CALLAN ASSOCIATES INC

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February 11, 2008

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: 408(b)(2) Amendment
Room N–5655
U.S. Department of Labor
200 Constitution Avenue, NW.
Washington, DC 20210

**Re: Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure (RIN 1210-AB08)**

Dear Ladies and Gentlemen:

We appreciate the opportunity to provide comments on the U.S. Department of Labor's proposed regulation regarding disclosure of information to assist plan fiduciaries in assessing the reasonableness of the compensation or fees paid for services.

Callan Associates Inc. is the largest privately owned company engaged primarily in asset management consulting with more than 300 large fund sponsor clients who are responsible for $1.075 trillion in assets. Callan clients include defined contribution plans, multi-employer plans, corporate and public pension plans, and endowments and foundations.

Callan Associates performs dozens of record keeping, investment manager, and trust and custody fee transparency and fee benchmarking analyses each year on behalf of our defined contribution clients. We take the position that accurate defined contribution fee benchmarking requires an understanding of both administration and investment management fees. In the current environment, accurate component fee information can be difficult to obtain, especially when it comes to bundled providers.

<u>We endorse the Department of Labor’s efforts to improve fee transparency by requiring greater fee disclosure by providers. At the same time, we believe that the regulation should clarify the circumstances under which bundled providers must disclose the allocation of revenue sharing arrangements and internal allocations used to offset administration fees. Also, we believe that failure to require across-the-board disclosure of administration fees—regardless of the way such fees are paid within bundled arrangements—hinders plan sponsors’ ability to fully evaluate, monitor, and benchmark the component costs of their DC plans.</u>

**Clarification Requested**

The regulation says that the bundled provider generally is not required to disclose the allocation of revenue sharing or other payments among affiliates or subcontractors within the bundle. The proposed regulation cites exceptions including compensation or fees of any party providing services under the bundle that receives a separate fee charged directly against the plan's investment reflected in the net value of the investment, such as management fees paid by mutual funds to their investment advisers, float revenue, and other asset-based fees such as 12b–1 distribution fees, wrap fees, and shareholder servicing fees if charged in addition to the investment management fee. As stated, the intent of this section of the regulation is not to require disclosure of any revenue sharing arrangements or bookkeeping practices among affiliates that could legitimately be classified as proprietary or confidential.

It would be helpful to receive clarification from the Department regarding required disclosure of revenue sharing or internal allocation arrangements (e.g., through affiliates) used to offset administration fees for the following three bundled scenarios. Specifically, in each scenario, does the bundled provider need to disclose the compensation received, that the compensation will be used to pay for recordkeeping and other uses, and/or allocate any dollar amount or percentage attributable to revenue sharing.

1. The bundled provider receives asset-based revenue sharing from an external fund manager to pay for administration. For example, record keeper A has no mutual funds of its own, but receives revenue sharing from external mutual fund managers within its bundled arrangements, which offset the fees of record keeper A's administration.

2. The bundled provider receives revenue sharing from its own funds to pay for administration. For example, record keeper B has its own mutual funds and receives revenue sharing from them (as affiliates) in order to pay for record keeper B's plan administration within its bundled arrangements.

3. The bundled provider receives an internal allocation (an internal "offset arrangement" that is not revenue sharing) from its mutual fund division, which is paid out of the investment management fee, and which is used to offset the costs of plan administration. For example, record keeper C has its own mutual funds and receives an internal allocation from its mutual fund affiliate in order to pay for record keeper C's plan administration.

**The Need for Equitable Revenue Sharing and "Offset" Arrangement Disclosure**

We believe that an allocation of any dollar amount or percentage attributable to revenue sharing and internal allocations required to offset administration costs should be required in all of the three scenarios above. We believe that benchmarking of defined contribution plans is sufficiently complex that without a separate understanding of the investment management and administration fees, plan sponsors will not have the information necessary to evaluate, monitor and benchmark their plans. Overall cost of the bundled arrangement is not sufficient for these purposes. This is because:

1. Defined Contribution plans have different asset allocations, different proportions in active versus passive investments, etc. This makes it impossible to simply look at the aggregate asset based fee and determine if it is reasonable, even among similar-size plans.

2. Even if the asset allocation is identical, plans have varying levels of administrative complexity depending on such factors as number of loans, custom communication, number of payroll feeds, etc. Breaking out administrative versus investment management fees is essential in understanding whether this component fee—and fees overall—are reasonable given the specific features of the plan.

3. Without a clear understanding of investment management versus administrative fees, plan sponsors lose the ability to effectively negotiate plan costs. If administrative fees are buried in investment management fees, plan sponsors will find it difficult to disentangle fees that are reasonable given fund performance expectations, versus those that may or may not be reasonable for defraying administrative costs.

**Uneven Playing Field under the Proposed Regulation**

We also point out that the way the proposed regulation is written, disclosure requirements appear to be greater for unbundled versus bundled providers. If an unbundled provider must disclose its component investment management versus administration fees, while a bundled provider is not required to make such disclosure, it can be argued that the unbundled provider is being put at a competitive disadvantage.

True, the bundled provider might argue that its internal allocations are proprietary. This, however, is just a function of its business model and should not influence regulation. If unbundled record keepers must disclose this compensation, it is only reasonable that record keepers that use revenue sharing or internal allocations to pay for record keeping and administration should also be required to make this disclosure.

<u>We propose that the regulation require all record keepers to fully allocate the component fees of their arrangements—that is investment management versus administrative fees—whether or not the compensation is from revenue sharing or from internal allocations used to offset administration within the bundled arrangement.</u>

**Conclusion**

We believe that the Department of Labor's proposed regulation does much to create a fairer and more transparent environment for defined contribution plan fees. We also thank the Department of Labor for noting that ERISA 404(a) not only requires that plan fiduciaries engage in an objective process to determine a reasonable level of compensation, but also to determine the quality of the services provided. However, we believe the proposed regulation falls short in helping plan sponsors to obtain all of the information they need from bundled providers.

Sincerely,

Lori Lucas, CFA
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