

# Executive Compensation, Benefits, Employment and Labor Focus

January 2010

## Additional DOL Guidance to Assist Employers Comply with Schedule C



In October 2009, the Department of Labor (DOL) released additional guidance on the reporting of fees and other compensation paid to service providers, as required by the new Schedule C of the Form 5500 annual report. The latest guidance, consisting of 25 frequently asked questions (FAQs), supplements the November 2007 final amendments to the Form 5500 regulations, the form revisions and instructions, as well as the set of 40 FAQs released by the DOL in July 2008 (as discussed in one of our prior newsletters. (as discussed in one of our prior newsletters [here](#))

### Background – Fee/Compensation Reporting on Form 5500

Generally, large plans (i.e., plans with 100 or more participants as of the beginning of the plan year) must report compensation paid to a service provider on Schedule C if the aggregate amount paid to the service provider for the year is US\$5,000 or more. Beginning with the Form 5500 for the 2009 plan year (i.e., filings due in 2010), the new Schedule C requires plan sponsors to classify the fees paid to plan service providers as either “direct” or “indirect” compensation.

Direct Compensation	Indirect Compensation
<p>Compensation received by a plan service provider directly from plan assets.</p> <p>Example: Direct charges to plan participant individual accounts.</p> <p>Does not include anything the employer pays from corporate assets, since employer-paid fees do not reduce plan assets.</p>	<p>Any payment (either monetary or nonmonetary) received by a plan service provider from sources other than directly from the plan or plan sponsor, if received in connection with services provided to the plan or in connection with the service provider’s position with the plan.</p> <p>Examples: Management fees paid by a mutual fund to its investment advisor. Reportable gifts, meals, and entertainment.</p>

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Plan sponsors must also determine whether any indirect compensation qualifies as “eligible indirect compensation” (EIC). For compensation that qualifies as EIC, plan sponsors need only report the presence of such compensation and the identity of the service provider (name, address and tax ID), but not the amount paid. Such alternative reporting is intended to potentially alleviate the administrative burdens associated with reporting indirect compensation.

EIC is any indirect compensation received by a service provider as fees charged to investment funds in which a plan invests that are reflected in the value of the investment or in the return on investment that constitutes compensation for distribution, investment management, recordkeeping or shareholder services or that constitutes commissions or finder fees, float revenue, or other transaction-based fees or “soft dollar” revenue. To qualify as EIC, the service provider must submit written materials to the plan sponsor that disclose the following information: (i) the existence of indirect compensation, (ii) the services provided for this compensation, (iii) the amount (or estimate) of the compensation or a description of the formula used to determine this compensation, (iv) who received this compensation and (v) who paid this compensation.

Plan sponsors will be required to list on the new Schedule C any service provider who fails, or refuses, to provide this information.

## Issues covered in the 2009 FAQs

The DOL has provided guidance on the new Schedule C to address questions from plan sponsors and service providers on the reporting requirements. Below is a summary of some of the topics covered in the new FAQs.

### Small Gifts, Meals, Entertainment and Educational Conferences

**Ordinary promotional gifts.** Generally, plan administrators are allowed to exclude from Schedule C nonmonetary compensation of insubstantial value, which is tax deductible for federal income tax purposes by the person providing the gift or gratuity and that would not be taxable income to the recipient. To avoid Schedule C reporting, the nonmonetary gift or gratuity must be valued at less than US\$50, and the aggregate value of gifts from one source in a calendar year must be valued at less than US\$100. If the US\$100 aggregate value limit is exceeded, then the value of all gifts will be reportable compensation. Further, nonmonetary gifts of less than US\$10 do not need to be counted toward the US\$100 limit. Nonmonetary gifts of less than US\$10 also do not need to be included in calculating the aggregate value of all gifts required to be reported even if the US\$100 limit is otherwise exceeded.

The new FAQs clarify that ordinary promotional gifts such as coffee mugs, calendars, greeting cards, plaques, trophies and similar items of insubstantial value that display a company logo of the person or entity providing the promotional gift are generally presumed to have a value of less than US\$10.

**Business meals and entertainment** received by persons who have business relationships with ERISA plans are not reportable compensation, provided that the amount of the item (or eligibility to receive such item), is not based, in whole or in part, on the recipient’s position or amount of business conducted with the plans.

**Educational conferences conducted by a service provider** and attended by a plan representative (e.g., the plan sponsor’s human resources staff or finance personnel) at no cost to such attendee is generally reportable Schedule C compensation because it is provided due to the person’s position with the plan. However, the DOL will not require such educational conference expenses to be reported if a plan fiduciary (other than the person attending the conference) reasonably determined, in advance and without regard to whether such conference expenses will be reimbursed, that:

- the plan’s payment of educational expenses would be prudent;
- the payment or reimbursement of educational expenses would be consistent with a written plan policy or provision designed to prevent abuse;
- the conference had a reasonable relationship to the duties of the attending plan representative; and
- the expenses for attendance were reasonable and unlikely to compromise the representative’s ability to carry out his or her duties.

#### Note

These are Schedule C *reporting* rules only. As the FAQs expressly note, a plan fiduciary’s acceptance of gifts and gratuities of any amount may violate ERISA and give rise to civil liabilities and criminal penalties.

### Investment and Fund Manager Fees

**Look-through investment funds.** Fees received in connection with a plan’s direct investment in a pooled investment fund (“top tier” fund) would be subject to Schedule C reporting to the extent the fees constitute reportable direct or indirect compensation. If, however, a top tier investment fund makes an investment in another investment fund (“lower tier” fund), fees received by persons at the lower tier fund level in connection with the top tier fund’s investment in the lower tier fund would not be reportable

compensation for Schedule C purposes. Compensation received directly or indirectly by persons at the top tier fund from the lower tier fund in connection with the investment of an ERISA plan would, however, be subject to Schedule C reporting requirements.

**Contingent deferred sales charges, market value adjustments or similar surrender or termination charges.**

Contingent deferred sales charges, typically referred to as “back-end loads” or “deferred sales loads” or commissions investors pay when they redeem mutual fund shares or other investments, are direct compensation to the person receiving the load or commission, to the extent paid by the plan or charged to a plan or participant’s account. If such deferred sales load or commission is charged against an investment fund and reflected in the value of the plan’s investment, such fees may be treated as eligible indirect compensation assuming the required disclosures are provided.

Market value adjustments or similar surrender or termination charges that are adjustments to the value of the investment in accordance with the contract would not be reportable compensation for Schedule C purposes where the market value adjustment or surrender charge reflects only the contractual difference in the plan’s investment because it was not held for the stated duration of the contract.

**Redemption fees** are charges by mutual fund companies to discourage investors from making a short-term “round-trip” (i.e., when a participant transfers out of an investment fund within a certain timeframe—often 30 to 60 days following their investment in the fund). Although a redemption fee is deducted from redemption proceeds just like a deferred sales load, it is not considered to be a sales load. Such redemption fees paid directly to an investment fund to defray costs associated with investors’ redemptions are not reportable on Schedule C. However, a person could not avoid Schedule C reporting by labeling a deferred sales load as a “redemption fee.”

**Funds relying on the VCOC/REOC and 25% Test exemptions from ERISA.** Investment funds in which benefit plans invest that are structured as “venture capital operating companies” (VCOCs) or “real estate operating companies” (REOCs), or that limit benefit plan investors to less than 25 percent of each class of equity interests (the “25% Test”) are exempt from ERISA’s fiduciary responsibility provisions. Mutual funds are also exempt from ERISA regulation. In a significant change from traditional ERISA rules, for purposes of Schedule C, the FAQs create a distinction between (1) funds that operate as VCOCs or REOCs and (2) investment funds, including funds that rely on the 25% Test and mutual funds. Compensation received by managers of VCOCs and REOCs (and other operating companies) is expressly exempt from the Schedule C reporting rules, whereas compensation

received by managers of investment funds is reportable indirect compensation for Schedule C purposes. This type of compensation may qualify as EIC and the less onerous alternative reporting method described above.

## Mechanics of Schedule C Reporting

**Classifying services and fees.** To provide more informative disclosures about the types of fees being paid to or received by plan service providers, the new Schedule C expanded the service/fee codes (from 23 codes in 2008’s Schedule C to 55 codes in 2009’s Schedule C) to better identify the types of direct and indirect compensation received by services providers. According to the FAQs, the DOL will accept a reasonable good faith effort to properly classify services and fees, and will not reject a 2009 Schedule C because it might have used a different service or fee code than that selected by the service provider or plan administrator.

**Unable to ascertain service provider’s tax ID.** The FAQs clarify that plan administrators that are unable to ascertain the employer identification number (EIN) of a service provider may use the EIN of such service provider’s parent company to identify the service provider. The DOL expects that same EIN to be used consistently from year to year and on different schedules that identify the same service provider.

**Limited transition relief for 2009 reports.** The FAQs clarify that plan administrators will not be required to report service providers who fail to provide information necessary to complete Schedule C for 2009 reports as long as the service provider (i) submits a written statement to the plan administrator explaining that despite its good faith efforts, such service provider was unable to complete the necessary recordkeeping and information system changes for the 2009 year and (ii) provides any information that it was able to collect. Nevertheless, the DOL expects administrators to discuss with their services providers the steps being taken to provide the required information for future Schedule Cs.

**Disclosures that satisfy the alternative EIC reporting option.**

The FAQs clarify that if disclosures meet the requirements of securities laws, but do not include the information necessary to meet the requirements of the alternative reporting option for EIC (e.g., the standard disclosure by investment advisors of their “soft dollar” compensation in a manner that meets the requirements of securities laws), then additional disclosures would be required for a plan to take advantage of the alternative reporting option. There is no specific form or method of disclosure required for disclosures to satisfy the alternative reporting option requirements. Thus, plans and their service providers have substantial flexibility in establishing programs to provide the necessary disclosures.

### Among Other Clarifications

**Bundled service arrangements/Revenue sharing.** Service arrangements in which an employee benefit plan hires one company to provide a range of services either directly from the company, through affiliates or subcontractors, or through a combination, which are priced to the plan as a single package, are, for purposes of Schedule C, called “bundled service arrangements.” As a general rule, in the case of bundled service arrangements, revenue sharing within the bundled group does not need to be separately reported on Schedule C. There are two exceptions to this general rule which provide for certain bundled compensation to be separately reported. These exceptions are:

- any person in the bundle receiving separate fees charged against a plan’s investment (e.g., investment management and 12b-1 fees), and
- compensation that is commissions and other transaction-based fees, finder’s fees, float revenue, soft dollar and other nonmonetary compensation paid to “conflict of interest sensitive persons” (i.e., any plan fiduciary and any person providing contract administrator, consulting, investment advisory, investment management, securities brokerage or recordkeeping services).

The new FAQs clarify situations in which certain bundled compensation may be separately reported.

- Where one service provider receives a fee and passes some of the fee along to a second service provider as a revenue sharing payment (and the fee represents reportable indirect compensation with respect to both service providers), information reported on Schedule C concerning this fee could either:
  - include a description of the total fee received by these service providers and the portion of the fee passed on to the second service provider, or
  - treat the fee as paid under a bundled service arrangement, so that only the total fee, and not the division of the fee between the two service providers as revenue sharing, is reported.

- However, if an intermediary fund agent is “merely a conduit” (not defined) for transmission of the revenue sharing fee to the ultimate recipient, the conduit would not itself be receiving any reportable compensation by acting as the conduit.
- In the case of a recordkeeper’s fee that is paid in part from a shareholder servicing fee charged by an investment fund in which a plan invests and in part directly by the plan, the recordkeeping fee can be reported in part as indirect compensation and in part as direct compensation for purposes of Schedule C reporting.

**Health and welfare plans.** The FAQs confirm that health and other welfare plans that are unfunded and self-insured or fully insured (or a combination thereof) are not required to file a Schedule C. The fact that there are revenue sharing payments among the plan’s service providers would not subject such a plan to Schedule C reporting. However, health and other welfare plans that are funded through a trust (such as through a “VEBA”) are required to file Schedule C and are subject to the indirect compensation reporting rules.

### Conclusion

Compliance with these new rules will likely require significant effort by plan administrators and service providers. With the recent close of the 2009 year and start of a new year, now is the time for plan administrators and service providers to (i) gather the data necessary for completing the 2009 Schedule C, (ii) assess whether any changes to their recordkeeping and information systems are in order to capture the information for the 2010 Schedule C and (iii) establish programs to provide the necessary disclosures. In addition, plans should maintain a reasonable written policy governing the receipt of items or services by plan representatives from plan service providers and monitor adherence to that policy. White & Case would be pleased to discuss these new rules and assist plan administrators and service providers with compliance.

## COBRA Premium Subsidy Extend by Congress

On December 19, 2009, the provisions of the American Recovery and Reinvestment Act of 2009 (ARRA) that established a 65 percent government subsidy toward payment of premiums for continuation coverage provided by the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") were amended by the Department of Defense Appropriations Act for Fiscal Year 2010 (the "Act") to extend both the eligibility period and the length of the premium subsidy. The Act also implemented additional reimbursement, retroactive election and notice requirements on group health plans subject to COBRA.

Prior to the Act, the federal government paid 65 percent of the cost of a qualified beneficiary's COBRA premium, where the qualified beneficiary (i) was eligible for COBRA continuation coverage during the period from September 1, 2008 through December 31, 2009, due to an involuntary termination from employment, and (ii) elected COBRA continuation coverage (qualified beneficiaries who meet these requirements are called "Assistance Eligible Individuals," or "AEIs"). The COBRA premium subsidy provided by ARRA could be applied to an AEI's COBRA premium payments for up to nine months. Click [here](#) to read our February 2009 Client Alert detailing the enactment of the COBRA premium subsidy.

In response to the current economic conditions in the US, the Act extends the period during which the involuntary termination giving rise to the qualified beneficiary's COBRA rights from December 31, 2009 to February 28, 2010 (the "Extended Period"). The Act also extends the maximum length that an AEI may receive the COBRA premium subsidy from nine months to fifteen months.

The Act also includes transition provisions to address the affect of the two extensions on AEIs whose eligibility for the COBRA premium subsidy had expired before the Act's passage. Under the Act, AEIs who had received a full nine months of the COBRA premium subsidy before December 19, 2009, and had subsequently dropped COBRA coverage, can now elect to receive COBRA coverage, retroactive to the day the AEI dropped the coverage, by making a payment equal to 35 percent of the cost of their COBRA premium for those subsequent months. AEIs electing the retroactive COBRA coverage provided by the Act may receive the COBRA premium subsidy up to an additional six months, and must submit the retroactive payment by the later of (i) February 17, 2010 or (ii) thirty days after receiving a notice

from the plan administrator that describes the Act's changes. The Act also allows AEIs who had received a full nine months of the COBRA premium subsidy before December 19, 2009, and had subsequently elected to continue COBRA coverage by paying the entire cost of the COBRA premium, to receive either a refund of the 65 percent overpayment or a credit of the 65 percent overpayment toward the COBRA premium due in future months.

Group health plans will also be required to meet new notice requirements promulgated by the Act. Such plans must provide notice of the extensions to two groups of individuals. First, the Act requires group health plans to notify all individuals who were either AEIs or who experienced a qualifying event relating to a termination of employment on or after October 31, 2009; the plans must notify such individuals by February 17, 2010, or within the notification period required by COBRA where the termination of employment occurs after December 19, 2009. Second, the Act requires group health plans to notify all AEIs who are eligible to take advantage of the transition provisions described above within the first 60 days of the AEI's transition period (e.g., for an AEI who received the COBRA premium subsidy beginning on March 1, 2009 and lost the subsidy after receiving the subsidy the next nine months—until November 30, 2009—the group health plan would need to notify the AEI of the extension by January 28, 2010).

Notably, the Act also amended the requirements for a qualified beneficiary to become an Assistance Eligible Individual (and thus to be eligible to receive the COBRA premium subsidy) by removing the condition that the qualified beneficiary become eligible for COBRA coverage during the Extended Period. As a result, a qualified beneficiary who becomes eligible for COBRA coverage at any time during or after the Extended Period may still qualify to receive the COBRA premium subsidy, so long as his or her eligibility for that COBRA coverage results from an involuntary termination that occurs during the Extended Period. For example, if Employer ABC provides Joe with six months of ABC-paid continued medical coverage after his involuntary termination on January 31, 2010 (and Joe was covered by ABC's medical plan on the date of his termination), although Joe would be eligible to elect to receive the COBRA premium subsidy, Joe would not begin to receive it until August 1, 2010, since he would not experience a loss of his medical coverage until July 31, 2010.

To comply with the Act's changes to the COBRA premium subsidy provisions of ARRA, employers will need to determine the individuals affected by the changes and will need to prepare notifications to send to those individuals, as required by the Act. Although the Department of Labor has advised that it will be publishing model notices designed to meet the Act's new notice

requirements, the Act's timeframe for compliance with those notice requirements may require employers to draft and send notifications before the DOL's model notices are available. As always, White & Case would be happy to help you determine how the Act's changes will affect your group health plan's administration.

## New FTC Guidelines May Subject Employers to Liability for Blogging Employees

Employers should be aware that final guidelines issued by the Federal Trade Commission ("FTC") last year, and effective December 1, 2009, may create liability for certain blogging activities of their employees. Specifically, under the FTC's revised *Guides Concerning the Use of Endorsements and Testimonials in Advertising* (16 CFR Part 255) ("Guides"), an employer may be liable under certain circumstances if an employee makes statements about the employer's products or services in blogs or social media websites (e.g., Facebook) without disclosing the connection between the employer and the employee or if the employee has made "false or unsubstantiated statements" regarding such products or services.\* The Guides provides the following example regarding employers:

"An online message board designated for discussions of new music download technology is frequented by MP3 player enthusiasts. They exchange information about new products, utilities, and the functionality of numerous playback devices. Unbeknownst to the message board community, an employee of a leading playback device manufacturer has been posting messages on the discussion

board promoting the manufacturer's product. Knowledge of this poster's employment likely would affect the weight or credibility of her endorsement. Therefore, the poster should clearly and conspicuously disclose her relationship to the manufacturer to members and readers of the message board."

In its comments to the revised Guides, the FTC stated that it would consider "[an employer's] establishment of appropriate procedures" in determining whether to seek legal enforcement against the employer because of inappropriate endorsements or testimonials made by its employees. The FTC further stated that "it is not aware of any instance in which an enforcement action was brought against a company for the actions of a single 'rogue' employee who violated established company policy that adequately covered the conduct in question." The FTC chose, however, not to specify what procedures should be put in place by companies to monitor their employees' compliance with the Guides. Given the foregoing, employers should revise any existing social networking policies to address endorsements and testimonials by employees.

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\* The FTC's Guides define an endorsement as "any advertising message (including verbal statements, demonstrations, or depictions of the name, signature, likeness or other identifying personal characteristics of an individual or the name or seal of an organization) that consumers are likely to believe reflects the opinions, beliefs, findings or experiences of a party other than a sponsoring advertiser."

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