GROOM LAW GROUP

Stephen M. Saxon
(202) 861-6609
sms@groom.com

Jennifer E. Eller
(202) 861-6604
jee@groom.com

February 11, 2008

By Electronic Mail to e-ORI@dol.gov

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, N.W.
Washington, D.C. 20210

Re: Comments on Proposed Fee Disclosure Rule Under Section 408(b)(2) of ERISA

Ladies and Gentlemen:

Groom Law Group, Chtd. represents a number of financial institutions and administrative services providers that offer insurance, investment products and/or services, including investment, recordkeeping, plan administrative services, consulting and advisory services to employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). This letter represents the comments of a group (the "Groom Comment Group" or "Group") of these companies[1] on the proposed regulation interpreting what constitutes a reasonable contract or arrangement under ERISA section 408(b)(2) (the "Proposed Regulation" or "Proposal") published by the Department of Labor (the "Department") on December 13, 2007. 72 Fed. Reg. 70988 (Dec. 13, 2007). We appreciate this opportunity to file comments on behalf of the Group.

The Group provides products and services to thousands of plans throughout the United States. In total, the Group provides services with respect to plans with many billions of dollars in assets. In short, Group members are extremely knowledgeable about the services provided to plans and the effect that the Department's Proposal will have on the employee benefits community, including plan fiduciaries, plan participants, and plan service providers. We believe that this effect will be massive. We would be happy to meet with the Department to discuss the concerns of the Group in greater detail.

---

[1] Not all of the companies in the Group provide all of the services or products described above. One or more members are limited to providing non-discretionary administrative services, including recordkeeping services.

Executive Summary

The Group is committed to the concept of fee transparency and open communications with plan customers. To that end, Group member companies are committed to providing information to plan customers to help plan fiduciaries understand the fees and expenses charged to the plan. Group members are also aware that plan fiduciaries, like any type of consumer of services, vary in terms of their sophistication and the time and resources they have to devote to plan operations. For this reason, while the Group supports the goals of fee transparency and providing helpful information to plan fiduciaries, the Group has identified a number of serious concerns with the Proposed Regulation. As an initial matter, neither the Department, plan fiduciaries, nor plan service providers have yet had time to consider the implications of applying the Proposed Regulation to welfare plan arrangements. In order to allow for a reasoned and well-considered set of requirements that make sense in the welfare plan context, the Group asks the Department not to apply the final regulation to welfare plans. Rather, the Department should assess and separately address disclosure issues in the context of welfare plan arrangements.[2]

In general, the Group is concerned about the extraordinary breadth of the Proposal's required disclosures, the serious consequences that could result for service providers in the case of disclosure errors or good faith compliance mistakes and the significant demand on the resources of plan fiduciaries in keeping up with the new requirements. The Group suggests that the primary goal of the Proposed Regulations, to provide plan fiduciaries with useful, accurate information that will empower them to safeguard plan resources, can be better accomplished if several changes and clarifications are made when the regulations are finalized. With these concerns in mind, the Group has several specific comments and suggestions on the Proposal, covering the following areas of concern:

- The obligations imposed by the final regulation should be clearly limited to entities that need relief under ERISA section 408(b)(2) – i.e., entities that are "parties in interest" that provide services to ERISA plans as defined in ERISA Section 3(14).

- The final regulation should provide that a contract or arrangement for services to an employee benefit plan will not fail to be "reasonable" if a service provider makes reasonable efforts to comply with the disclosure requirements contained in the final regulation.

- The Department should eliminate the requirement that contracts for services include a written representation by the service provider that the required disclosures were provided before the contract was entered into.

---

[2] The Group also suggests that the level of disclosure required in the Proposed Regulation would overwhelm many small plan fiduciaries and that the Department should consider an abbreviated set of requirements for small plans.

- The final regulation should clearly allow service providers to express compensation in terms of a formula, an estimate or other explanation that reasonably describes the nature of the compensation.

- The rules governing bundled arrangements raise a variety of issues requiring clarification, including: (a) whether a package of services offered by a single service provider qualifies as a bundle; (b) whether a plan service provider offering services that facilitate plan investment transactions as part of a bundle will be deemed to be offering or making available the investment products in which the plan invests as part of the bundle; and (c) what types of payments must be separately allocated among participants in a bundle.

- The requirement in the Proposed Regulation that service providers disclose "conflict of interest" relationships is poorly defined and will lead to different interpretations and thus uneven playing field in the service provider community; the result will not benefit plans.

- The requirement in the Proposed Regulation that service providers disclose whether they will be able to affect their own compensation unfairly casts a specter of impropriety on legitimate and mainstream practices, including service level guarantees, performance-based fees and float. The Department should clarify that if a service provider follows existing Department guidance with respect to the disclosure of float, the service provider will not be viewed as affecting his own compensation merely by receiving float.

- The breadth of the Proposed Regulation, when combined with the requirement that service providers update their disclosures within 30 days, will result in a continuous reporting obligation that will be costly and inefficient and that will not provide plan fiduciaries with helpful information.

- The Department should clarify that the final regulation will not apply to contracts in effect as of the effective date, absent a renewal, extension or material change.

- The Department should clarify that the Proposed Regulation does not require an amendment of existing contracts, so long as the required disclosures are provided for in some other writing.

- The Department should clarify that an annuity or similar contract that refers to additional services to be provided to a plan will not be required to meet the requirements of the Proposed Regulation so long as any separate services contract between the insurance company and the plan meets the Proposed Regulation's requirements.

- The Department should provide an appropriate period of time for plans and service providers to transition to the new requirements. The effective date should be extended to at least one year after issuance of the final regulation.

- The Department should not condition the section 408(b)(2) exemption on the plan's ability to terminate on reasonably short notice. To the extent that the Department retains the condition, the Department should confirm that a market-value adjustment, surrender charge or similar fee does not constitute a "penalty" for purposes of this condition.

- The Department should amend the regulations under Internal Revenue Code section 4975(d)(2) to parallel the requirements that are finally adopted by the Department with respect to ERISA section 408(b)(2). However, in adopting such an amendment, the Department should make clear that the expanded conditions apply only to "plans" as defined in section 4975(e)(1)(A) of the Code, and not to "plans" as defined in Code sections 4975(e)(1)(B)-(G).

- The requirements of the Proposed Regulation should not apply where: (a) services are provided to the plan by the plan sponsor, so long as the plan pays no more than "direct expenses" as defined by ERISA section 408(c)(2) and the regulations thereunder; or (b) to the extent that the plan sponsor is paying for the services provided.

- The Department should reconsider its position that meals, entertainment and gifts constitute "compensation" for purposes of the Proposed Regulation. At the very least, the Department should recognize that plan service providers cannot disclose the value of future gifts at the time of contract.

Comments

I. The Department should clarify that the requirements of the Proposed Regulation apply only to entities that plan to engage in a transaction with a plan which requires the relief provided by section 408(b)(2) of ERISA.

The Proposed Regulation suggests that the Department may view entities that provide services not to ERISA plans, but to other plan service providers or to investment vehicles that do not hold "plan assets" as plan "service providers" to whom the requirements of the Proposed

Regulation apply. For example, under this view, the following entities could be deemed plan "service providers":

- An adviser to a mutual fund;
- The manager of a limited liability company that is a "venture capital operating company" for purposes of the Department's "plan assets" regulation; and
- A subcontractor providing claims processing services to a plan's third-party administrator.

The Department should clarify that the Proposed Regulation, and the direct disclosure obligations that they contain, are inapplicable to these types of entities because they do not engage in services transactions with employee benefit plans for purposes of ERISA section 406(a)(1)(C) for which the relief in ERISA section 408(b)(2) is required.

The confusion over this matter may stem from the fact that the Department adopted a very broad view of who is a "service provider" in the context of the Form 5500 Schedule C. Specifically, the preamble to the Schedule C regulations indicates the Department's view that the Schedule C reporting requirements are not limited to persons with a "direct service relationship" with the plan, and further that persons who provide services to non-plan assets vehicles are "indirectly" providing services to the plan for purposes of ERISA section 406(a)(1)(C). Preamble to Final Revision of Annual Information Return/Reports, 72 Fed. Reg. 64731, 64739 (Nov. 16, 2007). Unlike Schedule C, the Proposed Regulation does not clearly explain whether, in the Department's view, a direct service relationship with an ERISA plan is necessary for the Proposed Regulations' requirements to apply.

If the Department <u>does not</u> intend for the Proposed Regulation to apply to entities other than those providing services directly to ERISA plans or to entities that hold "plan assets," it should clearly say so in the final regulations. If the Department <u>does</u> intend for the Proposed Regulation to apply to entities other than those providing services directly to ERISA plans or to entities that hold "plan assets," it must explain how it can conclude that such entities have engaged in a transaction for which the relief under section 408(b)(2) is required.

ERISA and the Department's plan assets regulation control the question of whether an entity providing services to a non-plan assets vehicle is a party in interest and the Department cannot take a different interpretation for purposes of the Proposed Regulation Section 3(14) of ERISA provides that the term "'party in interest' means, as to *an employee benefit plan-* . . . (B) a person providing services to such plan." This definition does not lend itself to the interpretation that a person is a party in interest by reason of providing indirect services to a plan.

In the case of registered investment companies, including mutual funds, section 3(21)(B) of ERISA provides that neither a registered investment company, nor the company's adviser or

principal underwriter is a party in interest to a plan by reason of the plan's purchase of shares of the investment company. Mutual funds and their advisers are clearly not, then, providing services (directly or indirectly) to plans for purposes of ERISA section 406(a)(1)(C). Thus, the Department cannot take the position that investment management and other services provided to such entities are being "indirectly" provided to plans that invest in such vehicles. Since the requirements of ERISA section 408(b)(2) (and therefore the Proposed Regulation) only apply to the extent necessary to exempt an otherwise prohibited transaction, the requirements of ERISA section 408(b)(2) (and therefore the Proposed Regulation) cannot apply to entities, such as registered investment companies, that are not engaged in services transactions with plans.

The preamble to the plan assets regulation explains that the purpose of the regulation is to distinguish investments that are the "indirect provision of investment management services from those that are not." Preamble to the Final Regulation Relating to the Definition of Plan Assets, 51 Fed. Reg. 41262, 41264 (Nov. 13, 1986). Thus, the Department clearly intended that persons providing services to non-plan assets vehicles would not be considered to be indirectly providing services to plans. This is the whole point of the plan assets regulation. For the Department to reverse this position now, in the context of the Proposed Regulation, would be tantamount to changing the meaning of the statute. It should be noted that Congress recently amended ERISA's definition of "plan assets" but did not make any changes to the plan assets regulation's basic tenet that a person who provides services to a non plan-assets vehicle is not providing indirect services to a plan.

Similarly, a provider of services to a plan service provider is not a service provider to a plan, and therefore does not engage in a transaction for which the relief provided in ERISA section 408(b)(2) is required. In at least one advisory opinion, the Department has taken the position that where an entity acts as a "subcontractor" to a plan service provider, the subcontractor is not performing services for the plan for purposes of ERISA section 406(a)(1)(C) but is instead performing services for the service provider. DOL Adv. Op. 82-55A (Oct. 15, 1982). Importantly, the Department took this position even though, under the facts presented in the advisory opinion request, the subcontractor was a party in interest to the plan by reason of its status as an owner of the service provider. Even considering this party in interest status, the Department stated that "[the subcontractor] will not be performing any services for the employee benefit plans for which the [direct plan service provider] acts as fiduciary but, rather, will perform certain services for the [direct plan service provider]. Consequently, the retention of [the subcontractor] to provide services to the [direct plan service provider] would not be a transaction between the plan and a party in interest. As a result, it does not violate section 406(a) of ERISA." While the advisory opinion noted that the direct plan service provider would inform the fiduciaries of the plans of the subcontracting arrangement and "will disclose fully to these fiduciaries the basis of any reimbursement" the Department did not condition its opinion that the subcontractor is not a plan service provider on any such disclosure.

We submit that, unlike the Schedule C to the Form 5500, the disclosure requirements of the Proposed Regulation must necessarily be limited to those transactions that would, without the

benefit of ERISA section 408(b)(2), be prohibited under ERISA section 406(a)(1)(C). Moreover, Congress, and the Department in prior interpretations of the scope of 406(a)(1)(C), have determined that neither service providers to service providers, nor service providers to non-plan assets vehicles engage in services transactions with plans for purposes of ERISA section 406(a)(1)(C).

II. The final regulations should provide that a contract or arrangement for services to an employee benefit plan will not fail to be "reasonable" if a service provider uses reasonable efforts to comply with the disclosure requirements contained in the final regulation.

The Proposed Regulation mandates a contract term in each service agreement stating that the service provider will deliver the required disclosures "to the best of the service provider's knowledge." The Group suggests that the final regulations instead provide that a services arrangement will not be unreasonable provided a plan service provider makes reasonable efforts to comply with the disclosure requirements and when it becomes aware of a deficiency in its disclosure, uses reasonable efforts to correct such a deficiency.

The Proposed Regulations are complex and require a significant volume of different kinds of information. Many service providers, including members of the Group, have literally thousands of services arrangements that will be covered by the new disclosure obligations. While the vast majority of all service providers will endeavor to provide the required information to each responsible plan fiduciary, there will inevitably be oversights and errors. In addition, the rules are complex and will require a significant amount of interpretation and analysis. A plan service provider who has used reasonable efforts in complying with these requirements should not be subject to potential excise tax liability and should not be reported to the Department merely because of a mistake or interpretive error.

III. The Department should eliminate the requirement that contracts for services include specific contract terms, such as a written representation by the service provider that the required disclosures were provided before the contract was entered into.

The Proposed Regulations requires that each contract between a plan and a service provider include a written representation from the service provider that "all required information" has been provided to the responsible plan fiduciary before the contract was signed. 72 Fed. Reg. 70988, 71004. The Group asks the Department not to include this requirement in the final regulation. As discussed below, the requirement is burdensome and nonsubstantive, is likely to lead to confusion, and is impossible to comply with in some cases. The Group suggests that any disclosure requirements in the final regulation should be imposed directly, rather than requiring a contract term with a disclosure representation.

The requirement is burdensome and nonsubstantive because it could be read to mean that every plan services agreement is immediately ineligible for the section 408(b)(2) exemption,

even if the required disclosures are being provided, merely because the contract terms do not require that the disclosures be provided.

The requirement is likely to lead to confusion because in many services relationships, plan fiduciaries and service providers need to do a lot of work to design and implement a service package for a plan, and there may be a variety of agreements and understandings between the parties prior to the effective date of a services relationship. For example, plan fiduciaries for participant-directed individual account plans often select a plan recordkeeper and enter into a basic plan services agreement without necessarily having determined the final list of services to be provided or the investment alternatives that will be included as plan investment options. The plan recordkeeper may receive fees from affiliates of investment providers selected by the plan fiduciary, which fees will depend on the investment elections the plan fiduciaries make after the initial services agreement is signed. Plan fiduciaries may select additional services (or eliminate some services) after an initial written agreement for services is signed by the parties. The Group is concerned that the requirement for services agreements to include a written representation that all required information has been disclosed before the "contract" is signed will lead to uncertainty about the point in time during the creation of a services relationship when disclosures must be made. To require disclosures before the parties have started discussing the nature of the services relationship, even if an initial agreement has been reached, would limit, rather than enhance, the ability of plan fiduciaries to design a service package that meets the plan's unique needs, and to get the best price for the package.

The requirement is unworkable in certain instances because there are many examples of compensation that may need to be disclosed by a plan service provider under the Proposal that cannot be known at the time of contract. For instance, to the extent that commissions paid to brokers executing securities trades for an insurance company separate account, a single customer account managed by an ERISA investment manager, or a bank collective investment fund are required to be disclosed under the final regulations, the plan service provider (whether a recordkeeper in a bundled arrangement, or the plan's investment manager or trustee) simply will not know the commissions to be paid at the time the services contract is signed.

As the above examples illustrate, the Proposed Regulation's requirement that plan service providers represent that all required disclosures have been made before the services contract is entered into is not workable. The Group suggests that the Department reconsider this requirement. In considering alternative approaches, the Department should be aware that plan service arrangements are often not effective upon execution of a services agreement. As discussed above, plans and service providers need time to design and implement the selected services. A service agreement generally will not become effective until at least the initially selected services are in place. The Group therefore suggests that the Department consider adopting a requirement that disclosures be made to the responsible plan fiduciary prior to the date a contract for services becomes effective or in advance of the service provider's receipt of compensation, if later.

Of course, even this rule will not be workable with respect to certain services and certain types of compensation. By their very nature, many commissions and other transaction-based fees are not known until they are negotiated, which often happens on a transaction by transaction basis. Still other types of costs that may be required to be disclosed are costs that cannot be known at the time of contract, simply because they have not yet been negotiated or incurred. The Group suggests that these types of disclosures may be best made in the form of expense ratios, or estimates or other explanations designed to inform plan fiduciaries of the nature of compensation. For an existing investment portfolio, an expense ratio informs investors of the costs associated with the investment in the past (usually on a yearly basis). For new portfolios, such as a single customer account, an estimate of expenses would be helpful provide plan fiduciaries with information helpful in determining the reasonableness of the overall arrangement.

In any event, the contract requirement itself has no independent value to plan fiduciaries. There is no reason for the Department to mandate a contract requirement when it can simply mandate disclosures.

IV. The final regulations should clearly allow service providers to express compensation in terms of a formula, or an estimate or other explanation that reasonably describes the nature of the compensation.

The Proposed Regulation provides that compensation disclosed by service providers may be "expressed in terms of a monetary amount, formula, percentage of the plan's assets, or per capita charge for each participant or beneficiary of the plan." Id. at 71005. The Proposed Regulation also provides, however, that the disclosure must provide "sufficient information to enable the responsible plan fiduciary to evaluate the reasonableness" of the compensation. Id. The Group requests that the Department specifically allow the use of estimates and that the Department clarify that use of a formula or an estimate will not fail to provide a "sufficient" level of information to plan fiduciaries where the plan fiduciary cannot, at the time of contract, use the formula or estimate to calculate a dollar amount of compensation specific to the plan.

The Department has permitted the use of formulas and estimates in the context of disclosures that are made to plan fiduciaries under the alternative method of reporting available for "eligible indirect compensation" on a plan's Form 5500 Schedule C. 72 Fed. Reg. 64742. Under this alternative method, plan administrators will be able to report in less detail on the plan's Schedule C with respect to certain types of compensation received by plan service providers so long as the administrator has already received certain disclosures regarding the compensation received by the service provider. Such disclosures may be made in the form of an amount, an estimate or a formula. Id. The Department has also indicated that in some instances (e.g., soft dollars) even a formula or estimate may not be practicable or provide helpful information to plan fiduciaries. In such cases, the Department noted that "a description of the eligibility conditions sufficient to allow a plan fiduciary to evaluate them for reasonableness and potential conflicts of interest" would be appropriate. Id. The Group asks the Department to

confirm that where a plan service provider discloses an estimate or formula of compensation or fees received, or, where appropriate, other information that is available, such as "a description of the eligibility conditions" for a particular type of compensation, the Department would not necessarily view such disclosure as insufficient to allow a plan fiduciary to evaluate the reasonableness of the compensation.

V. Comments on Bundled Arrangements

A. The Department should clarify that a set of services that is offered to a plan and is "priced as a package" but provided by a single service provider can qualify as a bundle.

The Group requests that the Department clarify that where a single plan service provider offers services to a plan that are "priced as a package" the package of services will qualify as a "bundle" for purposes of the final regulations.

The Proposed Regulation's "general rule" provides that a service provider must disclose all services to be provided under an arrangement, and with respect to each service, the compensation or fees received by the service provider. 72 Fed. Reg. at 71004. The Proposed Regulation's rule for "bundled" services requires the bundle provider to disclose all of the services offered under the bundle and the "aggregate compensation or fees" for the services (unless an exception to this aggregate rule applies). Id. at 71005. The Preamble to the Proposed Regulation states that, "[i]n many cases, administrative and investment services are provided to employee benefit plans in 'bundled' arrangements, whereby a package or 'bundle' of services is provided, *either directly*, or through affiliates or subcontractors of a service provider." 72 Fed. Reg. 70988, 70990-91 (emphasis added).

The confirmation we request is necessary to avoid the absurd result that a service provider who offers, for instance, recordkeeping, Form 5500 preparation, and SPD delivery services as a package for a single price would have to artificially create a separate price for each component if the service provider does not use an affiliate or subcontractor to deliver the services, but would not have to create a separate price for each component if the service provider does use an affiliate or subcontractor to deliver the services.

B. The Department should clarify that, where a bundled service arrangement includes services that facilitate plan investment transactions, in a universe of investment alternatives, or a selection of platforms, each containing a universe of investment alternatives, the relevant service for purposes of the disclosure requirements of the Proposed Regulation is the access to the universe of investments and, not the investment management services themselves.

One of the difficulties with the "bundle" rule under the Proposed Regulation is that it is not clear where the bundle ends. For example, a bundled provider may offer directed trustee,

recordkeeping, Form 5500 preparation, and payroll processing services. The bundled provider may be directly responsible for providing directed trustee services and may hire subcontractors or arrange with affiliates to perform the other services. The bundle provider may consent to allow plan participants to establish a brokerage account for the investment of the participant's assets in any investment permissible under the plan, process trading instructions, settle trades and hold custody of the assets held in the brokerage account. The bundle provider should not be viewed as bundling the investment management "services" provided by the investment alternatives selected by the participant through their brokerage account, and should have to disclose only compensation generated by the access to the investments, and not by the investments themselves. As a practical matter, in the above example, the directed trustee simply will not know, and has no way to know, the compensation that each participant's investments may generate for any other party. The Department must address the very real difficulty that plan service providers such as the directed trustee in this scenario, will have in obtaining the information required under the Proposed Regulation.

To the extent that the Department believes it is important to encourage disclosure of indirect fees paid to non-service providers in connection with the investment of plan assets, we encourage the Department to reconsider whether interpreting ERISA section 408(b)(2) to require such disclosure from the bundle provider is the best way to accomplish this goal. If the Department believes that it is appropriate to require plan service providers to disclose, for purposes of availing themselves of the relief offered under ERISA section 408(b)(2), compensation paid to entities that are not providing services to the plan, the Department should adopt a specific set of required disclosures.

For instance, the Department could require that if a plan service provider offers access to one or more investment alternatives (an "access provider"), and there is no direct service relationship between the plan and the manager or adviser of the investment alternative,[3] the access provider must disclose any information about the fees and compensation paid from the assets of the investment alternative that is contained in the disclosure documents provided to the access provider by the investment alternative.

Alternatively, the Department could identify the types of information it expects that access providers will request from investment providers or platform providers and require that the access provider disclose the responses to these information requests to plan fiduciaries. As noted above, to the extent service provider makes necessary efforts to obtain information and cannot, the service provider's contract with the plan should not fail to be a reasonable arrangement.

---

[3] Of course, if such a direct relationship exists, the manager or advisor of the investment alternative would have the disclosure duty under the general rule of disclosure in the Proposed Regulations and there would be no need to place additional requirements on the plan service provider who merely provides access to the investment alternative.

C. The Department should clarify the types of payments that must be separately allocated in the context of a bundle.

With respect to bundled services, the Proposed Regulation requires the bundle provider to disclose the aggregate compensation "that will be or may be received by the service provider, affiliates, subcontractors and any other party in connection with the bundle of services." Id. at 71005. The bundle provider must allocate the specific amount of compensation among its affiliates, its subcontractors and any other party, to the extent such compensation constitutes either: (1) a separate charge directly against the plan's investment reflected in the net value of the investment, or (2) that are set on a transaction basis. Id.

The preamble to the Proposed Regulation indicates that management fees paid by mutual funds to their 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 management fee would qualify as fees that are a "separate charge directly against the plan's investment." The Proposed Regulation does not make clear whether second-tier fees, i.e., those that are paid not from an investment fund itself, but from a party with a direct relationship to the fund (such as a distributor, adviser or transfer agent) would be considered a "separate charge directly against the plan's investment" for purposes of the Proposed Regulation. We ask the Department to clarify whether it intends such fees to be separately disclosed.

The Group also suggests that some flexibility is required with respect to determining when services are provided as a "bundle." For instance, where more than one entity shares the responsibility for providing a single service to a plan, the entity offering the service to the plan should not be required to disclose anything other than the aggregate compensation (direct and indirect) paid for the service. Thus, if a service provider's primary service is investment management, and the service provider, in accordance with the terms of the investment management agreement, hires a sub-advisor to conduct the investment management activities, the service provider should be required to disclose only the aggregate compensation for the single service (investment management) that is provided by itself and the subadviser. To do otherwise would be similar to requiring each service provider to disclose the amount it pays its employees, its overhead costs, and its profits.

VI. The requirement in the Proposed Regulation that service providers disclose "conflict of interest" relationships is poorly defined and will lead to an uneven playing field in the service provider community; the result will not benefit plans.

The Proposed Regulation would require plan service providers to disclose any "material" relationship with any entity that "may create a conflict of interest for the service provider in performing services" under the contract. Id. at 71005. The preamble indicates that a service provider's conflict of interest will be "material" if a "reasonable" plan fiduciary would consider the relationship "significant in its evaluation of whether an actual or potential conflict of interest exists." Id. at 70992.

This disclosure requirement implies that service providers have a duty to act other than in their own economic self-interest. On the contrary, it is incumbent on ERISA plan fiduciaries to assume that non-fiduciary service providers will act in their own economic self-interest. As currently drafted, the Proposed Regulation would require each plan service provider to disclose to each plan fiduciary any relationship it has with any entity that may create a conflict of interest for the service provider in providing services to the plan.

Information that may be material to some fiduciaries may not be material to others. It is unfair for plan service providers to be placed in the position of determining the information their clients would want to have. The requirement is so broad that plan service providers will inevitably reach different conclusions regarding the scope of the required disclosures. As a result, service providers inclined to provide more information will be disadvantaged in the marketplace because plan fiduciaries will perceive that such service providers have "conflicts of interest," that those providing less fulsome disclosures don't have. This uneven playing field will inevitably result in less rather than more complete disclosure. Moreover, the Group is concerned that, given the Department's characterization of plan service provider relationships as "conflicts of interest" that plan fiduciaries may view large companies, which have more affiliates and which will inevitably have a greater number of relationships that must be disclosed as somehow more "conflicted" and therefore less capable of providing good services than smaller companies.

The requirement to disclose the relationships of a provider's affiliates or other participants in a bundled arrangement is overly burdensome. It is reminiscent of a party in interest list and will be virtually impossible to keep up to date. For a plan service provider offering a bundle of services, each relationship of each bundle participant would have to be monitored, evaluated for materiality, and then disclosed to the appropriate plan fiduciaries. This is an extremely burdensome requirement and unlikely to provide helpful information to plan fiduciaries. If the Department insists on including a disclosure designed to apprise plan fiduciaries of relationships between plan service providers and other parties, the requirement must be defined more narrowly and more precisely.

We suggest the Department consider requiring plan service providers to disclose relationships that: (1) generate fees that are not otherwise required to be disclosed under the Proposed Regulation; and (2) may affect the quality of the services the service provider has agreed to provide pursuant to the arrangement.

VII. The requirement in the Proposed Regulation that service providers disclose whether they will be able to affect their own compensation unfairly casts a specter of impropriety on legitimate and mainstream practices, including service level guarantees, performance-based fees and float. The Department should clarify that, if a service provider follows existing Department guidance with respect to the disclosure of float, the service provider will not be viewed as affecting hi own compensation merely by receiving float.

The Proposed Regulation calls into question legitimate service structures by requiring additional disclosure where a service provider "will be able to affect its own compensation or fees . . . without the prior approval of an independent plan fiduciary." A number of common service structures could arguably be captured by this requirement, including "service level guarantees" in which a plan service provider's compensation is affected if it does not meet certain service goals (e.g., call center responsiveness) or performance fees. It is not clear from the Proposed Regulation whether an arrangement that includes such features would require this additional disclosure.

The Proposed Regulation specifically identifies "float" as a type of compensation that must be disclosed in connection with a service provider's "ability to affect their own compensation." The Department should clarify that if a service provider follows existing Department guidance with respect to the disclosure of float, the service provider will not be viewed as its own compensation, or as acting without the prior approval of an independent plan fiduciary.

As the Department has previously recognized, certain types of "compensation," including float, are unique. Plan service providers have little or no control over many of the factors that affect float, e.g., the amount of time participants wait before they cash checks. Moreover, in an omnibus environment it is simply technologically impossible to disclose exact dollar amounts with respect to float, particularly at the time of entering into a contract, which is prior to the time any float is actually earned. Given this reality, it is important that the Department more clearly provide that float disclosure that meets the Department's existing guidance will not result in a plan service provider having the ability to influence its own compensation with the prior approval of an independent plan fiduciary.

VIII. The breadth of the Proposed Regulation, when combined with the requirement that service providers update their disclosures within 30 days, will result in a continuous reporting obligation that will be costly and inefficient and that will not provide plan fiduciaries with helpful information.

The Proposed Regulation requires that plan service contracts must require providers to update their disclosures within 30 days of the service provider's learning of any "material" change in the information. As noted above, plan fiduciaries and service providers may differ as to what constitutes a "material" change. Furthermore, to the extent disclosures regarding a bundled arrangement must be made by a single service provider, a 30-day rule is simply not enough time for the elements in the bundle to give notice of a change to a provider *and* for the bundle provider to give notice to the plan.

Similarly, as the requirement to update applies to all of the disclosure elements required under the Proposed Regulation, plan service providers would have to separately track each required element and, absent fortuitous timing, provide separate updates. This will result in an

extremely burdensome tracking and reporting regime for service providers and a constant barrage of information that will be unhelpful to plan fiduciaries.

The Department should alter the proposal to require updates on a yearly basis (to the extent that there has been a material change in the services or fees required to be disclosed under the Proposed Regulations), or upon reasonable request by the plan fiduciary.

IX. The Department should clarify that the Proposed Regulation does not apply to contracts in effect as of the effective date, absent a renewal, extension or material change.

The Department should clarify that the Proposed Regulation's requirements do not immediately apply, upon the final regulation's effective date, to every existing contract. Instead, the regulation's requirements should apply as each contract is modified or extended.

The application of the disclosure requirements in the Proposed Regulation to contracts in place as of the effective date is unclear. The preamble to the Proposed Regulation suggests that ongoing contracts do not need to be amended in accordance with the Proposed Regulation until they undergo material changes, or are renegotiated for extension or renewal. In determining the recurring costs to service providers, the Department recognized that service providers "need[] to develop the written disclosure statement each time the contracts are entered into or renewed." 72 Fed. Reg. at 70998.

While the Department assumed that ongoing contracts are likely to incur material changes requiring disclosure annually, id., it does not follow that contracts without such modifications need to provide annual disclosures.[4] Thus, in calculating the paperwork effect of the Proposed Regulations, the Department assumes that each of the existing 1,108,000 contracts or arrangements between plans and service providers will be either entered into or renewed within the first three years of the Proposed Regulations. Id. at 71003.

The Department's stated objective is to ensure that the responsible fiduciaries have adequate information to make prudent selections of service providers: "The primary goal of this proposal [is] to provide comprehensive and useful information to responsible plan fiduciaries when entering service contracts or arrangements." Id. at 70992 (emphasis added). Thus, the Proposed Regulation does not "designate any specific time period prior to entering into the contract or arrangement for receipt of the required disclosures." Id. at 70990 (emphasis added). Both the Proposed Regulation and the preamble frequently refer to disclosures before a contract's

[4] The requirement to disclose any material change to the required disclosure information presumes that the changed information was previously required to be provided to the responsible fiduciary. See 72 F.R. at 70992 (changes by service provider may alter the information "previously disclosed by the service provider"). This provision does not itself require service providers to make disclosures as to ongoing contracts, absent material changes.

initial or renewal consummation. E.g., Proposed Regulation § 2550.408b-2(c)(1)(iii) (service provider must provide required disclosures "before the contract or arrangement was entered into (or extended or renewed)"); 72 F.R. at 70989 (the disclosures must be in writing to "ensure a meeting of the minds").

Requiring each of the existing service contracts to immediately comply with the disclosure requirements on the effective date of the final regulations would be administratively difficult for fiduciaries and service providers, and expensive for plans. The Department should clarify that existing contracts need only comply with the regulations upon renewal, extension or material change.[5]

X. The Department should clarify that the Proposed Regulation does not require an amendment of existing contracts, so long as the required disclosures are provided for in some other writing.

In addition, it is not clear whether the Proposed Regulation requires formal amendment of a contract or arrangement. The Proposed Regulation states "No contract or arrangement to provide services to an employee benefit plan, nor any extension or renewal of such contract or arrangement [by specified service providers] is reasonable ... unless ... [t]he terms of the contract or arrangement (including any extension or renewal of such contract or arrangement)" requires the specified disclosures. Id. at 71004. This suggests that the actual contract must be amended. The requirement is an example of an additional expense (which would ultimately be borne by the plan and its participants) without a corresponding benefit to plans.

Some types of agreements commonly used in employee benefit plans require governmental approval. For example, under state law, an insurance company's contracts must be approved by the state's insurance commission before they can be issued to the public. If the contracts are materially modified, they must be resubmitted for approval. It is not clear whether some or all of the insurance company contacts, such as group variable annuities, issued to covered plans will need re-approval. State consideration of contracts can be a lengthy process. Similarly, certain types of plans (such as prototypes and volume submitters) have been pre-approved by the Internal Revenue Service ("Service"). Some such plans include separate trust agreements that have also been approved by the Service, while for others, the trust agreements are included in the plan itself. Such agreements cannot be revised without being resubmitted to

[5] For contracts with perpetual terms or with automatic renewal periods (i.e. "evergreen contracts"), the Department may impose a requirement that such plans be revised to include the required disclosure information within a specified period. In establishing this period, the Departments should consider that many such contracts cannot be amended without the consent of the plan client, and should provide relief for a service provider who attempts to bring the contract into compliance, but does not receive the cooperation of the plan fiduciary.

the Service. Under the IRS review cycle for pre-approved plans, submissions can only be made in specified years, and even if allowed, would be expensive and time-consuming.

The Group requests that the Department remove the requirement that the contract terms require the disclosures. The point of the Proposed Regulation is that the service providers provide the necessary disclosures, in writing, to the responsible plan fiduciary. If the parties wish to amend a services contract, enter into a new contract, or provide disclosures in a separate writing, addendum or rider, that should be sufficient.

XI. The Department should clarify that, for purposes of the Proposed Regulation, an annuity or similar contract that references to additional services to be provided to a plan will not be required to meet the requirements of the Proposed Regulation so long as any separate services contract between the insurance company and the plan meets the Proposed Regulation's requirements.

The Proposed Regulation refers to a "contract or arrangement to provide services" to a plan. The preamble notes that: "The Department believes that an investment of plan assets or the purchase of insurance is not, in and of itself, compensation to a service provider for purposes of these regulations. However, persons or entities that provide investment management, recordkeeping, participant communication and other services to the plan as a result of an investment of plan assets will be treated as providing services to the plan." 72 Fed. Req. at 70990.[6]

The Proposed Regulations do not prescribe a specific format for the disclosures. The preamble states "All of the required disclosures need not be contained in the same document, as long as all of the required information is presented to the responsible plan fiduciary in writing before such fiduciary enters into the contract or arrangement. Written disclosures may be provided in separate documents from separate sources and may be provided in electronic format, as long as these documents, collectively, contain all of the elements of disclosure required by the regulation." Id.

This suggests that a contract which memorializes the investment of plan assets, such as a variable annuity contract, need not itself comply with the requirements of the Proposed Regulation unless it also includes definite terms for the provision of the services specified in the Proposed Regulation, and the compensation to be received therefore. If the provision of such

[6] We do not understand the Department to be including as a service for purposes of the proposed regulations those activities that are integral to an insurance contract for investment, such as claims processing under a life insurance contract or account maintenance under a guaranteed investment contract. Nor do we understand the mere *sale* of a product, such as life or disability insurance to constitute a "service" even if some incidental "services", i.e., enrollment, take place in connection with the sale.

services is instead memorialized in a separate services agreement or other arrangement, that document should be subject to the Proposed Regulation's requirements, not the annuity or investment contract.

Thus, the Department should clarify that the term "contracts and arrangements to provide services to a plan" means only an enforceable contractual arrangement that specifies the covered services to be provided and the compensation to be paid. Even if an annuity or similar contract incidentally refers to services to be provided, it will not be considered within the scope of the Proposed Regulation if another document actually memorializes the contract for services.

XII. The Department should provide an appropriate period of time for plans and service providers to transition to the new requirements. The effective date of the Proposed Regulation should be extended to at least one year after issuance of the final regulation.

The Department has proposed that the Proposed Regulation be effective 90 days after publication of the final regulations in the Federal Register, and invited comments on the effective date. Id. at 70994.

The Proposed Regulation requires extensive and specific disclosure, some of which is not currently being provided. Service providers will need significant lead time to revise their contracts to conform to the Proposed Regulation's requirements, and to obtain the information specified for disclosure from other, non-party-in-interest service providers to the plan. Furthermore, robust comment on the Proposed Regulation is expected, and the specifics of the Proposed Regulation hopefully will change before they are issued in final form. It would therefore be a poor use of limited resources for service providers to begin making changes in advance of the final regulations. In addition, as discussed above, if certain contracts or arrangements themselves need to be amended, governmental approval of the amendments will require additional time.

XIII. The Department should not condition the section 408(b)(2) exemption on the plan's ability to terminate on reasonably short notice. To the extent that the Department retains the condition, the Department should confirm that a market-value adjustment, surrender charge or similar fee does not constitute a "penalty" for purposes of this condition.

Current regulation section 2550.408-b(c) states that no contract or arrangement is reasonable, within the meaning of section 408(b)(2), if it "does not permit termination by the plan without penalty to the plan on reasonably short notice." The current regulation clarifies, however, that "A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start- up costs is not a penalty. Similary [sic], a provision in a lease

for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages." This language is retained as new section 2550.408-b(c)(2) of the Proposed Regulation. Although the Department has not changed this provision, it invited comment on whether the current regulatory framework presents practical problems, and whether further guidance could address such problems. Id. at 70993.

Just as the Department believes that the requirements of the Proposed Regulation are necessary due to changes that have taken place in the last several years in the way plans contract for services, the Group believes that the requirement that a plan be able to terminate an arrangement on short notice is outdated. Where a plan fiduciary determines it is in the best interest of the plan, he or she should be able to enter into long term contracts. Therefore, the Group requests that the Department eliminate this requirement in the final regulation.

If the Department decides to retain the requirement as part of the final regulation, the Department should clarify that a "penalty" for these purposes does not include a market value adjustment, surrender charge or similar fee charged upon withdrawal from an investment fund. Such fees compensate the service provider for losses caused by premature termination of participation in the fund, and/or expenses that it would have been able to recover absent early termination.

In regulations under ERISA section 401(c), for purposes of a lump-sum payment upon termination, the Department excluded market value adjustments and the recovery of costs from the definition of "penalty." See 29 C.F.R. § 2550.401c-1(e) ("For purposes of this paragraph (e)(1), the term penalty does not include a market value adjustment . . .or the recovery of costs actually incurred which would have been recovered by the insurer but for the termination or discontinuance of the policy, including any unliquidated acquisition expenses, to the extent not previously recovered by the insurer.").

XIV. The Department should amend the regulations under Internal Revenue Code section 4975(d)(2) to parallel the requirements that are finally adopted by the Department with respect to ERISA section 408(b)(2). However, in adopting such an amendment, the Department should make clear that changes to the Code regulations apply only to "plans" as defined in section 4975(e)(1)(A) of the Code, and not to "plans" as defined in Code sections 4975(e)(1)(B)-(G).

The preamble to the proposed class exemption indicates that the Department believes that, where a service provider fails to meet the requirements of the Proposed Regulation, the provision of services will be prohibited for purposes of ERISA and the Code. 72 Fed. Reg. 70893, 70894 (Dec. 13, 2007). However, the Department has not amended the regulations under section 4975 of the Code that parallel the existing ERISA section 408(b)(2) regulations.

We understand that the Department intends to interpret the Code regulations to include the conditions of the final ERISA section 408(b)(2) regulations, but only with respect to "plans" as defined in section 4975(e)(1)(A) of the Code and not with respect to "plans" as defined in Code sections 4975(e)(1)(B)-(G) (e.g., individual retirement accounts and individual retirement annuities, Archer MSAs, health savings accounts, Coverdell, education savings accounts, and other similar trusts, plans, accounts or annuities). However, without an amendment to the Code regulations, the Department's interpretation of the Code's application may not be sustained. A contract failing to meet the requirements of section 408(b)(2), would not necessarily result in a prohibited transaction for purposes of Code section 4975(c)(1)(C). If this is the case, no excise tax would apply to the transaction.

In order to avoid confusion on this matter, the Department should amend the regulations under Code section 4975(d)(2) to parallel the requirements that are finally adopted by the Department with respect to ERISA section 408(b)(2).[7] However, in adopting such an amendment, the Department should make clear that changes to the Code regulations apply only to "plans" as defined in section 4975(e)(1)(A) of the Code, and not to "plans" as defined in Code sections 4975(e)(1)(B)-(G). If the Department determines not to amend the Code regulations, it should at least confirm that it does not intend for the requirements to apply to individual retirement accounts and individual retirement annuities, Archer MSAs, health savings accounts, Coverdell, education savings accounts, and other similar trusts, plans, accounts or annuities.

XV. The requirements of the Proposed Regulation should not apply where: (a) services are provided to the plan by the plan sponsor (or an affiliate), so long as the plan pays no more than "direct expenses" as defined by ERISA section 408(c)(2) and the regulations thereunder; or (b) the plan sponsor is paying for some or all of the services provided.

The Proposed Regulation does not distinguish services provided to a plan by the plan sponsor. Department regulations under ERISA section 408(c)(2) provide that compensation is "reasonable" for purposes of section 408(b)(2) if it is limited to reimbursement of "direct expenses properly and actually incurred and not otherwise reimbursed." The regulations further explains that direct expenses are those that would not have been sustained had the service not been provided and do not represent an allocable portion of overhead (the "but for" test). 29 C.F.R. § 2550.408(c)(2).

When a plan receives services from the plan sponsor, the plan fiduciary is responsible for documenting that the plan has paid no more than "direct expenses." Often these services are provided at a significantly lower price than would be available from a third party. If the safeguards of ERISA section 408(c)(2) are met, plan fiduciaries should not also be required to

[7] Under Reorganization Plan No. 4 of 1978, the Secretary of Labor has the authority to issue regulations, rulings, opinions and exemptions under section 4975(d)(2) of the Code.

obtain from the plan sponsor the information required under the Proposed Regulation. Similarly, if the plan sponsor is paying for the services provided to a plan, there should not necessarily be a need for the plan fiduciary to gather all the disclosures required by the Proposed Regulation from the plan sponsor.

XVI. The Department should reconsider its position that meals, entertainment and gifts constitute "compensation" for purposes of the Proposed Regulation. At the very least, the Department should recognize that plan service providers cannot disclose the value of future gifts at the time of contract.

The Proposed Regulation defines reportable "compensation or fees" as "money or any other thing of monetary value (for example, gifts, awards, and trips) received, or to be received directly from the plan or plan sponsor or indirectly (i.e., from any source other than the plan, the plan sponsor, or the service provider) by the service provider or its affiliate in connection with the services to be provided pursuant to the contract or arrangement or because of the service provider's or affiliate's position with the plan." 72 Fed. Reg. at 71004.

Including within "compensation" anything received "in connection with the services to be provided pursuant to the contract or arrangement or because of the service provider's or affiliate's position with the plan" is too broad. In fact, many non-monetary items received by plan service providers may arguably meet the "in connection with" requirement. Yet, such items are in no way provided or received as "compensation" for services to the plan or to anyone. We suggest that the final regulations provide for a single disclosure that a plan service provider can make to all its customers outlining its policies and procedures applicable to meals, gifts and entertainment. This would allow plan fiduciaries to evaluate each provider's policies without requiring service providers to spend costly hours tracking routine business entertainment and plan fiduciaries to spend plan resources monitoring how many lunches a service provider has that are arguably related to the plan's business with the provider.

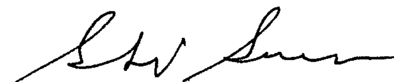
If the Department decides not to adopt this suggestion, the Group requests that the Department consider adopting, for purposes of the final regulations, similar guidance to that included in the final Schedule C changes, regarding allocation of this type of "compensation" among a service provider's various customers and a de minimis reporting threshold.

The treatment of gifts and entertainment is a very important issue and the Group urges the Department to adopt clear, consistent and fair guidance.

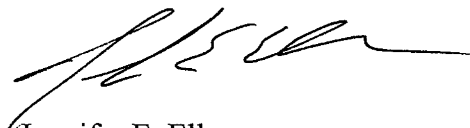
* * * *

The Group appreciates the opportunity to comment on this important Proposal. We would be happy to meet with the Department to discuss these comments or to provide additional input as you work to finalize the regulations.

Best regards,



Stephen M. Saxon



Jennifer E. Eller