THE
SPARK
Institute, Inc.

Memorandum

To: The SPARK Institute Membership

From: Larry H. Goldbrum

Date: March 24, 2009

Re: **Analysis of Form 5500 Schedule C Reporting Survey Results**

Earlier this year we surveyed our membership regarding certain Form 5500 Schedule C reporting issues. Set forth below is a summary of the results and key findings. A copy of the tabulated results is attached hereto. The survey was completed by member firms that collectively serve approximately 174,000 plans with nearly 34 million participants.

I. Executive Summary

Although the Department of Labor ("DOL") has provided some additional guidance regarding the new Form 5500 Schedule C reporting requirements, a substantial majority of service providers, including companies that prepare 5500s and investment funds that must report information, are unsure how to comply with the new rules and will likely interpret them differently. As a result, significant resources will be spent on making systems changes that will be of little or no value to plan sponsors, the DOL and anyone else who uses the reported data because the data will be inconsistent and may also be inaccurate. Additionally, most service providers intend to change their 5500 preparation service models and require the plan sponsor to be more involved in gathering data. Many service providers intend to charge more for their 5500 preparation services. A significant number of providers do not expect to be ready to meet the current 5500 reporting deadline, and a substantial majority anticipate that they may have to rely on the "good faith" compliance statement.

The SPARK Institute intends to share this information with regulators and the retirement plan community in order to demonstrate the need for changes to, and a delay of, the new Schedule C reporting requirements.

II. Definition of "Eligible Indirect Compensation"

The new rules for Schedule C reporting require reported compensation to be broken into one of three categories: (1) direct compensation (compensation paid by the plan), (2) indirect compensation, (compensation paid by any source other than the plan or plan sponsor), and (3) eligible indirect compensation ("EIC") (indirect compensation consisting of fees or expense reimbursements that are charged to investment funds and reflected in the net value of the investment return). There are distinctly different reporting requirements for each of the categories of compensation. For compensation that is **not** EIC, extensive detail must be provided regarding the payments. For compensation that is EIC, the filer can basically rely on the disclosures provided in a prospectus or similar document and does not need to provide detailed reporting. The distinction, therefore, is a critical one.

Survey Data - The most critical finding (Question 1) was that nearly three out of four respondents (74%) believe the DOL has not provided sufficient guidance for providers to accurately determine what elements of compensation qualify as EIC. Respondents reported a lack of consistency between the instructions contained in the Federal Register and the DOL's FAQ issued in July of 2008.

One key point of confusion is whether compensation paid by a mutual fund agent can qualify as EIC based on the responses to DOL FAQ, Q&A 4 (see survey Question 2). Respondents that addressed the issue were equally split on this question, with half reporting that it didn't matter who paid it and half saying it would not qualify as EIC if paid through an agent rather than directly by the fund. Most mutual funds pay some types of compensation, such as sub-transfer agency fees, to their intended recipients indirectly. Consequently, different interpretations and reporting practices will result in inconsistent and unreliable data.

Another key point of confusion is which operating expenses of a mutual fund can be treated as EIC (related to DOL FAQ, Q&As 8 and 22).

Summary of Concerns - As noted above, we are concerned that reporting of indirect compensation and EIC will be inconsistent and unreliable. Service providers will invest in systems and processes for reporting that will need to be revised once a clear understanding is available. Additionally, the Schedule C reporting rules for indirect compensation have not been coordinated with the 408(b)(2) fee disclosure rules, which have not been finalized.

III. Reporting of Non-Cash Compensation

The new Schedule C rules require reporting of money and anything else of value (gifts, trips, etc.) received in connection with a person's position with the plan or for services rendered to the plan. There is an exception for small amounts.

Survey Data - A significant majority of respondents (63%) do not believe that the DOL has provided sufficient guidance for them to accurately report either the receipt or payment of non-cash compensation (Question 3). Concerns raised include benefits provided to employees of the plan sponsor, how to allocate among plans, valuation issues, and other questions.

Summary of Concerns - As noted above, a core concern is that service providers will incur significant costs to produce data that is inconsistent, and therefore, of little value to either plan fiduciaries or the DOL.

IV. Reporting of Pass Through Compensation

A common practice is for compensation that is paid by one party to another in connection with a retirement plan to "pass through" one or more related or unrelated institutions before reaching the ultimate intended recipient. There are several reasons why this occurs, one of which is the structure of the relationships among the various parties delivering investments and other services to the plan, including the investment funds, record keepers and financial advisors.

Survey Data - 27% of respondents were not confident that they knew how to report pass through compensation based on the DOL's current guidance (Question 6). A key concern that was raised is that compensation will be overstated under the current reporting rules because each entity through which the compensation flows must report it regardless of whether they retain any of it.

Summary of Concerns - Some of the concerns here are similar to the concerns raised with respect to the confusion over EIC. The data reported will be inconsistent and therefore of little or no value; money and other resources will be invested in processes and systems that will need to be revised; and the rules are not synchronized with an overall fee disclosure methodology. In addition to these concerns, there is a significant concern that compensation will be overstated, interfering with the plan sponsor's ability to understand what they are paying to whom. Additionally, we are concerned that because 5500 information is available to the public, the current rules will create a public record that significantly overstates the compensation paid by a plan and received by providers.

V. Service Model and Fees

Most 5500s are prepared for the plan by a third party vendor instead of the plan sponsor. The most common service model utilized in the past was for the vendor to prepare a "signature ready" completed 5500 for the plan administrator. The new Schedule C rules require reporting of data that is typically not available to the vendor that completes the 5500, such as compensation received by providers unaffiliated with the 5500 preparer. For example, the 5500 preparer will not know the amount of compensation received, the type of compensation, and the correct fee and service codes to use.

Survey Data – A significant majority of respondents (58%) reported that they are changing their 5500 service offering as a result of the Schedule C requirements and many (32%) will charge an additional fee for the new service (Question 7). A significant majority of respondents (68%) expect to require additional information to be provided from plan sponsors and many (21%) expect to charge for the effort (Question 11). Most respondents (53%) indicated that they will not collect data on compensation of third parties, but will expect this information to be provided to plan sponsors who in turn will provide it to them (Question 14).

Summary of Concerns - The survey results make it clear that there will be significantly more cost and effort involved in Schedule C reporting under the new rules. Plan sponsors will bear a part of this burden and will need to get more involved in data collection and reporting. Additionally, plans will incur additional fees in order to comply with the new rules. The SPARK Institute is concerned that such additional costs and burdens will be of little or no benefit because the confusion among providers will result in reporting of inconsistent and inaccurate data.

VI. <u>Service Provider Readiness</u>

Most of the burden for complying with the new rules will fall on the 5500 preparers. Service providers anticipated having final 408(b)(2) fee disclosure rules available so that they could coordinate their systems and procedure changes in order to comply with both sets rules at once. Coordinating such efforts is not only more cost effective but is also logical because of the substantive relationship between the rules. Service providers are now in the position of having to make substantial investments based on a set of rules that are unclear and with the knowledge that additional changes will be required in the future when the 408(b)(2) rules are adopted.

<u>Survey Data</u> - 79% of respondents expect to have to make systems changes to accommodate Schedule C requirements (Question 9). Only 60% of respondents making changes expect to be ready in time to meet the current deadline (Question 9.1). 79% of respondents think there is some possibility they will need to use the “good faith” statement contained in DOL FAQ, Q&A 40 for 2009 reporting years (Question 16).

<u>Summary of Concerns</u> - Systems changes are expensive and it is far more cost efficient to tackle multiple issues related to the same core data at the same time. As noted above, the vast majority of respondents are already investing in system changes that will need to be revisited after additional rules are adopted and clarifications are made. In spite of the current cost and effort being put into these changes, most providers think there is at least some chance they will not be ready in time to generate data for 2009 reporting. Based on the survey results, retaining the current effective date will most likely result in inconsistent reporting of data and an inability of the majority of providers to comply, despite the substantial cost incurred for system changes. Delaying the effective date and using the time to both clarify confusion and develop a comprehensive regulatory fee disclosure scheme will create a much more favorable cost versus benefit equation.

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Attachment

THE SPARK Institute, Inc.

FORM 5500 SCHEDULE C REPORTING SURVEY RESULTS

We recently surveyed our membership regarding certain Form 5500 Schedule C reporting issues. Set forth below is a summary of the survey results.[1]

Definition of "Eligible Indirect Compensation" (EIC)

1. **In your opinion, has the DOL provided sufficient guidance for your organization to accurately determine what elements of compensation qualify for treatment as EIC?**

   26% - Yes
   74% - No (please explain).

2. **Questions 4 and 8 in the DOL's FAQs about the 2009 Form 5500 Schedule C raise some questions about which operating expenses of a mutual fund can be treated as EIC and whether treatment as EIC is only available for amounts paid directly from a fund as opposed to through an agent of the fund. Please indicate your responses to the following questions with respect to these issues.**

   2.1 We will only treat as EIC amounts otherwise eligible that are paid directly from the mutual fund and will not treat as EIC any amounts paid through an agent of the fund.

   37% - Yes
   37% - No
   11% - Still not sure.
   11% - Not applicable.
   5% - Other

   2.2 We will treat as EIC all amounts otherwise eligible derived from a fund's expense ratio, including 12b-1 fees, investment management fees, and other operating expenses.

   58% - Yes
   32% - No
   11% - Other (Respondents said that they were either not sure or had not yet decided.)

[1] Some results may total more than 100% because of rounding.

<u>Reporting of Non-Cash Compensation</u>

3. **In your opinion, has the DOL provided sufficient guidance for your organization to accurately report for Schedule C purposes either the receipt or the payment of non-cash compensation related to ERISA plans?**

   37% - Yes
   63% - No

4. **If your organization sponsors educational/marketing events for customers and potential customers designed to facilitate future sales of ERISA plans, which one of the responses below best describes your intended strategy for communicating the value of this benefit to attendees for purposes of their Schedule C reporting?**

   11% A. Our organization has made the determination that the benefit is being provided solely for the purpose of generating future sales and is not being provided in connection with services being provided to any existing plan or any attendee's position with any plan. We will communicate this position to attendees and will not provide any data on the value of the benefit unless asked to do so.

   11% B. We will provide data on the full value of the benefit to all attendees and leave it to each attendee to determine whether it is reportable compensation for Schedule C purposes and, if so, how it should be allocated among existing client plans.

   16% C. We will provide data to each attendee on the value of the benefit, as well as how it should be allocated to existing client plans, based on data in our system.

   5% D. We will cease or significantly curtail the sponsorship of educational/marketing events due to the complexities posed by Schedule C reporting obligations.

   26% E1. Other - Undecided.

   16% E2. Other - Minimal amounts or do not sponsor such events.

   16% E3. Other.

5. **If employees in your organization receive non-cash compensation (meals, outings, gifts, entertainment, etc.) from third party vendors where the benefit is being provided for the purpose of promoting future sales to your organization related to ERISA plans, which one of the responses below best describes your intended strategy for tracking receipt of this compensation for Schedule C reporting purposes?**

   16% A. We will tell our employees that if the benefit is being provided for the purpose of promoting future sales and is not being provided in connection with services to an existing plan or their position with any plan, it does not need to be tracked or reported. We will allow employees to rely on their own judgment and/or representations made by the provider of the benefit regarding the purpose for which the benefit is being provided.

   53% B. We will require employees to report all non-cash compensation received from third party vendors with whom we have any shared ERISA business. We will compile the information at year-end to determine what is reportable and how it should be allocated.

   5% C. We will require employees to report all non-cash compensation from third party vendors with whom we have any shared ERISA business. We will also require them to allocate the benefit to existing client plans after taking into account the exception for small amounts.

   5% D. We will adopt a policy of not allowing any employee to receive any benefit from any third party vendor with whom we have existing shared ERISA business due to the complexities of Schedule C reporting.

   16% E1. Other - Not applicable.

   5% E2. Other - Undecided.

<u>Reporting of Pass Through Compensation</u>

6. **In your opinion, has the DOL provided sufficient guidance for your organization to accurately report for Schedule C purposes compensation you receive in a "pass through" capacity that is ultimately paid to an unaffiliated plan service provider?**

   68% - Yes, we are confident we know how to report on the Schedule C compensation that "passes through" our organization and is ultimately paid to an unaffiliated service provider.

   27% - No, we are not confident that we know how to report "pass through" compensation that is ultimately paid to an unaffiliated service provider.

   5% - Stated that they do not receive "pass through" compensation.

5500 Preparation Service Model, Fees and Readiness

7. Are you changing your current service offering for Form 5500 preparation to include additional reporting on Schedule C?

26% A. Yes, our current Form 5500 service offering is changing, but with no change in fees in spite of the additional Schedule C reporting requirements.

32% B. Yes, our current Form 5500 service offering is changing, and with additional charges in view of the additional reporting requirements.

11% C. No, our Form 5500 service offering is not changing. However, the description of our Form 5500-related service is changing (for example, from calling the service 'final' or 'signature-ready' to calling it 'draft' or 'Form 5500 assistance' services).

16% D. No, our Form 5500 service offering is not changing and our description of our Form 5500 assistance or preparation services is not changing.

11% E1. Other - Undecided.

5% E2. Other.

8. If you are a firm that provides Schedule C (Form 5500) preparation services for some of your clients, but not for all of your clients, do you plan on providing substantially the same information related to Schedule C reporting to each set of clients?

79% - Yes, both sets of clients will receive substantially the same information.

21% - No, Schedule C information will only be provided to clients for whom we prepare the Schedule C.

9. Are you expecting to implement systems changes on your platform to accommodate the additional reporting requirements for Schedule C and, if so, when?

37% A. Yes, we expect to make changes to our systems, but those changes have not yet begun.

42% B. Yes, we expect to make changes to our systems, and those changes have begun.

5% C. No, we are not expecting to make any changes to our systems to accommodate any additional reporting requirements for Schedule C.

5% D. We are still considering whether or not system changes need to be made, and no changes have been made up to this point.

11% E. Other.

Respondents who answered either "A" or "B" were asked to answer Question 9.1.

9.1 If you are making systems changes to accommodate the additional requirements, do you expect to be prepared for the first 5500 filing using the new Schedule C?

53% A. Yes, we expect to be prepared to file full plan year (12/31/2009) filings (but not short year 2009 filings that are due earlier).

7% B. Yes, we expect to be prepared to file both short year and full year 2009 plan year filings.

0% C. No, we are not expecting to be ready to file 2009 plan year filings.

27% D. We are still estimating whether or not we will be able to file 2009 plan year filings for Schedule C that conform to the new Schedule C requirements.

13% E. Other.

10. Are you currently reviewing your service agreements and other disclosures to determine whether they meet the requirements for disclosures for purposes of the Schedule C alternative reporting option relating to Eligible Indirect Compensation?

84% - Yes, we are reviewing our service agreements and other disclosures to determine whether they will provide sufficient information to rely on the alternative reporting option.

16% - No, we are not at this time reviewing our service agreements or other disclosures for purposes of the Schedule C alternative reporting option.

Data Collection Issues

11. Are you expecting plan sponsors to provide information to you which will need to be included in Schedule C, due to the additional reporting requirements?

21% A. Yes, we are expecting to receive additional information from sponsors to include on Schedule C, and will assess a fee for including it.

47% B. Yes, we are expecting to receive additional information from sponsors to include on Schedule C, but will not assess a fee for including it.

11% C. No, we do not expect any additional information from sponsors and will include only our own compensation on our draft preparations of Schedule C. Sponsors will be expected to obtain additional required information from other service providers, and complete the Schedule C with information they obtain from these service providers.

21% D. Other.

NOTE - AFTER TAKING INTO ACCOUNT THE EXPLANATIONS PROVIDED BY THE RESPONDENTS THAT ANSWERED "OTHER" THE ADJUSTED AND CONSOLIDATED RESPONSE RATES ARE:

79% - Yes, we are expecting to receive additional information from sponsors.
16% - No, we do not expect any additional information from sponsors.
5% - Unsure.

12. Have you been approached by nonaffiliated service providers to act as a 'central distributor' of disclosures or other information that they want you to pass on to mutual clients for purposes of Schedule C reporting? An example might be broker-dealer firms that have no contract with you asking you to report to plan sponsors' commissions or other payments (indirect compensation) that pass through your firm but are ultimately received by them for services they perform.

21% - Yes
79% - No

13. If you are not a mutual fund company, but provide Schedule C preparation services for plans that hold mutual funds, do you expect that mutual fund companies will provide you or your clients with the information necessary (beyond what they already report in prospectuses) to report indirect compensation related to fund investments?

26% - Yes, mutual fund companies will provide additional informational materials that are focused on Schedule C reporting so that Schedule C reporting is made easier for plan sponsors and service providers.

32% - No, mutual fund companies will not provide any new materials that are focused on Schedule C reporting.

32% - Other.

11% - Not applicable.

14. If you provide Schedule C 5500 preparation services, and there are other nonaffiliated service providers also servicing the plan AND YOU WILL BE REPORTING THEIR INFORMATION ON THE SCHEDULE C, how do you expect that the information you need to complete the Schedule C will be furnished to you?

53% A. The plan sponsor will need to obtain this information from nonaffiliated service providers and provide this information to us so that we can report it on the Schedule C.

0% B. We will contact nonaffiliated service providers and obtain the necessary information directly from them.

26% C. A combination of A and B.

21% D. Other.

15. For compensation of nonaffiliated third parties, such as investment companies, trustees, or others whose services would be eligible for the alternative reporting method (i.e., Eligible Indirect Compensation), what role, if any, do you expect to take with respect to providing the required disclosures on behalf of the third parties?

11% A. We expect to provide disclosures for the third parties but will take the position that we are merely delivering the disclosure on behalf of the third party (Schedule C, Line 1(b) will indicate that the service provider performing the services provided the disclosure for eligible indirect compensation).

21% B. We expect to provide disclosures for the third parties and will take the position that we are the actual entity providing the disclosure (Schedule C, Line 1(b) will indicate that we are providing the disclosure for eligible indirect compensation).

47% C. We expect that we will not provide disclosures for third parties. Third parties will need to provide them directly to plan sponsors.

11% D1. Other - Undecided.

11% D2. Other - Combination of B and C.

Respondents that answered either "A" or "B" were asked to answer Question 15.1

15.1 Please list the types of service providers for whom you will furnish disclosures. For example, if you are going to provide information about an institutional trustee, the disclosure might include the trustee's fees and any float income earned by the trustee.

NOTE - FIVE COMPANIES RESPONDED AND IDENTIFIED ONE OR MORE TYPES OF SERVICE PROVIDERS AND COMPENSATION.

<u>Reliance on Q&A 40 and "Good Faith" Statements for 2009 Reporting</u>

16. Which of the following statements best describes your organization's current thinking regarding relying on Q&A 40 of the DOL's FAQ for 2009 Schedule C reporting?

21% A. We are on track with an implementation plan that will allow us to deliver all required data for 2009 reporting and do not anticipate relying on Q&A 40 or sending out any "good faith" statements.

63% B. We have a project plan and are working to deliver actual data for 2009 reporting but believe there is a possibility we will need to rely on Q&A 40 and send out "good faith" statements.

16% C. We will be working on an implementation plan in 2009 but do not anticipate completing it in time to deliver actual data for the 2009 reporting year and intend to rely on Q&A 40 and send out "good faith" statements to our customers.

0% D. Other.