marcia Wagner

Tax -qualified and 403(b) Plans

IRS Determination Letter Program for Tax-Qualified Retirement Plans

As discussed in our previous Newsletters, the IRS processes applications for determination letters using a staggered five-year system. A determination letter is the method by which a plan sponsor seeks the Internal Revenue Service's approval that the form of a plan complies with all legal requirements. Under this system, each individually designed retirement plan is assigned to one of five "cycles" (12-month periods starting on February 1 and ending the following January 31) based upon the last digit of the sponsor's federal employer identification number ("EIN"). These cycles are as follows:

<i>EIN ends in:</i>	<i>Cycle:</i>	<i>First day of cycle:</i>	<i>Last day of cycle:</i>
1 or 6	A	February 1, 2006	January 31, 2007
2 or 7	B	February 1, 2007	January 31, 2008
3 or 8	C	February 1, 2008	January 31, 2009
4 or 9	D	February 1, 2009	January 31, 2010
5 or 0	E	February 1, 2010	January 31, 2011

The initial Cycle A, Cycle B, Cycle C and Cycle D have closed. If your EIN ends in a 1, 2, 3, 4, 6, 7, 8, or 9 and you sponsor an individually-designed qualified retirement plan that was not submitted for a determination letter during the applicable period, please contact our office as soon as possible to discuss your options.

The first round of cycles will end on January 31, 2011, when the current cycle, Cycle E, ends. If your EIN ends in a 5 or 0, your individually-designed qualified retirement plan will have to be submitted for a determination letter by January 31, 2011.

There are two additional groups of plans that might have to be submitted for a determination letter by January 31, 2011:

- o An election could have been made by members of a controlled group that maintain more than one plan for the group to defer the determination letter filings for all of the plans sponsored by the members of the controlled group until Cycle E.
- o A plan sponsor of a Cycle D plan whose first plan year beginning on or after



Marcia Wagner

Published Article

Here is a recent article that Marica wrote:

"An Overview of Health Care Reform With Recommended Action Steps to Take," *BNA Pension and Benefits Reporter*, July 29th

Recent Television Appearance

Marcia appeared on NECN where she discussed alternatives to 401(k) plans on August 4th.

Click here to watch the interview: Poor Man's Pension

Recently Presented Seminars & Papers

Here is a list with links to seminars, webinars and papers that Marica has recently presented.

"What is New in DC: The Most Critical Items to the Obama Administration," 401(k) Coach Program Year 1 Session 3 Webinar, July 14th

"Advisory Committee on Tax Exempt and Government Entities (ACT)," IRS/ASPPA Northeast Area Benefits Conference, July 12th in Boston

Click here for the [ACT Report](#)

Quoted Articles

Marcia has been quoted in a number of publications.

"New Rule Could Reduce 401(k) Fees," **CBS MoneyWatch.com**, July 19th

"Retirement Plan Providers to Disclose Compensation," **Chicago Breaking Business - Tribune**, July 14th

"IRS Advisory Committee Recommends Changes To

January 1, 2009 ended or ends on or after February 1, 2010, could have deferred submitting its plan until Cycle E and still be treated as having been filed within the plan's EGTRRA remedial amendment period. Such a plan will be treated as a Cycle E plan solely for the initial cycle, and all subsequent submissions will be made in Cycle D.

The next round of cycles will begin February 1, 2011, when the second Cycle A opens. These cycles will begin and end as follows:

<i>EIN ends in:</i>	<i>Cycle:</i>	<i>First day of cycle:</i>	<i>Last day of cycle:</i>
1 or 6	A	February 1, 2011	January 31, 2012
2 or 7	B	February 1, 2012	January 31, 2013
3 or 8	C	February 1, 2013	January 31, 2014
4 or 9	D	February 1, 2014	January 31, 2015
5 or 0	E	February 1, 2015	January 31, 2016

Because this firm, and more importantly the IRS, believes that having a current determination letter represents a best practice for all plan sponsors, we strongly recommend that we apply on behalf of our clients for updated determination letters during the appropriate cycle. The determination letter system anticipates that plans will file for a new determination letter only once every five years, but plans must still be amended from time to time as the law and regulations governing tax-qualified plans change.

Note: Marcia Wagner was the Chairperson of the Employee Plans section of the IRS Advisory Committee on Tax Exempt and Government Entities, and in such position, was lead author of a report to the IRS which recommends significant changes be made to this Cycle system. The report is entitled "Analysis and Recommendations Regarding the IRS' Determination Letter Program", and is available on our website www.erisa-lawyers.com under Events, Government Testimony, or you may access the report on www.irs.gov.

Partial Plan Termination

With the downturn in this economy, it is important to remember that layoffs and downsizing can have a significant impact on tax-qualified plans, whereby certain affected persons must be fully vested and, in certain circumstances, notice must be provided to the Pension Benefit Guaranty Corporation ("PBGC"), as follows:

1. Vesting - An employer's reduction in force or a series of reductions in force may trigger a "partial plan termination." Whether a partial plan termination has occurred is based on a facts and circumstances test. However, the general rule of thumb is that if at least 20% of a plan's active participants are terminated as a result of the reductions in force, a partial plan termination has occurred. In the event of a partial plan termination, all affected participants must be made fully vested to the extent that benefits are funded. For a defined contribution plan, the participant's account balance generally must be made fully vested; for a defined benefit pension plan, the participant's accrued benefits must be made fully vested to the extent the plan has sufficient assets, which requires an actuarial calculation as to the present value of vested benefits in the plan.

2. Reportable Event - In addition, when the number of active plan participants in a defined benefit pension plan insured by the PBGC reduces to less than 80% of the number of active plan participants at the beginning of the plan year or 75% of the number of active plan participants at the beginning of the prior plan year (for example, as a result of a reduction in force), a reportable event may have occurred. If a reportable event occurs with respect to a plan, a notice must be filed with the PBGC within 30 days of the event unless a reporting waiver applies or the reporting deadline can be extended.

3. PBGC Proposes New Rules on Partial Terminations- On August 10, the PBGC published proposed regulations under ERISA Section 4062(e), which provides for reporting of and liability for partial terminations of defined benefit pension plans.

The proposed regulations provide guidance on whether and when a "Section 4062(e) event" occurs, describe the liability that arises and how the liability is satisfied, prescribe recordkeeping requirements, and provide for waivers in appropriate circumstances. Under these rules, companies that shut down a facility (or other similar "cessation of operations") that results in a reduction of 20% or more of participants in a pension plan would be required to file a notice regarding the event with the PBGC within 60 days and either pay the partial termination liability amount to the PBGC (which will be held in escrow) or post a bond of up to 150% of the liability. The PBGC can also work out other means of satisfying the liability.

Determination Letter Process," ***CCH Pension***, July 9th

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The Wagner Law Group Description

The Wagner Law Group, A Professional Corporation, is a nationally recognized ERISA, employee benefits, executive compensation and employment firm.

Established in 1996, The Wagner Law Group has 15 attorneys engaged exclusively in employee benefits law. The firm is among the largest ERISA boutiques in the country. The practice is national in scope, with clients in more than 30 states and several foreign countries.

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Comment: If you believe your company might have experienced a partial plan termination and did not fully vest all affected plan participants, or the applicable PBGC forms were not filed timely, please call us so that we can advise you how best to proceed.

Roth IRA Conversions

Beginning January 1, 2010, the restrictions on converting traditional IRAs to Roth IRAs have been removed. Prior to January 1, 2010, individuals with more than \$100,000 of modified adjusted gross income could not make this conversion.

Traditional IRAs are funded with either tax deductible contributions or after tax contributions and receive tax deferred investment earnings until distributed. Roth IRAs are funded with contributions that have already been taxed and also receive tax free (not deferred) investment earnings. In other words, the entire proceeds from a Roth IRA are non-taxable when distributed at the later age of 59½ or five (5) years after the Roth IRA was established.

- o Converting a traditional IRA to a Roth IRA requires paying the tax on the value of the IRA at the date of conversion. The advantages of converting a traditional IRA to a Roth IRA include the following:
 - o Conversions made in 2010 are allowed to have the tax due split between 2011 and 2012. Conversions made after 2010 must pay the entire tax in the year of conversion.
 - o There are no age 70½ required minimum distributions for Roth IRAs as there are with traditional IRAs.
 - o Distributions from Roth IRAs are not taxable when paid to a beneficiary or estate due to death, paid in the event of disability, or used to pay for qualified first time homebuyer expenses.

Note:The most favorable method of converting a traditional IRA to a Roth IRA is to use assets outside of the IRA to pay the taxes, not proceeds from the traditional IRA itself.

Pension Funding Relief Law

On June 25, 2010, President Obama signed into law the "Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010" (H.R. 3962) (the "Act"), which provides temporary pension funding relief for single-employer and multiemployer plans necessitated by the significant losses in asset value due to the steep market slide in 2008. The more significant changes made by the Act are as follows:

1. Funding Relief for Single-Employer Plans -

(a) Extension of Amortization Period. The Pension Protection Act of 2006 ("PPA") required faster funding of defined benefit plans by generally requiring funding shortfalls to be amortized over seven years. The Act extends this period, so that a single-employer plan sponsor may elect to extend the amortization periods in any two plan years during the 2008, 2009, 2010 and 2011 period to either a:

- o nine-year schedule (the "2 plus 7" schedule), which requires that the sponsor pay interest only on the shortfall amount in the first two years, after which the sponsor would use a seven year amortization schedule that requires level annual amounts be paid over seven years; or
- o 15-year amortization schedule that requires level amounts be paid annually over 15 years.
- o If a sponsor elects to apply an extended amortization period to two election years, it must elect the same schedule for both years.

(b) Notice Requirement. Sponsors that elect an extended amortization period must provide notice to the plan's participants and beneficiaries and must inform the Pension Benefit Guaranty Corporation of its election.

(c) Additional Contribution Requirement. The sponsor's funding obligation for a plan year under an extended amortization period would increase if "excessive" employee

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compensation or extraordinary shareholder dividend or stock redemption payments are made during the "restriction period".

"Excessive" compensation is looked at on a controlled group basis and is defined as paying any individual employee over \$1 million in annual compensation for a plan year for services performed after February 28, 2010. Extraordinary dividends and stock redemptions generally include dividends and stock redemptions after February 28, 2010 in excess of the plan sponsor's net income for the preceding plan year (dividends within a controlled group and redemptions by an employee benefit plan or on account of death or termination of employment of an employee or shareholder are disregarded). The "restriction period" is determined based on the type of relief selected by the plan sponsor: it is a three year period if the 2-plus-7 schedule is used, or a five year period if the 15-year schedule is used. However, the amount of any additional contributions is limited so that the sum of the additional contribution and the installment payments does not exceed the cumulative reduction in the amount of the installment payment as a result of the election of the funding relief.

2. Benefit Restriction Relief- Under the PPA, defined benefit pension plans that are significantly underfunded (i.e., the Adjusted Funding Target Attainment Percentage, or "AFTAP", is less than 60%) are subject to benefit restrictions and the freezing of benefit accruals. Under the Act, for plan years beginning on or after October 1, 2008 and before October 1, 2010, a plan may generally use the AFTAP for the plan year beginning after October 1, 2007 and before October 1, 2008 if the AFTAP is over 60%, which will delay a potential freezing of benefit accruals. The Act also provides relief by allowing benefits to be paid in the form of a social security leveling payment which would have otherwise been restricted.

3. Funding Relief for Multiemployer Plans - (a) Extension of Amortization Period. The Act provides a special relief rule for multiemployer plans by allowing such plans to elect to amortize investment losses over a 30-year period instead of a 15-year period in either or both of the first two plan years ending on or after August 2008. The plan could use the extended amortization period only if the actuary certifies that the plan satisfies a "solvency test," i.e., that the plan is projected to have sufficient assets to timely pay benefits and expenses over the extended amortization period.

(b) Asset Smoothing Relief. The new law allows multiemployer plans to extend asset smoothing up to 10 years from five years under the current rules for either one or both plan years ending after August 2008. The Act requires that the smoothed asset value be within 80% to 130% of fair value, rather than the current requirement of 80% to 120%.

(c) Notice Requirement. The Act also requires sponsors to give notice of the election to extend the amortization period and/or to take advantage of the asset smoothing relief to plan participants and beneficiaries and to PBGC.

4. Health Care Relief - The Act also makes a Medicare physician payment fix by preventing a 21% payment cut and adding a 2.2% payment increase through November 30, 2010.

FBAR Rules

On February 26, 2010, the Financial Crimes Enforcement Network ("FinCEN") issued proposed regulations regarding foreign bank account reporting on Form TD F 90-22.1 (the "FBAR"). Employee benefit plans and those with authority over their investment activities may be required, like other investors, to file an FBAR if plan investments involve foreign banks or securities accounts. The FBAR for calendar year 2009 had to have been filed with the IRS no later than June 30, 2010.

1. General Reporting Requirements - The FBAR reports a person's financial interest in, or signature or other authority over, one or more foreign financial accounts.

(a) Financial Interest. With few exceptions, a person that is a citizen or resident of the United States, including a domestic trust and most other types of domestic entities, must file an FBAR for any calendar year in which that person

has a "financial interest" in a foreign bank, securities or other financial account, if during the year the aggregate value of all such accounts exceeds \$10,000. This would include credit cards drawn on a foreign bank. A person has a financial interest in a reportable account if the person is "the owner of record or has legal title" to the account, "whether the account is maintained for his own benefit or for the benefit of others."

(b) Signature Authority. A U.S. person that does not own any reportable financial accounts may nonetheless be required to file an FBAR if the person has "signature or other authority" over a reportable account. Signature or other authority includes authority to control the disposition of assets in an account, alone or in conjunction with another, by delivering written or other instructions directly to the person with whom the account is maintained.

2. Penalties for Failure to File - Civil and criminal penalties may be imposed for failure to file an FBAR. The IRS may impose civil penalties of up to the greater of: \$100,000 or 50% of the value of the foreign account. Furthermore, the government could bring criminal charges for willful failure, a federal felony, punishable by up to \$250,000 fine, five years imprisonment, or both. If the willful failure is part of other illegal activity, the penalty doubles to up to \$500,000, ten years imprisonment, or both.

3. Do Employee Benefit Plans Have a Reportable Financial Account? - Employee benefit plans invest plan assets in a wide variety of investments through many different types of investment vehicles, which can be divided into two broad categories: (i) shares and other similar interests in commingled investment funds; and (ii) separately managed investments.

(a) Commingled Funds. The proposed regulations make it clear that shares of foreign mutual funds are considered "financial accounts" and must be reported on the FBAR. However, Notice 2010-23 states that pending the issuance of final regulations, other foreign commingled funds such as hedge funds and private equity funds, are not reportable on the FBAR for 2009 or any prior year. Therefore, interests in those foreign commingled funds need not be reported until June 30, 2011, the due date for the 2010 FBAR.

(b) Other Separately Managed Investments. The proposed regulations treat the following as "financial accounts" subject to FBAR reporting: (i) foreign bank accounts; (ii) foreign securities accounts; (iii) accounts with a foreign financial agency; (iv) foreign insurance policies that have a cash value; (v) foreign annuity policies; and (vi) foreign brokerage accounts used for commodities trading.

Identifying investments that include reportable accounts is complicated, and identifying the reportable accounts themselves is complicated.

ERISA requires the indicia of ownership of plan assets be held in the U.S. For example, when a plan invests abroad in a private equity fund, the plan must hold its ownership interest in the fund in the U.S. Often such interests are held in an account with a U.S. custodial bank. Even though that account is in the U.S., the assets held within the account might be reportable on the FBAR.

In addition, plan investments may trigger an FBAR reporting obligation if the investment involves foreign securities. When a plan allocates assets for investment by a professional investment manager solely on behalf of the plan (i.e., a separately managed investment, as opposed to a commingled fund), those assets generally are placed in an account with a U.S. custodial bank. U.S. custodial banks generally open sub-custody accounts with banks in foreign countries to settle foreign securities transactions. These accounts may be established with an unrelated foreign bank, or in a foreign branch of an affiliate of the U.S. custodian. Although not entirely clear, it is advisable to report sub-custody accounts on the FBAR.

4. Who Must Report a Plan's Foreign Accounts? - Because many different parties may be involved with an employee benefit plan's investments, the broad language of the instructions and proposed regulations could require a number of identical FBARs be filed with respect to a single plan account. Some of these FBARs will report a "financial interest" in plan accounts, while others will report "signature or other authority". A plan investment in a foreign financial account may trigger an FBAR filing by:

(a) The Plan Trust. The proposed regulations confirm that employee benefit plans are not exempt from filing the FBAR. In addition, because certain trusts are considered "financial accounts", an FBAR may be required with respect to rabbi trusts.

(b) The Plan Sponsor. The current instructions may require plan sponsors to file an FBAR to report a financial interest in any foreign financial account held by the plan. A person is treated as having a financial interest in "a trust that was established by the person and for which the person has appointed a trust protector that is subject to the person's direct or indirect supervision." The term "trust protector" is not defined in the proposed regulations.

(c) Members of a Plan Committee, such as an Investment Committee or Administrative Committee, and Other Officers and Employees of the Plan Sponsors. Each committee member, officer or employee with the requisite signature or other authority over the plan's foreign financial accounts may be required to file an FBAR to report that authority, and may also be required to report on their personal income tax return that they were required to file an FBAR.

(d) The Plan's Trustees. Plan trustees, whether institutional or individual, may have to report both a financial interest in and signature or other authority over plan accounts. Plan trustees generally have authority to execute documents on behalf of the plan, or at least to deliver instructions to financial institutions that hold plan assets. Each plan trustee with such authority may be required to report "signature or other authority" over plan accounts. Furthermore, trustees may be required to report legal title to plan accounts as a "financial interest" in those accounts.

(e) Others Involved with the Plan's Investments, such as an Investment Advisor, Investment Manager, or Custodial Bank. Whether an investment advisor, investment manager or custodian must file an FBAR to report a financial interest in, or signature authority over, plan accounts may depend in large part on their responsibilities under the terms of their contractual arrangements and on the facts and circumstances of each case. Some cases in which an FBAR filing may be required include: an investment adviser with authority to execute investment-related documents on behalf of the plan; an investment manager with discretionary authority over the investment of plan assets; and a custodial bank or other financial institution with record ownership of a plan's foreign accounts.

5. Disclosure on Form 1040 - If an individual is required to file an FBAR (e.g., a trustee), he must disclose that on Schedule B of his or her personal income tax return (Form 1040). Notice 2010-23 relieves those with signature or other authority of the obligation to make this disclosure on their 2009 and prior years' tax returns. However, if trustees are required to report financial interests in plan accounts, they arguably would not be entitled to this relief and, therefore, may be required to make an FBAR-related disclosure on Form 1040.

Note: If you believe your employee benefit plan needs to file an FBAR and did not, or if you need assistance with your FBAR filing obligations on your Form 1040, we would be pleased to assist you.

Heightened Enforcement Regarding Employee Misclassification

In its proposed budget for fiscal year 2011, the DOL is allocating \$25 million to fund a joint initiative with the Treasury Department to identify and litigate against employers who categorize members of their workforce as independent contractors when, in fact, they are employees who may be eligible to participate in the employer's employee benefit plan. Some states have begun their own effort to identify misclassifications. For example, five New England states have formed a joint task force to study and target misclassification.

Note: Employers should review their Forms 1099 to identify independent contractors, review job descriptions against actual duties and responsibilities, and the extent of management control over these employees, to determine if people are appropriately categorized.

Auto-IRA Legislation Introduced in Senate and House

On August 6, 2010, Senator Jeff Bingaman (D-NM) introduced the Automatic IRA Act to provide for automatic enrollment of employees in payroll-deduction savings plans. Under the bill, employees who work for an employer with more than 10 employees which does not offer a retirement plan would be defaulted into a program in which they contribute payroll earnings to an individual retirement account ("IRA").

Note: The bill could have implications even for employers who maintain retirement plans because categories of employees who are otherwise not eligible for coverage under the employer's plan might be required to be automatically enrolled in an IRA under the terms of this bill.

Elements of the bill include:

- o The bill sets the default contribution at 3% of compensation. Employees can raise or lower their contribution percentage, or can opt-out entirely from the program.
- o Employees who have been employed for at least three (3) months and employees who have attained age 18 as of the beginning of the year are automatically enrolled in an Automatic IRA, but can opt out.
- o Employees have the choice of contributing to either a traditional pre-tax IRA or Roth (post-tax) IRA. If no choice is made, Roth IRA accounts are the default vehicle.
- o Investment firms are not be required to accept Automatic IRA accounts. An employer can select an IRA provider to which all Automatic IRA contributions will be sent, using a central online resource developed by the Treasury Department including a list of approved providers.
- o An employer that fails to offer an automatic IRA for its employees is subject to an excise tax of \$100 for each employee.
- o All Automatic IRAs will offer the same three (3) standardized investment options (to be developed by Treasury and DOL): (1) a principal preservation fund or a special, new Treasury Retirement Bond ("R Bond"); (2) a life-cycle or other blended investment option; or (3) an alternative investment option with a somewhat higher concentration in equities.
- o The investment options must be based on low-cost investments, which may include index funds.

On August 10, 2010, Richard Neal (D-MA), chairman of the Subcommittee on Select Revenue Measures of the Ways and Means Committee, introduced the Automatic IRA Act of 2010 during the House of Representatives' rare mid-recess session held on that day. The House version of the bill is similar to the Senate bill.

Interim Final 408(b)(2) Regulations

The Department of Labor ("DOL") recently promulgated interim proposed regulations which will have a significant impact on the disclosure of fees plan sponsors receive from their vendors. This Section of the Newsletter details these new rules.

1. Statute and Prior Regulations - ERISA Section 408(b)(2) provides relief from ERISA's prohibited transaction rules for service between a plan and a party in interest (e.g., a plan service provider) if the contract or arrangement is reasonable, the services are necessary for the establishment or operation of the plan, and no more than reasonable compensation is paid for the services. The prior regulations said little as to when a service provider contract or arrangement was reasonable.

2. Proposed Regulations - In December 2007, the U.S. Department of Labor ("DOL") proposed amending its regulations to provide that certain service provider contracts would be reasonable only if the covered service provider discloses to a responsible plan fiduciary specified information about the services to be performed, the compensation to be received and potential conflicts of interest of the service provider. The intent of the proposal was to enable plan fiduciaries to assess the reasonableness of compensation paid for plan services.

3. Interim Final Regulations - On July 15, 2010, the DOL released a revised version of the fee disclosure regulations with an effective date of July 16, 2011. Thus, the final regulations will apply to existing services arrangements as of July 16, 2011 as well as to new arrangements entered into on or after that date. The one-year lead time is intended to accommodate the costs and burden of transition to the new disclosure regime. However, because the regulations are interim as well as final, new requirements may be added before the effective date. It is not clear whether any additional changes will have an extended effective date for compliance.

4. Covered Plans - Under the proposed regulations, all employee benefit plans subject to Title I of ERISA were subject to the regulation's disclosure requirements. The final regulations retrench by defining a covered plan to mean an employee pension plan. Excluded from this definition and, therefore, not affected by the disclosure requirements of the final regulation are:

(a) Welfare plans - because of significant differences between service and compensation arrangements of welfare plans and pension plans, the DOL intends to develop separate and more specifically tailored disclosure requirements for welfare plans, (b) IRAs, (c) Simplified employee pensions, and (d) Simple retirement accounts.

5. Covered Service Providers - The final rule is limited to service providers that reasonably expect to receive \$1,000 or more in compensation (direct or indirect) from providing plan services that fall under one of the following categories:

(a) Services as a fiduciary under ERISA or as a registered investment adviser. Such services include:

(i) Provider of Fiduciary Services. Services provided directly to a covered plan in the capacity of an ERISA fiduciary.

(ii) Investment Product Fiduciary. Services provided as a fiduciary to an investment contract, product or entity that holds plan assets. To be included in this new category, the plan must have a direct equity investment in the contract, product or entity. Fiduciary services provided to underlying investments (i.e., to second tier investment vehicles) are not taken into account.

A. Mutual funds are not considered to hold plan assets and, therefore, fund investment advisers are excluded from the definition of a covered service provider. Accordingly, mutual funds are not subject to the general disclosure obligation.

B. Insurance products providing a fixed rate of return are generally considered not to hold plan assets. Thus, products, such as GICs, general account investments and deferred fixed annuities will not result in the insurer becoming a covered service provider. However, a variable annuity based on a separate account that may be treated as a plan asset could give rise to compensation subject to disclosure.

C. Fiduciaries to plan asset vehicles, such as collective trusts, hedge funds and private equity funds are potentially subject to the fee disclosure rules.

(iii) Registered Investment Adviser. Services provided directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or state law.

(b) Recordkeeping or brokerage services provided to individual account plans that permit participants to direct the investment of their accounts. As discussed below, the final regulations expand the disclosure obligation of such recordkeepers and brokers to compensation information regarding each designated investment alternative.

(c) Services within a broad list of categories that are reasonably expected to be paid for by indirect compensation or compensation paid among related parties. Service categories include: investment consulting, accounting, auditing, actuarial, appraisal, development of investment policies, third party administration, legal, recordkeeping and valuation services.

6. Required Disclosure - (a) General. A covered service provider must disclose in writing to the plan sponsor or similar plan fiduciary all services to be provided to the plan. Service providers must also disclose whether they will provide any services to the plan as a fiduciary either within the meaning of ERISA §3(21) or under the Investment Advisers

Act of 1940.

(i) Formal Contract No Longer Required. Unlike the proposed regulations, the final regulation does not require a formal written contract delineating the disclosure obligations. (ii) Disclosure of Conflicts No Longer Required. In addition, the final rule eliminates required disclosure of conflicts of interest on the part of service providers. The reasoning for this change is that the expanded disclosure of compensation arrangements with parties other than the plan will be a better tool to assess a service arrangement's reasonableness, as well as potential conflicts of interest.

(b) Distinction Based on Direct or Indirect Compensation. Different rules apply to the receipt of direct and indirect compensation, with the latter thought more likely to implicate conflicts of interest.

(i) Direct compensation is defined as compensation received from the plan. (ii) Indirect compensation is defined as compensation received from a source other than the plan, the plan sponsor, the covered service provider or an affiliate or subcontractor in connection with the services arrangement. For example, indirect compensation generally includes fees received from an investment fund, such as 12b-1 fees, or from another service provider, such as a finder's fee. (iii) Non-monetary compensation valued at \$250 or less, in the aggregate, during the term of the contract, is disregarded.

(c) Disclosure of Compensation. Covered service providers are required to disclose all direct and indirect compensation that the service provider, an affiliate or a subcontractor expects to receive from the plan. In the case of indirect compensation, the service provider must identify the services for which the indirect compensation will be received as well as the payer of the indirect compensation.

(i) Format. Compensation may be expressed as a dollar amount, formula, percentage of covered plan assets, a per capita charge, or by any other reasonable method that allows a plan fiduciary to evaluate the reasonableness of the compensation.

(ii) Manner of Receipt. Disclosure must include a description of the manner in which the compensation will be received, such as whether it will be billed or deducted directly from participants' accounts.

(iii) Transaction-Based Fees Received by Affiliates or Subcontractors. Compensation set on a transaction basis (e.g., commissions or soft dollars) or charged directly against the plan's investment (e.g., 12b-1 fees) and paid among the covered service provider, an affiliate or a subcontractor must be separately disclosed. The services for which the compensation is to be paid, the recipient and the payer must be identified. Other types of compensation do not require separate disclosure.

(iv) Bundled Services. Except for the special rules discussed below, there is no requirement to unbundle service pricing.

(d) Special Rules for Recordkeepers. A person who provides recordkeeping services must provide a description of the direct and indirect compensation that the service provider (and its affiliates and subcontractors) expects to receive for recordkeeping services.

(i) If there is no explicit fee for recordkeeping services, a reasonable, good faith estimate of the cost to the plan of such services must be provided. The estimate may take into account the rate that the service provider would charge to a third party or prevailing market rates for similar services.

(ii) Disclosing a de minimis amount of compensation for recordkeeping when the amount has no relationship to cost will not be regarded as reasonable.

(e) Special Rule for Platform Providers. Recordkeepers and brokers that make investment alternatives available must provide basic fee information for each such alternative for which recordkeeping or brokerage services are provided. This information is in addition to

information regarding the recordkeeper's or broker's own compensation. The information to be provided includes the expense ratio, ongoing expenses (e.g., wrap fees), as well as transaction fees (e.g., sales charges, redemption fees and surrender charges) that may be charged directly against the amount invested.

(i) **Pass-Through of Information on Investment Products.** A recordkeeper or broker may satisfy its disclosure obligations for unaffiliated mutual funds by passing through the fund prospectus without having the duty to review its accuracy, provided that the disclosure material is regulated by a state or federal agency.

(ii) **Responsibility of Other Service Providers.** If there is no recordkeeper or broker to provide the required information as to the fees associated with an investment alternative, such responsibility passes to the fiduciary of the investment contract, product or entity.

(iii) **Exclusion for Brokerage Windows.** Open brokerage windows are not subject to the disclosure requirements for platform providers.

7. **Timing of Disclosures -** Disclosure of information regarding compensation or fees must be made reasonably in advance of entering into, renewing or extending the contract for services. All of the required disclosures need not be contained in the same document and may be provided in electronic format.

(a) During the term of the contract, any change to the previously furnished information must be disclosed within 60 days (expanded from 30 days under the proposed regulations) of the service provider's becoming informed of the change.

(b) In contrast to the proposed regulation, the final rule provides that a service contract will not fail to be reasonable (i.e., there will not be a prohibited transaction) solely because the service provider makes an error, provided that the service provider has acted in good faith and with reasonable diligence. Errors or omissions must be disclosed within 30 days of the service provider's acquiring knowledge of the error or omission.

(c) When an investment contract, product or entity is initially determined not to hold plan assets but this fact changes, if the covered plan's investment continues, disclosures are required as soon as practicable, but not later than 30 days from the date on which the service provider acquires knowledge that the investment vehicle holds plan assets.

8. **Curing Disclosure Failures: Prohibited Transaction Exemption -**

(a) **Relief for Plan Sponsor.** As under the proposed 408(b)(2) regulations, the final rule provides that a service provider's failure to comply with the disclosure obligations results in a prohibited transaction. Because the prohibited transaction could adversely affect the plan sponsor or similar plan fiduciary, the DOL had proposed a separate class exemption that would have provided relief for the plan fiduciary. This exemption is now incorporated into the final regulation. However, there is no relief for a service provider that fails to comply with the disclosure requirements.

(b) **Corrective Action.** Relief would be provided if the plan sponsor or similar plan fiduciary enters into a service contract under the reasonable belief that the service provider has complied with its disclosure obligations under the final regulations. To qualify for relief, the plan sponsor or similar fiduciary must take corrective steps with the service provider after discovering the disclosure problem by requesting in writing the correct disclosure information. If the service provider fails to comply within 90 days of such request, the plan fiduciary must notify the DOL not later than 30 days following the earlier of the service provider's refusal to furnish the requested information; or the date which is 90 days after the date the written request is made.

(c) **Termination of Service Contract.** As under the proposed regulations, the plan sponsor or similar fiduciary must also determine whether to terminate or continue the service contract by evaluating the nature of the particular disclosure failure and determining the extent of the actions necessary under the facts and circumstances. Factors to consider, among others, include the responsiveness of the service provider in furnishing the missing information, and the availability, qualifications, and costs of potential replacement service providers.

9. **Immediate Impact and Issues -** Currently, service providers need not disclose specific types of information to plan sponsors or similar fiduciaries. The final disclosure

regulations require service providers to disclose extensive amounts of information, including the identity of third parties from whom a service provider receives fees as a result of providing services to the plan.

While conflict of interest disclosures have been eliminated, required fee disclosure will present significant internal tracking and communication challenges for large and complex companies. The ongoing 60-day disclosure deadline for information changes will result in similar challenges.

Comment: The final regulation clarifies that the new rules will apply to contracts in place when the regulation becomes effective on July 16, 2011. Service providers should begin preparing now to meet the new disclosure requirements, but should be prepared for possible changes to the rules due to the interim status of the regulation.

DOL Proposes New Regulations for Investment Advice

On February 26, 2010, the DOL issued newly proposed regulations concerning the manner in which a fiduciary adviser may provide investment advice to participants of defined contribution retirement plans. These proposed regulations are intended to replace the controversial "final" regulations published by the DOL on January 21, 2009, which were withdrawn on November 20, 2009, before ever having taken effect.

1. Background: The Pension Protection Act of 2006 - Under the Pension Protection Act of 2006, Congress had intended to encourage the availability of participant-level investment advice by enacting a new prohibited transaction exemption to provide relief from fiduciary liability for providing such advice under certain conditions. To qualify for fiduciary relief under the terms of the statutory exemption (the "PPA Statutory Exemption"), a fiduciary adviser (e.g., investment adviser, broker-dealer) is required to ensure that either (i) the fiduciary adviser's fees for its investment advice will not vary based on any investment options that are selected by participants (the "Fee-Leveling Safe Harbor"), or (ii) the investment advice will be provided through an objective computer model that is independently certified not to favor investment options that would result in greater fees for the fiduciary adviser (the "Computer Model Safe Harbor").

Comment: The concept of the "Computer Model Safe Harbor" was first developed by Marcia Wagner and exemptive relief was provided to her client, Trust Company of the West, in Prohibited Transaction Exemption 97-60.

With respect to the Fee-Leveling Safe Harbor under the PPA Statutory Exemption, the DOL announced in its Field Assistance Bulletin ("FAB") 2007-1 that the applicable fee-leveling requirement applies to both the individual representative of the fiduciary adviser and the fiduciary adviser itself. However, the compensation payable to the fiduciary adviser's affiliates (e.g., affiliated investment advisers managing mutual fund options for a plan) may vary based on the investment options selected by plan participants. Thus, in the DOL's view, the PPA Statutory Exemption gives fiduciary advisers a new type of self-dealing relief that was not previously available under ERISA. Prior to the enactment of the PPA Statutory Exemption, with certain narrow exceptions, ERISA would have imposed fee-leveling on the individual representative of the fiduciary adviser, the fiduciary adviser itself, and the fiduciary adviser's affiliates.

2. Inclusion of Class Exemption in Final Regulations Triggers Withdrawal - The DOL had finalized its first iteration of the investment advice regulations during the last days of the Bush Administration, issuing them on January 21, 2009. This early 2009 release was highly unusual in that it included both (i) interpretive guidance with respect to the PPA Statutory Exemption, and (ii) a separate but related administrative exemption (the "Withdrawn Class Exemption") concerning investment advice.

The Withdrawn Class Exemption mirrored the PPA Statutory Exemption's Fee-Leveling and Computer Model Safe Harbors in many respects. However, the Withdrawn Class Exemption provided for significantly more expansive fiduciary

relief as follows:

(a) Additional Fee-Leveling Safe Harbor. The Withdrawn Class Exemption would have created a similar but new safe harbor, mandating fee-leveling for the individual representative of the fiduciary adviser only (and not for the individual representative and the fiduciary adviser as required under the PPA Statutory Exemption). Thus, the compensation payable to the fiduciary adviser and its affiliates would be able to vary with the investment options selected by plan participants. For example, the Withdrawn Class Exemption would have allowed the individual representative of a broker-dealer to provide investment advice to participants, so long as the individual representative received a level fee. Conversely, the broker-dealer itself and its affiliates would have been able to receive variable compensation, including 12b-1 fees and revenue sharing payments.

(b) Additional Computer Model Safe Harbor. Once investment advice based on an objective computer model had been provided to a participant, the Withdrawn Class Exemption would have allowed the fiduciary adviser to follow up with subjective, individualized advice to the participant. Any such individualized advice would not have been subject to any fee-leveling requirement.

The DOL under the incoming Obama Administration postponed on multiple occasions the effective date for both its interpretive guidance with respect to the PPA Statutory Exemption and the Withdrawn Class Exemption. Due to concerns over the Withdrawn Class Exemption and the perceived inadequacy of certain conditions, the DOL withdrew its final regulations in their entirety on November 20, 2009.

3. DOL Proposes Second Iteration of Its Investment Advice Regulations - The second iteration of the DOL's investment advice regulations, which were proposed on February 26, 2010 (the "Newly Proposed Regulations"), are substantially similar to the interpretive portion of the DOL's withdrawn regulations relating to the PPA Statutory Exemption. However, the Newly Proposed Regulations do not re-introduce any kind of new administrative exemption akin to the Withdrawn Class Exemption that had previously been incorporated into the DOL's withdrawn regulations.

Thus, the Fee-Leveling and Computer Model Safe Harbors under the Newly Proposed Regulations are consistent with the existing safe harbors under the PPA Statutory Exemption. Under the Newly Proposed Regulations:

o with respect to the Fee-Leveling Safe Harbor, participant investment advice may only be provided if the fees earned by both the individual representative of the fiduciary adviser and the fiduciary adviser itself (and not including the fiduciary adviser's affiliates) do not vary with the investment options selected by participants, and

o with respect to the Computer Model Safe Harbor, a fiduciary adviser may only provide investment advice to participants based on an objective computer model, and may not supplement such advice with subjective, individualized advice.

However, in the preamble to the Newly Proposed Regulations, the DOL highlighted one new interpretive requirement that it was proposing for the Computer Model Safe Harbor, which appears to favor passive investment over active management. Although it is not expressly required under the PPA Statutory Exemption, the Newly Proposed Regulations state that the computer model advice must not "[i]nappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future." In the preamble, the DOL clarified that differences in investment options' fees and management styles are likely to persist in the future. However, unlike the historical performance of asset classes, the historical performance of investment options in the same asset class are less likely to persist and therefore are less likely to constitute appropriate criteria for advice. Since many advisory computer models consider the historical

performance of investment options (rather than asset classes), the DOL is expected to receive significant commentary with respect to this proposed interpretive requirement, which had not been surfaced previously with the interpretive portion of the DOL's withdrawn regulations.

Comment: The regulatory rollercoaster with respect to the appropriate and legal provision of investment advice is coming to an end. Therefore, more and more vendors should be introducing their investment advice products in short order. Before plan sponsors adopt these programs, however, they should consult with legal counsel.

New Form 5500 Reporting Requirements; What Every Plan Sponsor Needs to Know

1. DOL EFAST2 All-Electronic Filing System -

(a) Getting Ready for Electronic Form 5500 Filings. All ERISA plans subject to annual Form 5500 reporting are required to file electronically for plan years beginning on or after January 1, 2009. Filings will be accepted on the DOL's new all-electronic system, called "EFAST2."

For plan years prior to 2009, Form 5500 filings could be filed electronically or by paper through the original EFAST, which stands for the "ERISA Filing Acceptance System." The original EFAST had been created through the joint efforts of the U.S. Department of Labor (the "DOL"), PBGC and IRS, featuring optical scanning technology to handle paper filings. EFAST2 is a new and completely different system, with separate protocols requiring separate electronic credentials (as discussed below).

Prior year delinquent or amended Form 5500s must also be filed electronically on EFAST2, with a narrow exception for timely 2008 filings (which may still be submitted through the original EFAST electronically or by paper until October 15, 2010).

(b) IFILE vs. Third-Party Software. Plan sponsors can file their Form 5500s electronically using the 5500 preparation and submission application on the DOL's website, "IFILE" (which stands for "internet filing"). The IFILE application is available through the DOL website at: www.efast.dol.gov.

Alternatively, plan sponsors can use EFAST2-approved third-party software (instead of IFILE). In either case, the plan sponsor must sign on to the DOL website to register for electronic credentials

(c) Electronic Credentials. All Form 5500s must be filed electronically on EFAST2. However, before filing, each plan sponsor must register for electronic credentials. This registration must be done even if the individual has previously obtained electronic credentials under the original EFAST.

To register, the plan sponsor needs to go to the "IREG" page (which stands for "internet registration") and apply for a user ID, PIN and password. While registering, the individual must select one or more user types. There are a total of 5 user types:

- o **Filing Author:** Filing Authors can complete the Form 5500 and the accompanying schedules, submit the filing, and check filing status. Filing Authors cannot sign filings unless they also have the "Filing Signer" role.
- o **Filing Signer:** Filing Signers can electronically sign the Form 5500 filing. Signers include Plan Administrators, Employers/Plan Sponsors, and Direct Filing Entities.
- o **Schedule Author:** Schedule Authors can complete one or more of the schedules that accompany Form 5500.
- o **Transmitter:** Transmitters can transmit Form 5500 filings to the EFAST2 system for processing on behalf of others. A Transmitter can be a company, trade, business, or individual.
- o **Third-Party Software Developer:** Third-Party Software Developers make Form 5500 filing preparation or transmission software for use in the EFAST2 system. Even if plan sponsors use EFAST2-approved third-party software (instead of IFILE), they will typically need to register on the DOL website as a Filing Signer (to electronically sign the form) and as a Transmitter (to actually submit the form to EFAST2).

2. Enhanced Fee Disclosures: Form 5500 - Schedule C - On November 16, 2007, the DOL published final regulations governing the 2009 Form 5500 annual report. These

regulatory changes amend the Form by heightening the plan sponsor's obligation to report plan fees and expenses in greater levels of detail on Schedule C, which is entitled "Service Provider Information." The new Schedule C reporting requirements are intended to increase the transparency of the fees and expenses that are being paid by the plan indirectly and to help sponsors understand direct payment arrangements, such as bundled fees. The changes to the Schedule C are also intended to help ensure that plan fiduciaries are provided the information they need to fully assess the total compensation paid for services rendered to the plan and to help plan fiduciaries recognize actual and/or potential conflicts of interest by the plan's service providers. This includes information on revenue-sharing arrangements among plan service providers.

(a) Plans Subject to Reporting on Schedule C. Large plans (i.e., those having 100 participants or more) are affected by these regulations. Under the pre-2009 filing rules for Form 5500, large plans were already required to use Schedule C to report certain service provider information to the DOL. Smaller plans needed to file Form 5500s, but did not need to file Schedule C.

Under the new EFAST2 filing rules, large plans will continue to be subject to Schedule C reporting, which will now require enhanced fee disclosures. Small plans will be permitted to file a Form 5500-SF (where SF stands for "short form"). Consistent with the old reporting rules, in no event will any small plans (which generally have fewer than 100 participants) be subject to Schedule C reporting.

(b) Service Providers Subject to Schedule C Reporting. Service providers are covered by Schedule C reporting if they receive \$5,000 or more in direct and indirect compensation in relation to a plan. The former Schedule C captured any fees or expenses paid directly by the plan to its service providers. However, given that the industry practices have shifted toward structures under which plans pay an increasing amount of their expenses indirectly through investment options, such as revenue sharing, the DOL felt it was necessary to amend the Schedule C reporting requirements to include indirect compensation.

The prior Schedule C rule requiring the plan to identify only the top "40" highest paid service providers has been eliminated. Now all providers receiving \$5,000 or more in total compensation must be included. Plans must also identify the type of service provided through "service codes", which have been expanded to include a greater variety of services (for a total of 58 service codes).

Schedule C now includes a section in Part II called "Service Providers Who Fail or Refuse to Provide Information" which requires plan sponsors to identify any non-cooperative service providers to the DOL. Fortunately, transition relief is available for the 2009 plan year. The plan sponsor is not required to identify a non-cooperative provider for the 2009 plan year if the provider furnishes a statement that it made a good faith effort to change its recordkeeping system, but that it was unable to timely complete the change.

(c) General Reporting Requirements. The DOL has updated the Schedule C reporting requirements to include both direct and indirect compensation paid by a plan to its service providers.

Direct compensation means payments made directly by the plan for services. If the plan sponsor pays for any expenses directly and is not reimbursed from the plan, the compensation paid to the provider is not reportable on Schedule C.

Indirect compensation means commissions, fees or other amounts received by a service provider from sources other than directly from the plan or plan sponsor. Thus, it includes all indirect compensation paid by an investment fund to a service provider, such as 12b-1 fees, sub-accounting fees and shareholder servicing fees which are charged against fund assets. A mutual fund's management fee (payable to the fund manager) must also be reported as indirect compensation on Schedule C. Float revenue and soft dollar services can also constitute indirect compensation for a provider. However, ordinary operating expenses of an investment fund (e.g., brokerage costs for portfolio transactions and accounting fees of the fund) are not reportable indirect compensation.

Generally, if a service provider received more than \$5,000 in direct and indirect compensation from the plan, the amount must be reported on Schedule C. However, the actual amount of such compensation need not be reported if it constitutes "Eligible Indirect Compensation."

(d) Simplified Reporting for "Eligible Indirect Compensation".

Eligible Indirect Compensation ("EIC") is subject to abridged reporting requirements on Schedule C. The intent of this alternative EIC reporting is to provide simplified reporting for "omnibus" account arrangements with asset-based fees (where the mutual fund's transfer agent merely tracks the plan's total ownership interest in the fund, and relies on the plan's recordkeeper to track the ownership interests of individual participants). For compensation to qualify as EIC, both conditions below must be met.

- o it must be indirect compensation that is charged directly to investment funds and reflected in the funds' investment returns (or it must be some other specific type of indirect compensation, including finders' fees, soft dollar revenue, float revenue, brokerage commissions and other transaction-based fees), and
- o written disclosure must be provided describing: (i) the existence of the indirect compensation; (ii) the services provided or purpose of the compensation; (iii) the amount, estimate or formula used to calculate the compensation; (iii) the identity of the person or persons receiving the compensation; and (iv) the identity of the person or persons paying the compensation. An e-mail from the provider will satisfy the written disclosure requirement for EIC, and such disclosure need not be furnished annually.

For example, if a plan's recordkeeper receives shareholder servicing fees from the plan's mutual fund investments directly in exchange for its services to the plan, such compensation would constitute EIC if the plan sponsor also received the necessary written disclosures. With respect to providers receiving EIC only, Schedule C need only show the name of the person who discloses the Eligible Indirect Compensation (and no other information is reported on the schedule). However, the plan sponsor should keep a record of any Eligible Indirect Compensation disclosure for recordkeeping purposes as required under ERISA. Indirect compensation that does not meet the definition of Eligible Indirect Compensation (because the disclosures are not adequate, the compensation is not reflected in the value of the investment, or for some other reason) must be reported separately on the Schedule C.

(e) Enhanced Reporting for Key Providers Receiving Non-EIC. Special reporting requirements apply to any "key provider" who receives indirect compensation (other than EIC) of at least \$1,000. Key providers include providers of any of the following services: fiduciary, contract administration, consulting, custodial, investment advisory (plan or participants), investment management, securities brokerage or recordkeeping. Any such key providers receiving ineligible indirect compensation of at least \$1,000 must be identified separately on Schedule C. The plan must report each source from which the provider received \$1,000 or more in indirect compensation, report the amount of indirect compensation, and include a description of such compensation.

(f) Bundled Providers. While the Schedule C instructions include a general rule that "bundled" arrangements (where the plan is paying a single fee for a bundle of services, instead of on a service-by-service basis) do not require separate disclosure of revenue sharing among the persons providing such bundled services, there are numerous and technical exceptions. Generally speaking, compensation must be separately reported if (1) a person receives a separate fee charged against the plan's investments or (2) if a person is "key provider" (e.g., fiduciary, custodian, recordkeeper) and receives indirect compensation in the form of commissions or other transaction-based fees. The new reporting rules for bundled providers are technical in nature, and other exceptions may apply.

Comment: The new rules regarding the Form 5500 filings will be challenging for all plan sponsors, but especially for those who maintain 403(b) plans, for whom this 2009 Form 5500 is the first time the full Form 5500 is required, which had been only applicable to tax-qualified plans.