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BENEFITS BRIEF

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Agencies Propose Significant Changes to Form 5500 Annual Reporting

On Monday, July 11, 2016, the Department of Labor ("DOL"), the Internal Revenue Service ("IRS"), and the Pension Benefit Guaranty Corporation ("PBGC") (collectively, the "Agencies") proposed revisions to the forms and regulations governing the Form 5500 annual reporting process for employee benefit plans ("Proposed Revisions"). These Proposed Revisions, if implemented, would be the most significant overhaul of the Form 5500 since the Agencies' last Form 5500 update, effective with the 2009 plan year (the "2009 Update"). The revisions would affect employee pension and welfare benefit plans, plan sponsors, administrators, and service providers to plans (including recordkeepers and trustees) subject to annual reporting requirements under the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code ("Code").

According to the Agencies, the Proposed Revisions are intended to meet several goals, including the following:

- Modernizing the financial statements and investment information filed about employee benefit plans;
- Updating the reporting requirements for service provider fee and expense information;
- Requiring Form 5500 reporting by all group health plans covered by Title I of ERISA; and
- Improving compliance and oversight under ERISA and the Code through new compliance questions regarding plan operations, service provider relationships, and financial management.

The Proposed Revisions have not yet been published in the Federal Register. Both the Form 5500 Notice of Proposed Forms Revisions and the Form 5500 Proposed Rule are scheduled to be published on July 21, 2016. If adopted on schedule, the revised reporting requirements would generally apply to plan years beginning on or after January 1, 2019.

The Agencies are seeking written comments on the Proposed Revisions on or before October 4, 2016. We have been informed by DOL that the entire Form 5500 is open for public comment during this process (not just the portions of the Form that have been revised), and that they are open to feedback.

A. Executive Summary

The Proposed Revisions greatly expand the scope of information captured by the Form 5500 for nearly every type of employee benefit plan, including defined benefit plans, defined contribution plans, large and small group health plans, and ESOPs. The Proposed Revisions are complex and will take time to analyze. Nonetheless, it is clear that, given the sizeable

civil penalties that apply to Form 5500 failures and the threat of agency scrutiny, plan administrators will need to collect more data and devote more resources than ever before to file a complete Form 5500 if these changes are adopted. No doubt, plan sponsors will be looking to their service providers – and in some cases, multiple service providers – to assist them in meeting these new reporting challenges.

The key takeaways from the Agencies' proposals are as follows:

- The Proposed Revisions make clear that, due to resource and other constraints, the Agencies are increasingly relying on the Form 5500 as a key component of their enforcement efforts. The changes add numerous new compliance questions aimed at disclosing whether a plan is in compliance with a host of specific legal requirements under ERISA, the Code, and various federal laws that apply to group health plans.
- The Agencies are seeking more information related to investments. First, they are expanding the Schedule H categories of plan assets to reflect new asset categories and sub-categories, intended to more closely reflect the variety of alternative and complex investments held by plans. Second, they are proposing material changes to the reporting rules governing plan investments in direct filing entities ("DFEs") and master trusts.
- The Agencies are attempting to harmonize the fee disclosure requirements (Schedule C) with the disclosure regime under ERISA section 408(b)(2) that applies to ERISA pension plans. As a result, the rules regarding the reporting of "indirect compensation" earned by service providers have been simplified and made more consistent with information already required to be disclosed under DOL regulations.
- The Agencies want more information about health and welfare plans. Thus, the Form 5500 reporting exception for small unfunded or fully insured group welfare plans has been eliminated, making all group health plans subject to Form 5500 reporting, regardless of size. Additionally, a new Schedule J has been added, requiring group health and welfare plans to answer a host of questions related to compliance with various federal laws, including the Affordable Care Act, and to provide detailed claims data.

We describe these and other Form 5500 changes in more detail in the remainder of this memorandum.

B. Changes to Schedule H (Financial Information)

The Proposed Revisions would retain the asset/liability and income/expense structure currently in place in Parts I and II of Schedule H. However, the balance sheet component of Schedule H would be modified to include additional categories and subcategories of assets. The Agencies intend to improve transparency for the current "other" categories which plans have been using to cover a wide variety of unspecified assets. Additionally, the Agencies are proposing to change the way alternative investments, hard-to-value assets, and investments through collective investment vehicles are reported. The Agencies believe these changes are necessary due to the changing nature of plan investments, particularly the increased use of sophisticated and complex investments that do not fit neatly into any of the existing reporting categories.

Specifically, the Proposed Revisions would make the following changes:

- The Proposed Revisions would add new categories for "derivatives" and "foreign investments." In addition, new sub-categories would be added to the existing "Partnership/Joint Venture Interests" category to separately delineate the value of a plan's investment in "limited partnerships," "venture capital operating companies," "private equity," "hedge funds," and "other partnership/joint venture interests." Filers would need to indicate the total value of such investments that are plan asset vehicles.

- The Proposed Revisions would require additional reporting of assets held through self-directed brokerage accounts ("SDBs"). Filers would need to include the total current value of all assets held through SDBs and also sub-totals for SDB investments in a number of categories, including tangible personal property, loans, and partnership or joint venture interests.
- The Proposed Revisions would add new sub-categories to the "Administrative Expenses" category of the "Income and Expenses" section of Schedule H to capture amounts paid for salaries, audit fees, recordkeeping fees, trustee and custodial fees, actuarial fees, legal fees, valuation fees, and trustee expenses, including travel and meetings (regardless of whether taxable). Further, new lines would require the plan administrator to specify how plan expenses were allocated to the plan, meaning whether expenses were paid by the plan directly or charged against participant accounts. If charged against participant accounts, the plan sponsor would have to specify how the expenses were allocated among participants (*e.g.*, whether allocated pro rata or per capita).

C. Changes to Schedule H, Line 4i Schedules of Assets

The Proposed Revisions include structural, data element, and instructional changes to the Form's Line 4i schedules of assets (currently the "Schedule of Assets Held for Investment at End of Year" and "Schedule of Assets Acquired and Disposed Within Year"), which are filed by plans and by certain DFEs. The Proposed Revisions would retain the two separate schedules of assets but would change the existing "Schedule of Assets Acquired and Disposed of Within Year" to a "Schedule of Assets Disposed of During the Plan Year." According to the Agencies, the change would capture information about alternative investments and hard-to-value assets purchased in one year and sold in the middle of a subsequent year that is not captured by the current schedules. Under the new line 4i attachment –

- Filers would be required to complete the schedules in a data-capturable format;
- A new method (check boxes rather than asterisks) would be utilized for identifying investments that involve parties-in-interest and hard-to-value assets; and
- Filers would need to add, if applicable, CUSIPs, CIKs and LEIs for each asset on the schedules.

D. Changes to DFE Reporting

The Proposed Revisions include changes to the information about DFEs and their underlying investments that need to be reported by the plan and the DFE. The Agencies intend for this revised reporting structure to enable them, the plan fiduciaries and service providers, and other users of the data to have a better and more complete picture of plan investments. New DFE reporting rules include the following:

- Rather than completing Schedule D, plans would show the DFEs in which they invest through the line 4i attachment;
- For collective trust and pooled separate account investments, a plan's interest in the investment would be reflected on a single line of Schedule H regardless of whether the investment itself files as a DFE;
- Detailed information about the investments held by a plan for collective trusts and pooled separate accounts that do not file as DFEs would be reflected on the plan's line 4i attachment; and
- The reporting rules for master trusts would be simplified, eliminating the current concept of master trust investment accounts.

E. Information on Plan Terminations and Mergers

The Proposed Revisions would add more information to the Form 5500 concerning plan terminations and mergers, including the following:

- The existing question in Schedule H and Form 5500-SF that asks whether the plan has adopted a resolution to terminate would be expanded to include more detail about the termination;
- A new question would be added that asks the filer to indicate whether another plan transferred assets or liabilities to the reporting plan and, if so, the date and type of transfer; and
- A terminated defined contribution plan would be required to provide additional information to allow missing participants to track down assets transferred to a financial institution (*e.g.*, to an IRA) on their behalf.

F. Schedule C – Service Provider Information

In a helpful change, Schedule C (used to report service provider information), has been rewritten to more closely align with the disclosure requirements for service providers under ERISA section 408(b)(2). In the 2009 Update, the Agencies completely revised Schedule C, adopting complicated new rules for the reporting of "indirect" compensation. The Schedule C rules for indirect compensation reporting were so complex that the DOL ultimately issued over 60 FAQs to assist Schedule C filers.

For the most part, the revised Schedule C significantly dials back the complexity of indirect compensation reporting, but it has created some new challenges as well. The key changes to Schedule C are as follows:

- Schedule C would require the reporting of indirect compensation information only for "covered service providers" within the meaning of DOL's section 408(b)(2) regulations, and the instructions have been harmonized to more closely track the section 408(b)(2) regulation. This change alone will have a dramatic impact on the number of entities required to be reflected on the Schedule C and the scope of materials that must be reviewed in order to complete the Schedule C. For example, investment managers of mutual funds that have no relationship with the plan other than the plan's investment would no longer be required to be reflected on the plan's Schedule C.
- Schedule C would retain the requirement to report service providers that earn more than $5,000 in direct compensation from the plan.
- Service providers to welfare plans would be reported only if they earned more than $5,000 in direct compensation from the plan.
- The alternative reporting rules for "eligible indirect compensation" (*i.e.,* a simplified reporting method for float, commissions, soft dollars, fees charged against funds and other forms of indirect compensation) would be eliminated.
- Going forward, Schedule C reporting would be required for small pension and welfare plans in addition to large plans.
- Schedule C would include a new line asking if the arrangement includes recordkeeping services without explicit compensation for such services or where compensation has been offset based on other compensation received by the provider (such as from plan investments). This is consistent with the section 408(b)(2) disclosure rules that require recordkeepers to provide cost estimates. If this box applies, the filer would enter a dollar amount received for recordkeeping services, which could be based on the cost estimate required to be provided by the provider in the recordkeeper's section 408(b)(2) disclosure.

- While prior versions of Schedule C allowed for reporting of indirect compensation as a formula, formulaic reporting would no longer be an option. Schedule C would continue to require filers to identify certain payors of indirect compensation consistent with the section 408(b)(2) disclosure rules. However, the new Schedule C would require the reporting of a specific dollar amount (or an estimate) paid by each payor of indirect compensation. This requirement would be particularly challenging for recordkeepers and administrative service providers who currently report much indirect compensation in the form of a formula (*e.g.*, mutual fund revenue sharing payments).
- The existing Schedule C question regarding the termination of accountants and actuaries has been moved to Schedule H and expanded to request information about any plan service provider terminated for a material failure.

G. Health and Welfare Plan Reporting Changes

1. Reporting Exemption for Small Welfare Plans

Under current reporting rules, plans that provide health and welfare benefits with fewer than 100 participants at the beginning of the plan year that are fully insured, unfunded, or a combination of both are exempt from filing a Form 5500. The Proposed Revisions would limit this exemption by requiring all ERISA-covered plans that provide group health benefits to file a Form 5500, regardless of size, whether they are funded with a trust, unfunded, or a combination unfunded/insured. However, any Schedule H, G, and C exemptions will continue to apply for such plans.

2. Content of Form 5500

The Proposed Revisions also impose a number of content changes that affect health and welfare plan filings. For example, the Proposed Revisions add a new Schedule J. That schedule would gather a wide range of information required to be reported under the Public Health Service Act, including –

- The number of persons offered and receiving COBRA coverage;
- Information on whether the plan offers coverage for employees, retirees, and dependents;
- The type of group health benefits offered under the plan;
- Whether the health plan funding and benefit arrangement is through a health insurance issuer and whether benefits are paid through a trust or the employer's general assets;
- Prototype/off-the-shelf policy information, if applicable;
- Grandfathered status of benefit options offered under the plan;
- Whether the plan is a high deductible health plan, a health FSA, or an HRA;
- Information on receipt of rebates, refunds, or reimbursements from a service provider (including medical loss ratio rebates);
- Information on service providers not identified on the Schedule A or C;
- Stop loss premium, attachment point, individual claim limit, and aggregate claim limit information;
- Information on employer and participant contributions (if not already reported on the Schedule H);
- Detailed claims payment data, including information on appeals, denials, and whether applicable timeframes were met;
- Information on compliance with the Summary Plan Description, Summary of Material Modifications, and Summary of Benefits and Coverage content requirements;

- Information on compliance with applicable federal laws and DOL regulations (*e.g.*, HIPAA portability and nondiscrimination, GINA, MHPAEA, the Newborns and Mothers' Health Protection Act, the Women's Health and Cancer Rights Act, Michelle's Law, and the ACA); and
- Small, fully-insured plans would be required to answer only limited questions on the Form 5500 and Schedule J (*i.e.*, basic participation, coverage, insurance company, and benefit information).

H. Small Plan Reporting Changes

1. Eligibility to Use Form 5500-SF

Under existing reporting rules, a plan may file a simplified annual return, the Form 5500-SF, if it meets the following requirements:

- It covers fewer than 100 participants at the beginning of the year;
- It is exempt from the audit requirement;
- It invests 100% of assets in certain secure investments with a readily determinable fair market value;
- It does not hold employer securities; and
- It is not a multiemployer plan or MEWA.

The Proposed Revisions exclude welfare plans with fewer than 100 participants that provide group health plan benefits from eligibility to use the Form 5500-SF. In addition, the Proposed Revisions would implement a number of content changes to the Form 5500-SF, requiring additional reporting by plans.

2. Changes for Small Plan Filers Not Using the Form 5500-SF

The Proposed Revisions also make significant changes for small plans that are not eligible to file a Form 5500-SF. For these plans, the Proposed Revisions –

- Eliminate the Schedule I, the schedule currently used by small plans to report financial information;
- Require that the Schedule H be completed, including the schedules of assets, though small plans that are currently exempt from the audit requirement will continue to be exempt under the Proposed Revisions;
- Revise the Form 5500 to add a new question asking defined contribution pension plans to report the number of participants with account balances at the beginning of the plan year; and
- Revise the audit exemption to be based on the number of participants with account balances as of the beginning of the plan year, rather than on the total number of participants at the beginning of the plan year.

I. Financial Transaction Reporting Changes on Schedule G

To improve the uniformity and reporting of investment and financial transaction information, the Agencies have proposed changes to Schedule G, which reports information on loans, fixed income obligations, leases in default or uncollectible, and nonexempt prohibited transactions. The revised Schedule G would collect additional information about plans' transactions and relationships, especially nonexempt prohibited transactions. Regarding prohibited transactions, new boxes would be added to indicate the specific type of transaction involved, such as whether it involves a purchase or sale of property, an exchange of property, a lease, extension of credit, or a furnishing of goods to or from the plan.

J. Schedule E Re-introduction for Employee Stock Ownership Plans (ESOPs)

Prior to 2009, ESOP information was reported on Schedule E, an IRS-required schedule. As a result of the move to mandatory electronic filing, Schedule E was eliminated in the 2009 Update, and some of the Schedule E questions regarding ESOPs were moved to Schedule R.

The Proposed Revisions would re-introduce a revised Schedule E for ESOPs that would provide information of interest to both the DOL and the IRS. The Agencies believe a single ESOP schedule would simplify the Form 5500 for all filers and lead to a more efficient information collection tool for the Agencies. The proposed Schedule E would reincorporate the questions originally moved to Schedule R in the 2009 Update, revise some pre-2009 Schedule E questions, and add new questions, including whether –

- The ESOP is maintained by an S corporation (and if so, whether any prohibited allocations were made to disqualified persons);
- The employer maintaining the ESOP paid dividends deductible under Code section 404(k);
- The ESOP held any preferred stock and the formula for converting that stock into common stock;
- Any unallocated securities were used to pay an exempt loan (and if so, the method); and
- The employer made payments in redemption of stock held by an ESOP to terminating participants and deducted them under Code section 404(k).

K. IRS-only Changes

The Proposed Revisions include a number of questions proposed solely by IRS. In 2009, when DOL moved to mandate electronic filing, IRS lacked the authority to require electronic filing. At that time, in order to facilitate electronic filing, certain questions that related only to the Code were dropped from the Form. IRS has expressed concern in recent years that this removal compromised its ability to effectively oversee retirement plans.

Starting with the 2015 Form 5500 and Form 5500-SF, IRS attempted to fold back in many of the IRS-only questions that had been dropped and add several new ones. After Groom and others raised concerns, IRS directed filers not to answer the questions for the 2015 plan year and re-issued the questions, intending that they would be required for the 2016 plan year. In particular, the questions require disclosure of –

- Trust information (*e.g.*, name of trust, EIN, name of trustee or custodian);
- Whether the plan identifies as a 401(k) plan or a pre-approved plan (previously characteristic codes);
- The method of satisfying nondiscrimination and coverage testing (Code sections 401(a)(4), 410(b));
- The method of complying with the ADP testing requirements;
- Whether the plan received a favorable determination letter and the date of the letter;
- Any distributions made to an employee who attained age 62 and had not separated from service for defined benefit and money purchaser plans; and
- The organization that prepared the form (if any) along with a signature and certain identifying information about the preparer (*e.g.*, name and address), and requires the preparer to sign.

IRS has also proposed adding additional compliance and oversight questions for plan years after 2016. The new IRS questions, which could be effective before the 2019 plan year, include questions asking whether –

- A defined benefit the plan complies with the minimum participation rules (Code section 404(a)(26));

- Minimum required distributions were made to 5% owners (Code section 401(a)(9));
- A 401(k) plan made hardship distributions during the plan year;
- The plan is an arrangement described under Code section 403(b)(1) or 403(b)(7);
- A defined contribution plan is frozen (*e.g.*, it does not provide any new benefit accruals as of the last day of the plan year);
- The plan is electing non-church plan status (Code section 410(d)); and
- The plan incurred unrelated business taxable income (Code sections 511-512).

Notably, the Proposed Revisions would also require trustees to sign Schedule H and the Form 5500-SF and certify that, under penalty of perjury, the trustee has examined the return/report (and accompanying documents) and believes it to be true, correct, and complete.

IRS has asked for comments as to whether there should be a single IRS-only schedule or whether its questions should be incorporated into other parts of the Form 5500 based on subject matter.

L. New Compliance Questions

The revised Schedules H and R (and Form 5500-SF) will feature several new compliance questions, including whether–

- Any person was permitted to serve the plan who was disqualified under ERISA section 411 (*i.e.*, persons convicted of specified crimes);
- The plan sponsor paid administrative expenses that were not reported as service provider compensation (Schedule C) or plan administrative expenses (Schedule H); and
- The plan sponsor, or any of its affiliates, acted as a service provider to the plan in exchange for compensation.

For participant directed account plans, the schedules would include questions related to –

- The number of designated investment alternatives a plan offers and how many are index funds;
- Whether a plan provides participants with disclosures required by DOL's participant-disclosure regulations, and if so, the plan must attach a copy of its comparative chart of investment alternative information;
- The number and value of uncashed checks at the end of the year and the plan's procedures for verifying a participant's address and for monitoring uncashed checks; and
- The number of participants investing in default investments and the type of default investment used (Schedule R).

PBGC is proposing to add a question asking whether a defined benefit plan is covered by PBGC insurance. Filers who check "yes" will be required to submit the confirmation number generated by their premium filing. PBGC believes that including this question on the Form 5500 and Form 5500-SF will improve data collection and bring in new premiums.

M. Proposed Regulatory Changes

DOL proposed regulatory changes to implement the Form 5500 revisions. Of note, DOL is proposing to amend the regulation that implements the limited scope audit exemption (29 C.F.R. 2520.103-8). Under the limited scope audit rules, a plan can exclude from an auditor's examination and report assets that are held by a bank or insurance

company, provided that the financial institution certifies certain information about the assets it holds. The proposed regulatory changes would enhance the information provided in these certifications and increase DOL's ability to review limited scope audits.