

ERISA Advisory

More Filers, More to File: ERISA Agencies Slate Major Expansion, Revamp of Form 5500 for 2019

September 1, 2016

As attention grabbers go, “This document contains proposed changes to the Form 5500 Annual Return/Report forms, including the Form 5500, Annual Return/Report of Employee Benefit Plan (Form 5500 Annual Return/Report), and the Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan (Form 5500-SF)” ranks well below “It was the best of times; it was the worst of times.” That lead in is unlikely to lure readers into the 147 dense *Federal Register* pages (about 165,000 words) that follow. 81 *Fed. Reg.* 47534 (July 21, 2016).¹ Nonetheless, sponsors of retirement and welfare plans should not ignore this massive production. Although the new forms are not slated for use until plan years beginning in 2019 (with the first filings in 2020), many of the data that they demand are not routinely collected and may not be easily retrievable from current information systems.

Some changes are matters of form rather than substance. Some questions have been moved to different schedules, others have been rephrased, and numerical codes for plan features have been replaced by a series of “yes/no” choices. More substantively, the new regime will expand both the universe of plans that must file annual reports and the quantity of information that the reports must include. Some highlights:

- Plan assets, income, and expenses will be grouped into much finer categories than before, with many new sub-categories (e.g., six for real estate and five for derivatives). “Other” will require a description of the item instead of being an anonymous catch-all.
- Information will have to be provided about many matters that are absent from, or touched on only lightly by, the current form, including securities lending, “hard-to-value” assets, plan mergers and terminations, participant-directed accounts, administrative expenses charged to participants, prohibited transactions, claims procedures, and even checks mailed to participants that have not been negotiated.
- Additional questions focusing on compliance with ERISA and Internal Revenue Code requirements will be added. Among other matters, plans will have to disclose whether summary plan descriptions and summaries of material modifications have been timely distributed and whether the plan auditors have advised the sponsor regarding irregularities in plan operations, internal control weaknesses, or qualification defects.
- Defined benefit plans with 500 or more participants will have to project their benefit payments year-by-year for the next 10 years.
- The reporting format will be revised to improve “data mineability.” For instance, schedules of assets will have to include Committee on Uniform Security Identification Procedures (CUSIP) or other standard identifiers, if available.

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¹ On the same day, the Department of Labor published proposed regulations to support the Form 5500 changes. 81 *Fed. Reg.* 47496 (July 21, 2016).

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- The IRS will make available electronic versions of IRS-only forms, such as 990-EZ, that currently can be filed only on paper. An electronic Form 5558 will make it possible to obtain filing extensions on-line. Except where IRS rules mandate electronic filing, filing these forms on paper will remain an option.
- All health plans will have to report information about plan characteristics, claims experience and administrative practices on a new Schedule J. Small fully insured or self-funded health plans (those with fewer than 100 participants) will lose their current exemption from Form 5500 reporting.
- Schedule C, which currently requires detailed information about service providers and their fees, will grow yet larger and more detailed.
- The former Schedule E (ESOP Annual Information), which was abolished after 2008, will be reintroduced and expanded.

The principle underlying the revised form is simple: The ERISA agencies (the Department of Labor (DOL), the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC)) want tools for keeping a much closer watch over employee benefit plans. The array of new data furnished by the new 5500s, along with the more “mineable” format, will serve two purposes: (1) to give policymakers fuller information about the employee benefits universe, and (2) to enable them to pick out individual plans for scrutiny.

Only peripheral efforts were made to reduce the reporting burden. For instance, the confusing concept of “master trust investment accounts,” which sometimes makes it necessary for a single master trust to file several 5500s, will be scrapped, and participants who have no account balances will not be considered in determining whether a defined contribution plan meets the 100 participant threshold for including an independent auditor’s report with its filing.

As in the past, the main body of the form will ask for only basic data about the plan. Most of the substance will be contained in schedules – 10 in all (14 if one counts sub-schedules), though no plan will have to file every one of them. The list of schedules gives an idea of the breadth of the information sought:

Schedule A –	Insurance Information
Schedule C –	Service Provider Information
Schedule D –	DFE/Participating Plan Information ²
Schedule E –	ESOP Information
Schedule G –	Financial Transaction Schedules
Schedule H –	Financial Information (which has sub-schedules for “Delinquent Participant Contributions,” “Assets Held for Investment,” “Assets Disposed of During the Plan Year,” and “Reportable Transactions”)
Schedule J –	Group Health Plan Information

² “Direct filing entities” (DFEs) are various pooling arrangements, such as master trusts and common or collective trust funds, that hold assets of a number of related or unrelated plans. DFEs may (or in some cases must) file Form 5500s whose information can then be incorporated by reference into the reports of participating plans. The proposed changes to DFE reporting are of great interest to banks, insurance companies, and partnerships in which plans invest but are too complex to describe here.

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- Schedule MB – Multiemployer Defined Benefit Pension Plan Actuarial Information and Certain Money Purchase Plan Information
- Schedule R – Retirement Plan Information
- Schedule SB – Single Employer Defined Benefit Pension Plan Actuarial Information

Also as before, most small plans (fewer than 100 or, in some cases, 120 participants at the beginning of the plan year) may satisfy their annual reporting requirements by filing Form 5500-SF, which requires fewer schedules and no independent auditor's report. Small plans that hold assets outside of specified plain vanilla categories (publicly traded securities, mutual fund shares, insurance contracts, and the like) are ineligible for Form 5500-SF. The short form will also be unavailable to small health plans.

Proposed Schedules C and H are the most significantly revised. Without delving into every detail, the remainder of this advisory will look at them and at the brand new Schedule J.

Schedule C – Service Provider Information

Schedule C's main purpose is to disclose the fees that plans pay, directly or indirectly, to service and investment providers. The proposal requires the schedule from more plans than before, though Form 5500-SF filers remain exempt. The principal burden – and Schedule C is disproportionately burdensome to complete – will fall on small retirement plans that invest in real estate, private equity funds, derivatives, or other assets that render them ineligible for Form 5500-SF. It seems implausible that these plans are particularly subject to abuse by service providers or that adding their data will materially improve the quality of statistics (the ostensible motive for the change). The effect, intended or not, will be to add an additional cost to “nonstandard” investments by small plans.

The revised schedule will lower the threshold for disclosing compensation paid to some service providers from \$5,000 to \$1,000. This expanded disclosure applies to –

- Services as a fiduciary or an investment advisor directly to a plan
- Services as a fiduciary to an investment vehicle (e. g., a mutual fund) in which a plan holds an equity interest
- Recordkeeping and brokerage services for participant-directed accounts
- Any services for which the provider receives indirect compensation (that is, compensation that is not paid directly by the plan or the plan sponsor)

At present, many types of indirect compensation, including fees reflected in mutual fund investment returns or paid with “soft dollars,” are reported only minimally. All that the Form 5500 must disclose is the identity of the recipient. A prerequisite for this exclusion is that the recipient must furnish information to the plan administrator about the nature of the fees and the formula by which they are calculated. A mutual fund or other service provider does not have to figure out how much of its aggregate indirect compensation is allocable to particular plans.

In the future, the indirect compensation received by service providers will have to be quantified plan-by-plan. Any “reasonable method of allocation” may be used, and estimates will be acceptable. Responsibility for performing these calculations will rest on the service provider, which will be exposed to prohibited transaction penalties if it fails to furnish the results to the plan administrator. Whether dollar figures for indirect compensation will be meaningful is open to question. The information currently

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furnished to plan administrators about why the fees are imposed and how they are determined seems more likely to shed light on dubious practices.

The following elements of the proposed Schedule C are also of interest:

- Compensation that is passed through to affiliates or subcontractors of a service provider must be disclosed, including the identity of the payor and the payee, the amount paid, and the services that the related party rendered.
- If an investment provider furnishes recordkeeping services wholly or partly free of charge, the value of those services must be estimated and disclosed. No guidance is offered as to whether the amount to be reported is fair market value, the provider's direct incremental cost, the incremental cost plus overhead, or something else.
- The plan's use of "ERISA budget accounts" (arrangements under which an investment provider offsets a portion of revenue sharing payments against fees owed by the plan) must be disclosed. The plan will still report only the net amount as direct compensation.
- Clarifying an area in which it has given ambiguous guidance in the past, the new form makes it clear that expense reimbursements to plan trustees and employees are reportable only when they result in taxable income to the recipient. The plan must, however, report (on Schedule H) the aggregate amount spent on trustees' travel, meetings, education, and the like, whether taxable or not.
- At present, Schedule C asks for information about any termination of the plan's actuary or accountant. This item will be moved to Schedule H and will be expanded to cover any service provider that is terminated for failure to meet its contractual obligations or the requirements of ERISA.

Schedule H – Financial Information

The revised Schedule H subdivides asset categories more finely than in the past and alters the structure of the form to facilitate "data mining." Its various sub-schedules will likewise demand more data. Lists of assets and other information now generally reported on PDFs will be entered into "structured attachments," the exact nature of which is left vague. Any competent data miner can, of course, work readily with PDFs, or even scans of paper documents, making the value of this change debatable. Like Form 990's Schedule O, it may simply slow down data entry with little improvement in the form's usability by third parties.

The current schedule has 21 lines for entering the values of various categories of plan assets. The revised schedule will have over three times as many. It will show certificates of deposits and money market accounts (currently lumped with "interest-bearing cash") separately, divide corporate debt instruments between investment grade and high-yield, divide unallocated insurance contracts among types of contract (deposit administration, immediate participation guaranteed (IPG), guaranteed investment contracts (GIC), and others), and real estate among developed real property, undeveloped real property, publicly traded and non-publicly traded real estate investment trusts, real estate operating companies, mortgage-backed securities, and other real estate. Comparably detailed break-outs will be required for partnership interests, derivatives, commodities, securities lending arrangements, foreign investments, and assets held in participant-directed brokerage accounts.

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Modifications to the income and expense statement are less extensive. One addition to note is that direct rollovers, hardship distributions by 401(k) plans, and distributions by defined benefit plans to active employees aged 62 or older will have their own reporting lines. Administrative expenses will also be further subdivided, in this case by restoring lines that appeared on Schedule H before the 1999 revision (actuarial fees, recordkeeping fees, legal fees, etc.). Plan expenses charged to participants' accounts will have to be disclosed, too, along with information about how they are allocated.

The revised sub-schedule of assets held for investment must include CUSIP numbers or other generally recognized securities identifiers (if available) and individually identify "hard to value assets." The latter are now defined as "assets that are not listed on any national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System (NASDAQ)." As at present, assets held in participant-directed accounts will be entered in a single line item on the sub-schedule, though a breakdown by category will be required on the main Schedule H.

The Department of Labor has long regretted the existence of limited scope audits but lacks the political backing for their abolition. The new Schedule H will police them somewhat by requiring the attachment of the investment certifications on which the plan auditor relied.

Finally, many compliance-oriented items have been added to the schedule, including –

- Information concerning peer review of the auditor's opinion
- Confirmation that the auditor advised the plan sponsor of any irregularities discovered in the course of the audit
- Dates and other information about plan terminations, mergers and transfers of assets (including the name and employee identification number (EIN) of any financial institution with which accounts were established for missing participants after plan termination)
- The number and amount of uncashed, stale checks issued to participants and a description of the plan's procedures for verifying distributees' addresses and following up on uncashed checks (for defined contribution plans only)

Schedule J – Group Health Plan Information

All plans that provide health benefits, including small unfunded or fully insured plans that are currently exempt from annual reporting, will have to file Form 5500 and Schedule J. The data required from small fully insured plans will be minimal; for those with unfunded or trustee benefits, the burden will be noticeable. The DOL estimates that a full Schedule J will take three and a half hours to complete, which one may assume is optimistic.

The new schedule is intended to elicit information about plan operations, ERISA compliance, and compliance with some requirements of the Affordable Care Act (ACA) (not including, for instance, the employer mandate and "minimum essential coverage"). Aside from what one would intuitively expect (such as types of benefits, number of participants and beneficiaries, and amount of benefit payments), the data to be disclosed includes (a non-comprehensive list) –

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- How many participants and beneficiaries were offered Continued Omnibus Budget Reconciliation Act (COBRA) continuation coverage and how many took it up
- Whether any part of the plan has “grandfathered” status under the ACA
- Whether the plan includes a high-deductible option, health flexible spending accounts, or health reimbursement accounts
- Whether the plan received rebates from service providers and, if so, the amounts involved and how they were applied
- Premiums paid for stop-loss coverage and information about the coverage (attachment points, individual claim limits, and aggregate claim limits)
- How many claims were submitted during the year, how many were denied, how many denials were appealed, how many denials were upheld, and how many were not adjudicated during the time frames set forth in DOL regulations (with the data on appeals broken down between services that did and did not require pre-certification)
- Whether the plan was unable to pay benefits in full and the number of unpaid claims
- Whether the plan was delinquent in paying insurance premiums and, if so, whether the delinquency resulted in any lapse in coverage

And that may not be all:

In an effort to collect more robust data on claims adjudication practices and policies, the DOL is considering, in addition to the information requested in the new Schedule J, whether to require plans to report more information on denied claims, such as the dollar amount of claims that were denied during the plan year, the denial code, and/or whether the claims were for mental health and substance use disorder benefits or for medical/surgical benefits.

Observations

To show the need for overhauling Form 5500, the ERISA agencies cite a plethora of government reports: Government Accountability Office, GAO-10-54, *Private Pensions: Additional Changes Could Improve Employee Benefit Plan Financial Reporting* (2009), Government Accountability Office, GAO-14-441, *Private Pensions: Targeted Revisions Could Improve Usefulness of Form 5500 Information* (2014), 2013 ERISA Advisory Council Report: *Private Sector Pension De-risking and Participant Protections*, Department of Labor Office of Inspector Gen., 09-13-001-12-121, *Employee Benefits Security Administration Needs to Provide Additional Guidance And Oversight to ERISA Plans Holding Hard-to-Value Alternative Investments* (2013), and many, many more.

The *Federal Register* notice does not, however, explain with any specificity what use the agencies will make of the wealth of facts that will be placed at their disposal. An obvious goal would be to develop a methodology for targeting plans for examination in place of the current more or less random selection, but that will be a monumental task. Do any of the agencies have the resources and expertise to undertake it?

One evident hope is that the new reporting regime will influence the way in which plans are operated. For instance, the questions about uncashed checks are designed to encourage improvements in tracking participants' addresses and following up on distributions that fail to reach their intended recipients.

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Some of the new data are not routinely collected by many, probably most, plans. An example is data on denied claims and appeals. The great majority of health plans farm out claims processing to insurers or third party administrators. The employer simply pays the bills and has hitherto had no reason to track approvals and denials.

This is not the place to discuss how essential the newly sought data truly are to the missions of the DOL, IRS, and PBGC. It will be interesting to learn what species of derivatives most appeal to plan investors and how much foreign real estate US plans hold and numerous other factoids. Whether that information can be practically applied to produce useful knowledge may be more arguable.