DEPARTMENT OF LABOR

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

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PUBLIC HEARING

PROPOSED AMENDMENTS TO SECTION 408(b)(2) REGULATION
REASONABLE CONTRACT OR ARRANGEMENT - FEE DISCLOSURE

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Monday, March 31, 2008

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The Panel met in Room S-4215 A-C in the Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C., 20210 at 9:00 a.m., Bradford P. Campbell, Chair, presiding.

PRESENT
BRADFORD P. CAMPBELL, Chair
JAMES BUTIKOFER, Panel Member
LOUIS CAMPAGNA, Panel Member
ADRIENNE DWYER, Panel Member
JOSEPH PIACENTINI, Panel Member
ALLISON WIELOBOB, Panel Member
FIL WILLIAMS, Panel Member
KRISTEN ZARENKO, Panel Member

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P-R-O-C-E-E-D-I-N-G-S

9:00 a.m.

CHAIRMAN CAMPBELL: All right. Well, thank you all for your patience. We have resolved our recording issue. We're taking audio recording of the initial part of this hearing until our official stenographer arrives. We're advised that that should meet the muster for the record. So with that, we apologize for the delay, and we'll get going.

As you probably know, my name is Bradford Campbell. I'm the Assistant Secretary of Labor for the Employee Benefits Security Administration. And I want to welcome you this morning as we kick off the first of two days of administrative hearings on our proposal which establishes disclosure requirements under ERISA Section 408(b)(2).

The Employee Benefits Security Administration -- or EBSA -- as most of you also probably know is responsible for overseeing the administration and enforcement of Title I of ERISA, which is the law governing private employer-provided benefits. The plans that we oversee provide benefits to about 150 million Americans, and hold about $6 trillion in assets.

As an Agency, we have both regulatory and enforcement authority. And we take these responsibilities very seriously. Last year in our Civil Enforcement Program, we had monetary results of about $1.5 billion. And our criminal program -- our investigations -- led to the indictment of 115 persons in connection with crimes against employee benefit plans.

As this hearing today demonstrates, we are equally vigilant in our efforts to use our regulatory authority to improve the legal environment in which employee benefit plans operate. Now as we do so, we are ever mindful of the voluntary nature of this system, and of the need to ensure that our regulations enhance not only the security of benefits, but their availability as well.

The financial services marketplace has increased in complexity. Plan fiduciaries who are charged under the law with responsibility of making prudent decisions when hiring service providers and paying only reasonable expenses have found their jobs more difficult as the number and types of fees proliferate and as the relationships between service providers become more complex. These trends caused us to conclude that despite the success of our fiduciary and participant education and outreach efforts that a new regulatory framework was necessary to better protect America's workers, retirees and their families. That's why we initiated three major regulatory projects that each address a different aspect of these disclosure issues.

The first, the Public Disclosures and the Form 5500 is a completed regulation. The second, the proposal we are here today to discuss as you know has been proposed, and we're having this hearing. And the third, which you'll be seeing in the next several months, is a proposed regulation addressing disclosures required to participants and participant-directed individual account plans.

But the purpose of this hearing today is to ensure that fiduciaries have the information they need to carry out their duties under the law and to act on behalf of participants. This is a regulation that we're going to complete by the end of the year. But even more important than getting it done is getting it done correctly. And that's why we are here today.

I personally am a big believer in the Public Notice and Comment process. No matter how smart our people at the Department are -- and by and large I think they're pretty smart -- and no matter how much time we've spent on this regulation -- and we did spend quite a lot of time on it -- our daily

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business is not running plans or providing services to plans, or carrying out all the functions that go into the everyday real work of plan administration. And your comments therefore have been very helpful to us as we go through this process and look at the proposal and look at what should be in a final regulation. You've identified through your comments many issues that we can consider as we craft this final regulation, and we appreciate that.

As I've said before, I think the regulatory process is ideally suited for achieving the goal of this overall of better disclosure. This process lends itself to a calm and rational evaluation of the issues and a full consideration of all points of view.

I do want to note that we don't hold a hearing here at the Department on every regulation we propose. But we did so for this regulation because of the technical and legal issues presented, some of which are quite

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complex. And we believe that we'll all benefit from additional comment and discussion in the public record on this proposal.

So in short, we're open to all of your praise and all of your criticism in equal measure. Give us your laurels and your arrows. And we will evaluate all that. We want our final regulation to work well, while well protecting workers.

And so with that, let me turn it over to Lou Campagna.

PANEL MEMBER CAMPAGNA: Hi. I'm Lou Campagna. I'm Chief of the Division of Fiduciary Interpretations with EBSA.

And Alan Lebowitz is sick with the flu today, and I'm going to go through his opening remarks.

On December 13, 2007, the Department published a Notice of Proposed Rulemaking in the Federal Register containing a proposed amendment to the regulation governing 408(b)(2) of ERISA, the statutory exemption for the provision of services to employee benefit plans by persons who are considered parties in interest. The proposal would amend the provisions addressing what constitutes a reasonable contract or arrangement for purposes of the statutory exemption by establishing disclosure obligations applicable to both fiduciaries and providers of services to employee benefit plans.

On December 13, 2007, we also published a proposed class exemption, which if granted would relieve a responsible plan fiduciary from any liability for a prohibited transaction that could result from the plan fiduciary entering into a service contract in a situation where the service provider fails to comply with the proposed regulations.

To date, the Department has received over 100 public comments on the proposed regulation and class exemption. The purpose of this hearing is to receive

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additional comments regarding the proposed regulation and exemption in order to develop a better understanding of how best to achieve the Department's goal of ensuring that appropriate fee disclosures are made to responsible plan fiduciaries.

As for the procedures for this hearing, we will follow the agenda that has been prepared and made available as provided for in the notice scheduling this hearing. The speakers will be called in the order listed. We ask that each speaker stay within the allotted ten-minute period for their testimony. To the extent that members of the Panel have questions for speakers, the question and answer part of the testimony will not be counted toward the designated time limit. Once a speaker's opening remarks have concluded, we will allow approximately 15 minutes for additional questions from the Panel.

We wish to note that you should

read nothing into the way questions may be phrased, and should draw no inferences as to the Department's views from the questions asked.

If you have filed a written statement with us, copies have been furnished to the members of the Panel. Accordingly, we encourage speakers to summarize their views or the views of their client in the oral testimony.

Prior to beginning your testimony, we ask that you identify yourself, your affiliation, and the organization you represent for purposes of our hearing reporter who is transcribing these proceedings.

For those who wish to supplement the record, the record of this proceeding will be kept open until the close of business on April 21, 2008. The official record of this proceeding will be open for public inspection and copies will be made available in the Public Disclosure Room of EBSA, Room N-1513,

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U.S. Department of Labor, 200 Constitution Avenue, Washington, D.C.

I'll now introduce the members of the Panel. To my left is Joe Piacentini, Director, Office of Policy and Research; Kristin Zarenko of the Division of Regulations, Office of Regulations and Interpretations; Adrienne Dwyer of our Solicitor's Office; and of course, Mr. Campbell.

With that, the first speaker.

CHAIRMAN CAMPBELL: Okay. And obviously, we will have various folks from the Department coming in and out as the course of the two days go on. That probably doesn't surprise you that we didn't have eight people to spare for two solid days. So we will shuffle in and out.

Our first witness, please.

MR. GOLDBRUM: Okay. Good morning, Assistant Secretary Campbell and members of the Panel.

My name is Larry Goldbrum, and I'm General Counsel of the SPARK Institute. And with me today is Tom Schendt, outside counsel for the SPARK Institute. He's with Alston & Bird.

Thank you for the opportunity to share with you our views regarding the proposed 408(b)(2) regulations amendment. I'd like to make this opening statement, and I welcome the opportunity to respond to your questions.

The SPARK Institute is an association that represents the interests of a broad-based cross section of retirement plan service providers including banks, mutual fund companies, insurance companies, third-party administrators and benefits consultants. The Institute's combined membership services more than 95 percent of all the fund contribution plan participants.

As you know, the SPARK Institute has publicly supported and advocated for more

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robust fee disclosure by retirement plan and investment providers, as well as by employers to their employees. We believe that greater fee transparency will ultimately not only benefit plan sponsors and plan participants, but also the retirement plan investment management industries. We commend the Department of Labor for taking a flexible, concept-based approach in the proposed regulations that will allow service providers to tailor disclosures to their products and customer needs.

As the Department knows, fee disclosure in the retirement plan and investment industries is extremely complex due to the diversity of investment products, the diversity of service provider business models, the demands of plan sponsors to shift the administrative costs of their plans to participants, and the costs associated with gathering and presenting the information. We urge the Department to continue to take the lead in resolving these issues and to take deliberate and measured steps as it develops new rules and regulations.

We urge the Department to retain the flexible approach to fee disclosure. However, the SPARK Institute strongly opposes the recommendations made in certain comment letters that urge the Department to require that disclosure be made through a prescribed one-size-fits-all form, and pre-determined categories as a percentage of assets regardless of the fee structure or that obligates a bundled provider to aggregate and present information from third parties in a single document.

The retirement plan and investment industries are very competitive and dynamic, so no single form or methodology can adequately address the diversity of products and service structures without favoring one segment of the industry over others. Additionally, mandating disclosure in a prescribed format or according to a specific methodology will ultimately be more costly for service providers and for plan participants.

We are concerned that the proposed regulation appears to override legislative and long-standing regulatory authority regarding the definition of plan assets. The SPARK Institute recognizes the importance of and the complexity associated with developing disclosure requirements that address the Department's concerns, but that are not overly broad. The final regulation should not impose additional detailed disclosure requirements on investment managers of and service providers to non-plan asset funds, for example, mutual funds. The Department's disclosure rules with respect to such parties should not go beyond the disclosure rules of the SEC or such other regulatory authority with specific jurisdiction over the particular investment vehicle.

We recognize that many investment

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products are made available to plans through intermediaries and investment providers may not know of or deal directly with the investing plans. However, the regulations should not shift the existing investor disclosure obligations of the investment fund to the intermediary. Instead, the investment provider and the intermediary should be permitted to determine how the disclosures will be delivered to the plan as part of the arrangement between the parties to make such funds available.

Under our approach, an intermediary could agree to deliver a mutual fund's statutory prospectus to the plans it services on behalf of the fund in order to assist the fund in meeting the fund's disclosure obligations. Our recommended approach is not intended to relieve the intermediary of any obligation to disclose to the plan the compensation it will receive from an investment provider such as payments under a 12b-1 program.

One of the most difficult issues that the proposed regulation attempts to address is disclosure with respect to bundled services arrangements. As we note in our comment letter, these arrangements come in a variety of forms, continue to evolve in an ever-changing market, and may be impossible to adequately define by regulation without being overly broad or too narrow. Regardless of how these arrangements are ultimately defined, several specific issues should be addressed in order to facilitate compliance with the final regulations.

We commend the Department for recognizing that bundled providers should not be obligated to unbundle their services and disclose the internal allocation of fees among affiliated companies. Bundled providers should disclose their compensation and fees for the services they consider to be part of their bundled arrangement, but should not be

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obligated to make disclosures for other entities and services that the bundled provider does not consider to be part of its bundled arrangement.

For example, when a bundled provider at the direction of a plan sponsor makes payments to a third party that the service provider does not consider to be part of the bundled arrangement, the third party should be responsible for satisfying any applicable disclosure and contract obligations under the final regulations. Additionally, when a record keeper makes an accommodation for a plan and agrees the record keeper holds special assets or plan-specific investments, the record keeper should have no fee disclosure or contract obligations with respect to the assets, except that the record keeper should have to disclose the compensation it or its affiliates will receive for the services it provides in connection with that special asset.

We agree with comments made by other groups that the fiduciary attestational requirement will be unworkable, and we are concerned that it will create opportunities for frivolous law suits. It is common for service providers to perform a variety of services for a plan, some of which are fiduciary services, and others which are not. Additionally, whether a service provider is a fiduciary is an inherently factual issue. We are concerned that the attestation will create traps for providers including those who use their best efforts to comply with the requirement and could have devastating consequences for the most well meaning service providers.

We agree with comments by other groups that the proposed conflicts disclosure provisions are too broad and will be extremely difficult to satisfy. We urge the Department to take a more targeted approach that focuses on the disclosure by a service provider of its

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financial interests with respect to plan assets.

The regulation should focus on revenue sharing agreements and payments from third parties. Although disclosure practices vary among service providers, most large- and mid-size retirement plans are already provided with information that discloses the provider's potential financial interest in the investment of plan assets. However, disclosure practices can be improved if all service providers that deal directly with the plan are required to disclose the financial interest they may have in connection with how plan assets are invested.

The SPARK Institute agrees with comments made by other groups that service contracts should not result in a prohibited transaction when a service provider makes a reasonable effort to comply with the regulation and corrects the error within a reasonable time after discovering it. The proposed rules are complex, will require a learning period, and will likely be subject to different interpretations. Imposing liability on service providers with no opportunity to remediate errors could be unduly harmful to the industry.

Additionally, the SPARK Institute requests that the Department expressly provide protection from penalties and liability for service providers when a plan sponsor fails to take the necessary and requested affirmative action to amend their service agreement after reasonable advance notice regarding such action. Service providers should be protected from any adverse consequences associated with continuing to service the plan and receiving compensation for its services provided that it otherwise attempted to comply with the regulations, but was unable to obtain affirmative consent from the plan sponsor. Absent such relief, plan service providers will be put in the untenable position of having to either refuse compensation while continuing to perform services, or discontinue providing services to the plan. Neither of those options serves the best interests of any of the parties involved, including plan participants.

The SPARK Institute requests the Department extend the compliance deadline for the new regulations and adopt a two-tiered approach. For new customer agreements, the final regulation should not be effective until at least six months after they are published. For existing customer arrangements, client deadlines to either amend an existing service agreement or sign a new one should be at least 18 months following the date the final regulations are published. Under this approach, during the first six months following the publication date of the final regulations, the affected parties will be able to prepare to comply with them and have a longer period to address existing agreements that may need to be amended.

On behalf of the SPARK Institute, I thank the Panel for the opportunity to share our views. And I welcome your questions.

CHAIRMAN CAMPBELL: Thank you. Why don't we go ahead and we'll go from my left to right -- your right to left. And we'll start with Director Piacentini with questions.

PANEL MEMBER PIACENTINI: Thank you, Brad.

I guess I have a short list of relatively narrow questions that in part are passed on the testimony you just presented; also partly based on the written comment that your organization submitted some time ago.

As I understand it, your organization is in favor of a requirement to disclose indirect compensation that the record keeper might receive from an investment provider or some other party. I guess my question is is that disclosed now, or is that

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something that would be a new practice that -- and have I correctly understood that you think that's all right?

MR. GOLDBRUM: Yes. I think that that's a fair characterization of what we're proposing.

I would also submit that in the large- and mid-size markets, it's been our experience that for the most part that indirect compensation is being provided by record keepers. That's not to say that there can't be improvement and that there may not be broad-based disclosure among all service providers in all segments of the market, but obviously since attention has been focused on this issue, the practices have been improving.

PANEL MEMBER PIACENTINI: Okay. Now I also understand that you think that there are some challenges in asking an intermediary like a record keeper to provide detailed uniform information on investment products, for example, that might be available in a platform. So I guess my question is is it your view that your clients -- the fiduciaries who are selecting these investment options, do they have adequate information now, or not?

MR. GOLDBRUM: Well, part of the issue -- I can give you an example -- if you were to ask a record keeper to make very detailed disclosure and by that I mean dollar-based disclosure of investment associated fees to a plan sponsor, part of the problem is coming up with those calculations. And it depends on when you are making that disclosure. If you're making that disclosure before the relationship even begins, that is going to be a difficult task because you really don't have good hard information to make that disclosure.

And then it depends on how deep the disclosure is that you require. If you're simply talking about making a disclosure with respect to the total expense ratio, that's a much easier thing to do, of course, after you have that particular plan as one of your customers because you can take their assets and figure out how much at a plan level they were charged.

PANEL MEMBER PIACENTINI: But my question though is do the clients -- the fiduciaries -- do they have adequate information now when they're selecting a subset of investment options off of a platform? For example, even the small plan client, would they have adequate information easily enough accessible now, or not?

MR. GOLDBRUM: I think that the information -- again, it depends on the level of detail that you're talking about. But in general and in particular if you're talking about mutual funds, that information is readily available. What it costs to use that particular fund, that information is available in the statutory prospectuses.

Now how that money might be shared

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between the parties, that will ultimately be up to the parties to disclose who is getting what. So is the financial advisor or is the record keeper receiving some form of compensation from the fund company in order to subsidize the services that it's providing? Well, to get to that level, it depends on the service provider to make that disclosure to the plan sponsor.

And again, our experience has been what our members are telling us that in the large-, medium-sized market, that disclosure is being made.

PANEL MEMBER PIACENTINI: Okay. My final question then, I guess, in deciding what investment options to include in a platform, what are the main things that are considered and what are the sources of information on that?

MR. GOLDBRUM: For a plan sponsor and they pick their investments?

PANEL MEMBER PIACENTINI: For an

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intermediary who's offering a platform with different investment options.

MR. GOLDBRUM: Well, the market is very, very competitive. And obviously, service providers are competing for plan business. So they're going to want to put together a fund line-up that is in today's market open architecture because in order to compete, you really do need to make not only your proprietary funds available, but the funds of other investment complexes. And you're going to want the most competitive funds out there, because ultimately when a plan picks a service provider, they want to know that you can provide the record keeping services but that also they're going to have access to some of the best funds that are out there. So they may look at historical performance of the fund. They will look at the expense ratio of the fund. But ultimately, it's going to be things like reputation of the investment manager, the

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historical performance of the fund.

PANEL MEMBER PIACENTINI: So I think I'm hearing that it's more demand-driven rather than some sort of deliberate quality screen?

MR. GOLDBRUM: I think that a quality screen goes into it, because the quality screen helps you pick out the funds that are the most competitive funds in the marketplace.

The demand side of it is that you know that plan sponsors want to offer the best possible funds that are available in the marketplace.

PANEL MEMBER PIACENTINI: Thank you.

PANEL MEMBER CAMPAGNA: Picking up on some of Joe's questions, I suppose what you're saying is with respect to the funds, there's disclosure pursuant to prospectuses or whatever regarding those funds. But what isn't really a focus is the indirect compensation or compensation that other service providers may be receiving, such as record keepers. That's not part of what is in the prospectus.

MR. GOLDBRUM: That's not in the prospectus. But it's a common practice that in the service contract that an employer has with their plan service provider that they will disclose what those indirect sources of compensation will be. And that typically will be done in the form of rates.

So in the front end, that type of disclosure can be made, and it's our experience that it's commonly being made.

PANEL MEMBER CAMPAGNA: Is there any kind of uniform nature to that, or is it just employer by employer, or service provider by service provider at this point?

MR. GOLDBRUM: It's probably more service provider by service provider in large part because of all the different investment products that you have out there. So if the

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service provider is a fund company, they might take one approach. If the service provider is affiliated with an insurance company, they make take a different approach.

And part of what we have talked about in the past, Lou, is that the real difficulty here in trying to create a single form is that there are so many different service structures. There are so many different investment products that it really is hard to just come up with a single form. So each service provider tailors their disclosure form to what ultimately fits their product line-up.

PANEL MEMBER CAMPAGNA: You mentioned in your testimony that intermediaries in funds should have an ability to enter into an agreement to I guess come up with this disclosure idea. Could you elaborate on what you think that agreement might look like, or how it should be implemented?

MR. GOLDBRUM: Well, part of our issue goes to what disclosure is required with respect to mutual funds, and sort of our uncertainty what the regulations require in terms of the level of detail below the actual mutual fund itself.

It's very common for bundled providers, record keepers to have agreements with various unaffiliated fund companies to make their funds available. It's that agreement that could -- and in many cases already says that the record keeper or the bundled provider will provide prospectuses for that fund company to the plan sponsors. And so that's what we're talking about.

That statutory prospectus is the official disclosure of the fund, and that's really what an intermediary who is offering a third party's fund should be providing to the plan sponsor, and should not be required to go beyond that in trying to dig into information that's not available in that statutory prospectus.

PANEL MEMBER CAMPAGNA: Would that apply as well if the record keeper was affiliated with the fund in offering the platform?

MR. GOLDBRUM: Yes. I think in order to have sort of a level playing field what we would say is that same thing, that the intermediary arm of that institution would deliver the prospectuses to the plan sponsor. And again, that does not mean that additional disclosures will not be made. In fact, additional disclosures will be made.

What our view is though is that the responsibility for making disclosures for unaffiliated funds should not be shifted from that third party to the intermediary because that intermediary really should not be put in a position of trying to make legal disclosures for someone that it's not affiliated with.

PANEL MEMBER CAMPAGNA: Last question. Going back to your comment letter, you said that the record keeper should inform the plan about any inaccuracies in the fund prospectus when you're informed by the fund within a reasonable cure period. Any elaboration on what you have in mind there?

MR. GOLDBRUM: Well, part of that issue just goes to the fact that there appears to be sort of this strict liability approach in the proposed regulation where a service provider really has no opportunity if their disclosures may be incorrect to correct them. And what we're saying is that regardless of where the error's made, if the error is one that a third party had made in their prospectus or even the service provider made as a result of what it put it in its agreement with the plan, that when that error is discovered, there should be a reasonable opportunity to go ahead, notify the plans and make correction of that.

PANEL MEMBER CAMPAGNA: Thank you.

CHAIRMAN CAMPBELL: Just briefly,

I noticed in one of your comments earlier that you had suggested that IRAs not be covered by this regulation. Is that in part because you view the disclosures that would go to IRA holders to be more akin to disclosures to participants rather than fiduciaries, which is the subject of this regulation? Could you expand on that a little more?

MR. GOLDBRUM: Well, our view was that this regulation is intended to cover the disclosures that are made by a service provider to a plan who is offering the retirement plan to its employees. And when you're dealing with most of these IRAs, you're not dealing with a plan sponsor. And for those institutions that have these IRAs, it just creates a really awkward situation. So that's the basis for what we're saying to clarify that they should be excluded.

CHAIRMAN CAMPBELL: Thank you.

Adrienne?

PANEL MEMBER DWYER: Adrienne

Dwyer from the Solicitor's Office.

You talked earlier in response to Mr. Piacentini's questions about information being disclosed in the prospectus, but that there was additional money sharing that is not in the prospectus but that you had said that is for the most part being voluntarily disclosed by intermediaries. Can you give us some examples of what that sharing would be that is voluntarily being disclosed but is not in the prospectus?

MR. GOLDBRUM: Yes. Let me clarify that statement.

The prospectus will likely have the disclosure of the programs that ultimately are used to provide those payments -- so a 12b-1 program, or a sub-transfer agency program. That may be disclosed. But what's not disclosed in the prospectus is who the fund company is making those payments to.

So if you are an intermediary or record keeper, and you're offering a third party's fund to your plans, the fact that you're receiving that payment would not be readily apparent from going to the prospectus. You could see in the prospectus that there's a 12b-1 program, but the prospectus won't tell you that I as the record keeper am receiving a payment under that program.

And it's that disclosure that in my experience, again, large- and medium-size plans in dealing with the large providers are receiving that disclosure. And that would be in the service agreement. So it would disclose the compensation and in addition to whatever specific items we receive, we will also receive 25 basis points from the following fund with respect to the assets that are invested.

PANEL MEMBER DWYER: And if I would ask you to make an educated guess about the percentage of intermediary contracts where that information is being disclosed to plan fiduciaries, what would you say?

MR. GOLDBRUM: That -- although after this testimony, I'm heading out to Las Vegas. Those are odds that I'm not willing to make.

(Laughter.)

MR. GOLDBRUM: So I just couldn't give you -- we could look into that and get back to you. However, sitting here right now I think it'd be difficult for me to give you an estimate.

PANEL MEMBER ZARENKO: I just have a follow-up questions about the prospectus in and of itself.

I'm sort of envisioning your members as record keepers. They have a variety of either affiliated or nonaffiliated funds on their platform. And we often keep coming back to, you know, pass through a prospectus. How helpful is a prospectus document to a plan fiduciary, especially given the wide variety and sophistication? Is there a pressure at the record keeper level to educate plan fiduciaries about what's disclosed in there, and how those sort of fund level cost disclosures relate to what it's going to cost a plan? If you could just comment on that for a few minutes.

MR. GOLDBRUM: I'm not going to sit here and tell you that the funds prospectus is the most user-friendly document, because it is not.

However, when you're talking about who is going to be responsible for making the legal disclosure for a mutual fund that a plan invests in through an intermediary, you really have to come up with a practical solution to how is that disclosure going to be made. If the intermediaries are responsible for making really technical disclosure beyond what's in the prospectus for an unaffiliated party, that could cause them to not offer as many unaffiliated funds. That's a risk issue that they may not be willing to take.

So from the basic legal standpoint

and who's responsible for making disclosure for those unaffiliated funds, the prospectus is probably the best document to look to. However, because the market is so competitive and because of the focus on disclosure, ultimately plan sponsors will receive disclosure. That goes a little further.

But that's going to be something that the intermediary is going to tailor to what their products are and what their plan sponsors' needs and sophistication levels are. But ultimately the plan sponsors have to be responsible for making sure that they're educated about the decisions that they have to make in gathering the information that they need.

The service providers or the intermediaries are going to try and make it as easy for them as possible. But they probably will not be willing to accept a legal responsibility for making financial disclosures for unaffiliated companies.

PANEL MEMBER ZARENKO: And what about, obviously a prospectus only comes into play when we're talking about SEC-registered investment products. Do your members have a lot of non-mutual fund investments on their platforms? Is there a go-to document for those, or does it just vary a lot more what's currently being passed through about those products?

MR. GOLDBRUM: You're right. There is a lot of variation. There isn't a go-to document.

But again, when you're talking a bundled provider, and a bundled provider could be making insurance products available for an unaffiliated company, you don't have a prospectus to point to or to rely on. And in discussing this issue with our members, it became apparent to us that in most of those instances, the employer is signing some form of agreement already with the investment provider.

And what we would propose again when you're trying to figure out who is responsible for making that legal disclosure, instead of shifting that responsibility to the intermediary that that responsibility should be between the investment provider and the plan sponsor. And pursuant to that agreement that for the most part today exists. They may not today meet the requirements that you ultimately want them to satisfy, but that's where we think the responsibility should be.

PANEL MEMBER ZARENKO: Okay. Switching gears, in your comment letter -- and we've heard there's a lot of resistance sometimes and it's hard to get plan sponsors to sign a contract -- our proposal did not include an explicit signature requirement. So I'm wondering is the issue there that you're just concerned without a signature have we satisfied your written contract or arrangement requirement? Or is the concern that if we don't have a signature, we -- a service

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provider -- are uncomfortable that a plan fiduciary has complied with its side of the transaction? Could you just expand on that?

MR. GOLDBRUM: Yes. Well, it would be very, very helpful if in the final regulations it was explicitly stated that this agreement or arrangement requirement did not require a signature. If that is the case, that may make the agreement provision simpler.

So essentially, a service provider would send the agreement and the disclosures to the plan and they've satisfied the disclosure requirements. If that's the Department's intention, it would help to explicitly state that.

PANEL MEMBER ZARENKO: Do service providers want to have signatures? They just can't get them?

MR. GOLDBRUM: No. I don't believe that they would want to have the signatures. They would prefer not to have to get signatures.

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In trying to understand what the proposal was, it was not clear whether or not the agreement requirement required a signature or not.

PANEL MEMBER ZARENKO: Any state contract law issues that are either created by our proposal or that are out there right now that we should be aware of?

MR. GOLDBRUM: Yes. But I'm not the best one to summarize those for you.

CHAIRMAN CAMPBELL: Anyone else on the Panel have any questions?

All right. Any additional comments you'd like to make.

MR. GOLDBRUM: No. Thank you for considering our views.

CHAIRMAN CAMPBELL: All right. Well, thank you for coming to testify.

We had planned to do one more testimony before the break, but our stenographer has now arrived. So let's take our break a little bit early so we can get that set up and then we'll start with Mr. Wray when we return.

Ten, 15 minutes. Thank you.

(Whereupon, the above-entitled matter went off the record at approximately 10:00 a.m. and resumed at 10:10 a.m.)

CHAIRMAN CAMPBELL: All right, folks. If we can take our seats. We'll get started again.

Our next witness is David Wray from the Profit Sharing 401(k) Council of America.

MR. WRAY: Assistant Secretary Campbell and Panel members, thank you for the opportunity for us to share the views of the Profit Sharing 401(k) Council of America.

Established in 1947, PSCA is a national nonprofit association of 1200 companies and their six million participants. PSCA represents its members' interests to federal policymakers among its other services. It has both large and small companies. We

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have Fortune 100 companies and we have small entrepreneurial businesses as members.

Qualified retirement plan fiduciaries are expected to arrange for services paid for with plan assets only, when the fees charged for those services are reasonable. However, a determination of the fees paid from a plan and how those fees are determined can be difficult.

The operation of today's defined contribution program requires a multiplicity of services. In addition to investment management, these plans require record keeping, administration, compliance, communication to plan participants, consultants and advisory services, specialists like firms that handle only QDRO filings, and trustee services.

Plan sponsors and participants expect that the services provided to their plans are of the highest quality and constantly improving. Those who provide services to defined contribution retirement plans have responded with efficient, innovative and high quality solutions often using complex business models with complicated fees and fee-sharing arrangements.

Most plan fiduciaries do not have an expert understanding of the business models of those who provide plan services. They must rely on the fee-related disclosures provided by their service providers. Often service providers provide the information that plan sponsors need in a form that helps them meet their fiduciary obligation. Sometimes they do not.

In the proposed regulation, the Department of Labor has made it clear that it expects retirement plan fiduciaries to know with specificity all of those who receive compensation or fees as a result of the provision of certain plan services and how their fees are determined in order to ensure that fees paid from plan assets are reasonable.

While PSCA applauds the Department's intent to require fee disclosure by providers to fiduciaries, we have concerns about the proposed regulation.

First, the proposed regulation is not clear about the extent of the information required to be disclosed. The proposed regulation could be interpreted as requiring detailed lists of every entity and individual providing any type of services to an organization providing a covered service to the plan. The Department then makes it clear that the required disclosures must be considered when determining the reasonableness of plan fees.

The Department must recognize that a plan fiduciary is most often a small- or medium-sized business owner with no particular expertise in ERISA law or the service provider industry. The proposed regulation should be revised to reflect this reality, otherwise small business owners will likely reconsider the decision to offer a benefit plan to their workers.

Second, PSCA recommends that the requirement that a service provider disclose conflicts of interest be removed, but the requirement to disclose material relationships be retained. The conflict-of-interest concept is new and undefined. It is apparently not a condition that is prohibited under Section 406. The inclusion of this concept in the regulations will confuse both fiduciaries and providers, adding cost and uncertainty to the administration of employer-sponsored retirement plans. Additionally, a common sense definition of material relationship needs to be provided.

Third, PSCA is concerned that the current state of the law does not permit the Department to require compliance with the regulations by many of those being paid from plan assets, including some investment managers who receive the major portion of most plans' fees.

Unfortunately, much of the discussion about the proposed regulations is not about the disclosure information to help fiduciaries ensure the plan fees are reasonable. Rather, it is about who the Department can compel to comply. It is incumbent on the Department to clarify persuasively that it has the authority to require that everyone paid from plan assets comply with the disclosure requirements.

PSCA is concerned that the proposed regulations may have greatly expanded what plan fiduciaries must consider in order to ensure that fees are reasonable. At the same time, it is uncertain that the Department can compel service providers to provide the needed information. It is possible with these regulations the Department will have imposed increased accountability on plan fiduciaries without giving them what they need to act

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appropriately, thereby expanding the liability of plan sponsors and their exposure to frivolous law suits. This is a perilous outcome for plan sponsors that could result in reduced benefits for America's workers.

You have our comments, so I'm going to skip some of the specific stuff.

It is important to understand that the greatest service that a plan sponsor provides a 401(k) participant is not payroll deduction. It is fiduciary oversight. In today's litigious workforce, we can only be grateful that employers -- especially small companies -- are willing to take on this obligation. The purpose of these rules should be to provide these plan sponsors with what they need in a way that facilitates their oversight of their plans.

Thank you for the opportunity to testify. I am more than happy to answer questions. Ed Ferrigno has joined me to help if it gets too technical for me.

CHAIRMAN CAMPBELL: Okay. Joe?

MR. PIACENTINI: Thank you. I guess I'll start with questions that are similar to what I asked the previous panel.

So is it your sense then that after a fashion, plan sponsors are able to get the information they need now about the services they are providing, including the services associated with investment options, or not?

MR. WRAY: Plan sponsors who are large and aggressive get all the information that they want and need. As you move down the size of the company, this becomes more and more difficult. Small- and medium-size companies -- and for me a medium-sized company is 500 employees -- even a company of that size does not have leverage. It is only recently that the plan providers have begun to provide spreadsheets that actually list out the plan fees in a more understandable way.

It's still a relatively difficult

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thing to get for small- and medium-sized companies. They really have to know what to ask for. Remember, these people are working 24/7 to keep their businesses going. They are relying on a provider to help them run their plans. And they don't even know the questions to ask. And I know the Department has great information on its website and everything, but these people are not spending time researching the Department of Labor's website. I mean, they have a relationship with an intermediary. And if the intermediary does not provide the information, they don't have it.

MR. PIACENTINI: So a corollary question to that, we heard a lot in comments that the Department received about the costs to various intermediaries, potentially package up some of this information or provide it, even if they can get it.

I guess my question is is there a corollary cost that plan sponsors -- maybe particularly small plan sponsors -- are incurring now to try to do the same thing for themselves. Is that something we should be thinking about? I don't think we heard as much about that in comments.

MR. WRAY: That's interesting.

The large companies are hiring professionals. The costs are up to $10,000 for the very most basic fee audit arrangement. There's no question that small plans are not going to pay $10,000 to do a fee audit on a plan that has $2 million in it or something, or even $20 million.

So it would greatly facilitate the small plan sponsors' decision making if there was some systematic way of providing information in a reasonable format. We need some simplicity.

I know that there's concern in the provider community about bringing things to certain kinds of standard disclosures. But I think we need some kind of standardization in this -- some kind of format that kind of forces everything into an apples-to-apples comparison arrangement I think would be useful to small- and medium-sized plan sponsors. They can't afford to pay somebody to go and spend the hours it takes to read the contracts in great detail.

Remember, we're talking about a contractual arrangement here. These contracts are lengthy. They're complex. Analyzing those arrangements is a major undertaking to do that.

MR. PIACENTINI: And the last question, do plan sponsors in your experience currently get disclosure about indirect compensation received by the service providers?

MR. WRAY: If they know to ask for it and they are -- the large ones.

Understand, the large companies know practically to the penny what is going on in their plans. And they have professional people on staff who know what the questions are to ask. They have providers to assist them.

So I mean, our concern here is not with McDonalds or IBM. It's with the small, medium-sized companies.

Very large companies are getting what they want. The other companies are -- I mean, it's available. It's available if you know the right questions, but the providers are not walking in and saying by the way, there's 40 basis points of revenue sharing coming out of each of these funds, and this revenue sharing equals this much money and this pays for record keeping and this and that. I mean, that stuff is not offered to people. You have to ask for it. You have to dig it out.

So if you want a plan's function to analyze that information as part of the decision making process, the small-, medium-sized plan sponsors need some help with that.

MR. PIACENTINI: Thank you.

MR. CAMPAGNA: You mentioned that you object to the conflict's provision of the proposed regulation, and you suggest that there be a standard of material relationships in place. Could you elaborate on that just a bit as to what you had in mind, and what the difficulty is with the current conflict provisions?

MR. WRAY: I'll let Ed answer.

MR. FERRIGNO: As David mentioned, the conflict-of-interest provision is, we think, new. When the Department of Labor issued guidance a couple of years ago about dealing with plan consultants, we interpreted that as dealing with fiduciaries, and in the proposed rule we're talking about someone who's not in a fiduciary status. So the whole concept of conflict of interest is new and foreign.

Just as importantly, a service provider could arguably determine that they are acting in their own economic interests

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outside a fiduciary relationship, and therefore no conflict of interest exists. And then they would make a subjective decision and would not provide material information about material financial relationships because it's predicated on a conflict of interest.

On the plan sponsor perspective, being told by your service provider that a conflict of interest may exist or does exist could be extremely unsettling to the unsophisticated plan sponsor, and they wouldn't know how to react to that. On the other hand, if you remove the condition of conflict of interest and just require the disclosure of material financial relationships.

Having said that, that's an undefined term, and we recommend in our comments that there be a study with the Department of Labor and the industry to try and get a handle on what level of detail would be required.

CHAIRMAN CAMPBELL: Sorry to interrupt.

How would you conceive of that sort of material relationships differing from something like the Form ADV?

MR. FERRIGNO: Well, I think the Form ADV is being revisited by the SEC. So we'll have to see what's going on there.

And when you look at the definition of fees and compensation, and you put that together with material disclosure, which really how far down the line do you have to go. For instance -- well, the first question of course is who's subject to the rule. And if our mutual fund investment manager is subject to the rule or not, no one seems to know.

If you then want to go to a material financial relationship with a complex mutual fund company, it's really how far down the line do you go, and are you going to flood the small- and medium-plan sponsor with an overwhelming amount of information, that probably is not going to be helpful.

CHAIRMAN CAMPBELL: Sorry to interrupt.

MR. CAMPAGNA: Oh, no.

You said it's important for the small employer to understand everyone that's paid out of plan assets. And we have a lot of comments that say well, that non-plan asset vehicle -- the parties involved there are not necessarily service providers. But you're saying that everyone who's paying out of plan assets should get some disclosure. Could you elaborate about this?

MR. WRAY: Well, I mean we're very supportive of the Form 5500 disclosures. And I think it's pretty clear that people who provide -- who are paid significant amounts -- I mean, not de minimis amounts, but paid out of plan assets should be recognized, and the services that they provide.

MR. FERRIGNO: If I could just

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elaborate.

When we're talking about plan assets, we're talking about 404(a), as opposed to the definition of plan assets. Who's subject to 406? Who has protection under 321 Cap B? We think that you have to bring it back to the fiduciary responsibility comes in when plan assets are used under 404(a) to pay for administrative expenses, and that that should be the key. And I don't think that there's any question that there's not a plan asset exception under 404(a), or I don't think anyone is arguing that investment management fees are not always covered under 404(a) if plan assets are involved.

So we think that you have to get back to the intent of the rule, which is to get to 404(a). The DOL will tell us what we need to know under that, and then provide a tool for us to get it. And that's obviously different than considering a plan asset rule under the 25 percent rule or something like that.

MR. CAMPAGNA: In your comment letter, you said that you don't think it's of value to plan fiduciaries as to how much brokers receive internal to the mutual fund for transaction costs. Could you elaborate on that remark?

MR. FERRIGNO: I think the first question is what is the Department's position under 404(a) about fiduciary responsibility for brokerage costs that are paid with plan assets. Then what we're really trying to say is if an investment manager has 75 brokers that they deal with that we don't see the value of getting a list of those 75 brokerage firms. I think we read the rule -- and it's open to the final rule that under 404(a), you do have to be cognizant of brokerage costs by an investment manager.

Arguably, a mutual fund investment manager, if that's the case, and we think we probably need the aggregate number and we would want to know as well if there is a financial relationship between the investment manager and a particular broker. But we understand that there could be 75 to 100 brokers that would have to be disclosed and that that would be pretty meaningless information under these plans.

MR. CAMPAGNA: But the costs associated with brokerage -- not the 75 brokers -- but the costs associated --

MR. FERRIGNO: To the degree -- it is the Department's position that under 404(a) we are responsible for reviewing that information, then it should be disclosed. It all comes back to what the Department says we need to know under 404(a). And we'd like to see a matching principle.

MR. WRAY: Right. I mean, if you say that we don't need to know that -- the general prospectus type information is what's needed by a fiduciary -- we're happy to deal with that standard.

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Part of what's going on here is you're listing in fair detail what it is the plan's sponsors need to know. That's never been listed before. It's been -- well, while it's a fiduciary standard, it's sort of what other people do. Now you're listing things that we need to know. I mean, that's what this is doing.

You have great latitude in telling us what that is. We're hoping that you keep it simple and meaningful. But if you make it broad, then we're saying you have to give us the tools so that we can meet the standard or meet the obligation that you are imposing.

MR. WILLIAMS: I suppose a follow-up would be is there one particular thing that you would recommend that we could do to improve disclosures that are made by intermediaries to small plan sponsors who are acting as fiduciaries for small plans?

MR. WRAY: We think there needs to be some sort of standardization of disclosure.

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MR. WILLIAMS: So we're on the right track with requiring specific disclosures to be made by mere service providers who are in --

MR. WRAY: As long as we can get the information we think probably at this point.

We're in an evolutionary process. The expectations of plan fiduciaries have changed, and they're increasing. But we think that maybe at this point we need some specific direction from the Department on this. And again, as long as you can help us get the information.

MR. WILLIAMS: Right. So you're concerned about the breadth of it?

MR. WRAY: Yes.

MR. WILLIAMS: And the possibility that you don't get all the information that you would be required to get.

MR. WRAY: Right.

MR. WILLIAMS: But if you had a

defined amount of information that you knew you were supposed to get and you got it, then I think you said the remaining concern was with the complexity of the contracts.

MR. WRAY: I think that that would work out. I think the industry would adapt to that and come to that.

MR. WILLIAMS: Certainly they would be better off with a written contract than without one.

MR. WRAY: Absolutely. And the contract's narrower.

You have written contracts. It's the service agreement that really defines what is going on, not somebody's presentation in a PowerPoint or some summary discussion.

So, I mean no. We need good contracts.

MR. WILLIAMS: And it would be helpful for the service agreement to identify conflicts so that the plan fiduciary could make assessments about --

MR. WRAY: You see, that's the point. What you need to know is there's still a fiduciary oversight responsibility. What you do is provide information to fiduciaries, and the fiduciaries make decisions. Whether or not there's a conflict or not ought to be a decision by the fiduciary, not by some third party.

You give us the information. We look at it and say oh, I've dug into this as a fiduciary. And it could look a little funny. But I've worked it out. There's no conflict. It's my decision as a fiduciary to determine whether there's a conflict or not -- I think, not something in the rule.

MR. WILLIAMS: Thank you.

CHAIRMAN CAMPBELL: My interests have been particularly in the conflicts as well. And I think we've had a pretty thorough discussion. Let me tip it over to Adrienne.

MS. DWYER: You talked about the level of specificity that we were requesting

in the regulation and how concerned you are
about that. How do you think we could make
that provision more workable?

MR. WRAY: We've already talked
about the material disclosures. This is very,
very important stuff. I hope you understand
that this regulation will have enormous
ramifications in the system.

We think that -- and of course,
the time is passing, but it would have been
useful to have had some kind of discussion
early on about and had a working group or
something look at this, get some people in the
industry and some plan sponsors and regulators
sit down and have a round table on this and
talk about what it is that actually might be
the most meaningful.

We certainly have some ideas. But
I know the providers have their own ideas
about this. And I think the best practice
would be to have some kind of forum and sort
of just focus on that point so we make sure

that -- because we don't want the providers to have to do anything that they don't need to do. Absolutely, it is correct. Everything that we require the providers to do is going to cost money, and that cost is going to be passed on to participants.

We knew when we started on this disclosure project many years ago that these costs were going to be passed on to participants. Participants are paying for what we are talking about doing right now. I mean, we're talking about fees. We want the fees to be reasonable, but we are going to impose more fees on the plans. And they're going to be paid by participants. So we don't want to do that casually.

So I think we want to keep the disclosure and the process as simple as possible. Basically you don't want to burden people with what they don't need. And secondly, we don't want to charge participants for something they don't need to have as part of the process.

So I would say if we could get a group together and if there's time, that would be the way to do this. Because it needs a full airing, I think, just on that one topic.

MR. FERRIGNO: When you look at the definition of compensation and fees, how far down the chain do you want to go with that? Theoretically, examples have come up with the discussions with the Department about do we need to know what an investment manager's law firm is paid?

You could take this down to really ridiculous levels to how much -- if someone is running the cafeteria at an investment management company, yes, they are getting compensation as a result of an arrangement with the plan. So we need to get our hands around that.

MS. DWYER: Well, suppose you're the plan fiduciary. What do you want to know? Where do you want us to draw the line?

MR. FERRIGNO: Well, part of what you have to understand is we are at your mercy to a certain degree about you telling us what we need to know under the 404(a). And certainly we don't agree with everything in this proposed rule.

But the proposed rule can be viewed as an interpretive bulletin both to develop what plan sponsors should be doing to satisfy the requirements under 404(a). So to the degree that you define that -- and we would like to debate with you what that definition should be -- then there should be whoever is getting those plan assets should be required to give us the information we need to meet our requirements under 404(a). And with all the debate about plan assets and 321 Cap B and who's subject to 406, there's a disconnect right now.

MR. WRAY: I would just say that when people -- and that was the question earlier -- how do you make decisions. When you make decisions, the fees should be and are the last consideration in a determination of a provider relationship.

The first thing is can they get the quarterly statements out on time. I always say if our record keeping is the only place where perfect is just good enough, you have to demonstrate a high quality of service. If you can't deliver a high quality of service, then the fees don't matter. You're looking at performance. People are looking at performance over time. They're looking at the reputation of the organization. Those are all the critical factors.

When you have lined up what it is that you need and you have evaluated these other things, then you look and you see well, are the fees reasonable. Are the fees reasonable? And that's what we need. We just need to know that once we've evaluated these other things, are the fees reasonable?

And in that regard, you need the

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general categories of fees just to be sure. What are the revenue sharing arrangements? What are the overall costs that are coming out of plan assets? We don't need to go into great detail to know whether these are reasonable. Certainly not the detail that's currently in the regulation.

MS. DWYER: Thank you.

MS. ZARENKO: I just want to follow up on the formatting issue.

You mentioned that it would be very useful for plan sponsors to have some kind of a uniform presentation of this information so they can compare apples to apples. I guess it wasn't clear if you were asking that we -- the Department of Labor -- come up with some kind of a uniform disclosure format. And if so, what do you think that looks like? Would it be easy to -- especially given all the different kinds of services that we cover, the kinds of ways services are provided, and the various players -- your thoughts on how easy it would be to boil it down to a standardized format?

MR. WRAY: Well, first I don't think it should be part of the regulations. But I do think that the Department of Labor could facilitate that process. I do think that it makes some sense to have some standardization in this.

A lot of the providers now are moving to a spreadsheet format of fee disclosure with their clients, which I think has been very helpful. This has come on in the last couple of years.

And what you do, it's a fairly simple spreadsheet. But what you do is you lay out the various investments that are in the plan, how much money is in each of the investments, the dollar amount that's being generated from each of those, a couple of categories on the side like revenue sharing -- how that money is coming out. You come up with a total amount at the bottom. You put in

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additional expenses.

It seems to me that there are some simplicities that could be built into the system maybe as a recommended format or something. We had our fee disclosure format work sheet at PSCA for a long time. You have one on your website. It seems to me that it may be in more detailed, more up-to-date kind of disclosure work sheet like that that recognizes the new level of disclosure that's necessary because that was sort of the old disclosure. I think it would be very helpful.

Again, we don't have to go into great detail -- I don't think -- in order to meet our reasonableness requirement as fiduciaries.

MS. ZARENKO: Sort of getting out of the weeds for a minute and just trying to focus on the bigger picture, what currently for plan sponsors are the easier aspects of service and investment relationships to understand? What are the most confusing parts? Is it lengthy service provider agreements that are written in legalese? Is it the way that investments are charged to participants and beneficiaries of the plans? Is it the way the information flows from investments?

MR. WRAY: I think that there's still a significant number of plan sponsors that don't understand how the single point of payment arrangement flows fees to various types of service providers.

For example, we know the system actually is very efficient. The money is collected at one point, and then it is parceled out to people. Typically, that's at the investment management point. The money is deducted from the total plan assets by whoever is managing the money and then parceled out to the other people who actually provide the services. I think that is not well understood by a lot of plan sponsors.

I think that would be the part --

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and that's pretty basic. That's just the straight revenue sharing arrangements that are there. If that were clarified, I think you'd be a long way down the road on that.

MS. ZARENKO: So you think that information is important to plan fiduciaries? It's just that typically it's confusing?

MR. WRAY: And it's not provided in a way that most plan sponsors understand it. And it's certainly not offered up. You have to go and dig it out.

We've had articles in the newspaper where people double-count the fees in an article because they think that the amount of money to pay for record keeping is an additional fee when they didn't realize -- and even the plan sponsor who was interviewed did not realize -- that actually that was already coming out of the investments management fees. There was a 40 basis point revenue share. So the total cost of the plan where 110 basis points, the employer was

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paying 10. There was a wrap of 10 basis points, 100 basis points for fees. But actually of the 100 basis points coming out of the investments, 40 was actually paying for investments, 40 was paying for the record keeping and compliance. That confusion is -- I think -- unless you have a professional advising you, it's hard to have a good picture of how that actually works.

MS. ZARENKO: And this sort of sounds like the bundled issue in the extent to which allocations within a bundle should be disclosed to plan fiduciaries. And some feel that as long as a fiduciary knows the total cost, including all of these different factors and all the services that are going to be provided, that's sufficient. Whereas others believe to varying degrees what goes on within a bundle should be allocated. You sort of touched on that. But could you address that issue?

MR. WRAY: Well, our view first is

that you could make the decision on a total basis.

As I indicated, we have a multiplicity of business arrangements out there. And to ask a plan sponsor to go in there and say well, this particular function is correctly paid for looking at a plan-wide survey of QDRO retainers. We're going to check all the QDRO retainers out there and make sure that they're all lined up. No, you should be able to look at a bottom-line cost when everything has been assembled.

On the other hand, it's useful to know inside what are the services you're getting and how much are they, and how's the revenue being shared within the provider arrangement. But our view is that you shouldn't have to go and evaluate each one of those fees on an individual basis, but rather look at the collective arrangement.

As we said in our earlier testimony, the point is when you buy a car,

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you don't need to know what the cost of the back seat was. You're looking at the whole package. But you want to know what's the horsepower, what are the warranties. You want to make sure you've got all the pieces down and that you like all the pieces.

MS. ZARENKO: Some of the comments that we got on the conflict-of-interest provisions go to the fact that it seemed like we were asking fiduciary-like questions of non-fiduciary service providers. Do plan sponsors think of it that way? Do they make that distinction? Or do you think -- even if it was limited to just material relationships as you suggest -- that that information is equally relevant whether we're talking about fiduciary or non-fiduciary service providers?

MR. WRAY: Well, service providers are not fiduciaries. They may be in some cases. But basically, they're not fiduciaries. They're not required to act as fiduciaries.

MR. FERRIGNO: This is a rule on parties in interest to plans, not fiduciaries and plans.

I don't think there's a lot of confusion about how conflict of interest applied when there's a fiduciary relationship. We didn't think the concept applied at all outside of a fiduciary relationship.

And the proposed rule says the service provider is going to step into the shoes of the fiduciary in determining whether or not this is something that a fiduciary would consider a conflict of interest. Again, subjectively they could decide no. And therefore material information wouldn't be provided. So we just think it's cleaner to let's get our hands around what's material and just give it to the plan sponsor and let them deal with it.

MS. ZARENKO: Thank you.

MS. WIELOBOB: I just have one quick one.

You had mentioned earlier the 5500, and that you support 5500. You think the information that comes there is beneficial that's reported. And a number of comments we've gotten have suggested basically that the proposal is redundant to 5500 in some respects. It's some of the information. To which I'm confused because on that point it seems to me that it would be a retrospective analysis that the fiduciary would be able to -- do you have any insights on --

MR. WRAY: No, I think they're very different.

The 5500 is an after the fact -- how much actually is paid. It's a public document that is reported for many purposes.

This is about informing a buyer of information a buyer needs when they're making the decision. By the time the 5500 process works its way through, it's years past the decision process.

The point is that when the 5500

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report is made, you want it to look like everything is all nice and neat and tied up and all the fees are reasonable. And the way you do that is you make good decisions when you hire the providers. You don't look at the 5500 data and say oh my gosh, how did we end up in this spot. And then with all of the intended possibilities, including audits from the Department of Labor might come off those.

That's the point. You don't want the 5500 disclosure to have consequences that are adverse to plan sponsors.

MS. WIELOBOB: Thank you.

CHAIRMAN CAMPBELL: All right. Well, thank you very much. We appreciate it.

MR. WRAY: Thank you very much.

CHAIRMAN CAMPBELL: In the interests of time, we'll shuffle you off quickly, and move on to Mr. Chambers of the American Benefits Council.

MR. CHAMBERS: Five seconds?

CHAIRMAN CAMPBELL: All right.

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MR. CHAMBERS: Well, good morning. My name is Robert Chambers, and today I am a partner in the Charlotte, North Carolina, office of the law firm of Helms, Mulliss & Wicker. And I mention that because tomorrow I will be a partner in the Charlotte office of McGuire Woods, with whom Helms, Mullis is merging later on today.

I've advised clients with respect to 401(k) plan issues since 401(k) was added to the Internal Revenue Code. It seems like it was 1878, but I think it was 1978.

I'm also the past chairman of the Board of the American Benefits Council on whose behalf I'm speaking today. And Jan Jacobson, who will introduce herself, is from the Council.

MS. JACOBSON: And I am the Senior Counsel, Retirement Policy from the American Benefits Council.

MR. CHAMBERS: The Council appreciates the opportunity to present testimony with respect to the disclosure of 401(k) plan fees. Our goal is the creation and maintenance of an effective and fair employee benefit system that functions in a transparent manner and provides meaningful benefits at a fair price in terms of both fees and other expenses. So in this regard, we commend the Department of Labor for its efforts to enhance transparency, including the issuance of the proposed Section 408(b)(2) regulations. We understand that this was a difficult task.

However, as you will hear over the next two days, considerably more work is still required. We have many, many suggestions for improving the regulations, but I have limited the list to those dealing with the scope of the regulation, fiduciary safe harbors, the treatment of employer-paid services, conflicts of interest, gifts, and the regulatory effective date.

As drafted, the proposed

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regulations would provide broadly to define contribution plans, define benefit plans, and health and welfare plans. We urge you to finalize the proposed regulations in three separate tranches, or components: first for disclosure for defined contribution plans; second for defined benefit plans; and finally, for health and welfare plans.

Our reasons for this request are as follows: 1) Each component will require a massive and time-consuming negotiated undertaking; 2) each type of plan is sold and serviced very differently, and the fee structures are quite dissimilar; 3) each type of plan has distinctive legal structures; 4) any attempt - in our view -- to bring all three types of plans into compliance at the same time, especially in the breakneck fashion contemplated in the proposed regulations, will fail. And finally, the publicity and public policy discussions regarding fee issues over the past couple of years have focused on

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defined contribution plans in that area, so that it would seem appropriate to start there.

Next, the proposed regulation is silent on whether it applies to arrangements that are covered by the prohibited transaction rules of Section 4975 of the Code, but not by ERISA. This broad sector includes tax qualified retirement plans that are exempt from ERISA because they cover only non-employee business owners, also IRAs, HSAs and Coverdell Education Savings Accounts.

The Council strongly recommends that the Department clarify in the final regulations that these plans are not subject to the disclosure rules. There is no plan fiduciary involved in these arrangements. To the contrary, individuals understand that they're acting really in their own stead in determining which service providers to engage and what investment decisions to make. In this sense, IRA owners and other arrangement owners are far more like plan participants than plan fiduciaries. And in our view, it would be neither appropriate nor sensible to impose the so-called service provider to plan scope disclosure requirements to these non-ERISA arrangements.

The Council greatly appreciates the innocent plan fiduciary class exemption that's been proposed in connection with the proposed regulation. The proposed class exemption however only provides protection from prohibited transaction consequences.

The final regulation should also provide that these disclosures serve as an adequate financial predicate for a plan fiduciary in fulfilling its duty to understand any covered service arrangement. Of course, the fiduciary would still have to evaluate the quality of the services and the reasonableness of the cost.

The proposed regulation also implies than any violation of the requirements, no matter how minor, will result in a prohibited transaction and excise tax. This structure would benefit greatly from a correct mechanism that provides a means of dealing with reasonable errors without draconian penalties.

In addition, there will be times when a bundled service provider is unable -- despite reasonable efforts -- to obtain accurate information needed for disclosure from the other parties to its bundle. We recommend that the Department create a class-prohibited transaction exemption for such situations similar to the one that's provided for plan fiduciaries that are unable to provide necessary information from their service providers.

The proposed regulation appears to provide for its disclosure requirements, but they apply not only when a plan pays for the services, but also where the employer that sponsors the plan pays for services out of its general assets. ERISA regulates only the amount that a plan pays for services. It does not regulate in our view the amount that the plan sponsor directly pays. For these reasons, the Council strongly recommends clarifying that the proposed regulation does not apply where a plan service is paid for entirely out of the plan sponsor's general assets.

We appreciate that there's some circumstances -- some situations -- where the plan has the legal obligation to pay for plan expenses, except to the extent paid by the employer. We believe that the proposed regulation should not apply to the extent that the employer commits contractually to be responsible for specified plan fees.

Now on the conflicts of interest. We're puzzled by two aspects of the proposed requirements to disclose conflicts of interest.

The first relates to a service provider's ability to affect its own fees. We

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understand that where a service provider uses its powers in a discretionary manner to affect its own compensation, the service provider is functioning as a fiduciary, and has committed a prohibited transaction. If this is correct, we ask what must be disclosed under this rule? Only prohibited transactions? Or is the proposed regulation intended to implicitly overrule the Department's prior position that the service provider's ability to affect its own compensation is a prohibited transaction? We strongly doubt that that was intended, but we're left puzzled as to the actual intent. Seeing no purpose for this disclosure requirement, we recommend that it be deleted.

The requirement to disclose conflicts of interest is also puzzling. A conflict of interest can only arise where a service provider is acting as a fiduciary in providing a service -- for example, advice -- with respect to which the service provider could be seen to have divided loyalties or interests that are contrary to the plan's interests. In such cases, the existence of a conflict of interest generally gives rise to a prohibited transaction. But where the service provider is not acting as a fiduciary, the service provider is simply selling a service in an arms-length transaction. No fiduciary duty of loyalty to the plan exists. And accordingly, no conflict of interest in our view can exist. In this context, what must be disclosed under the proposed regulation? Only proposed transactions for which there is no exemption?

We strongly support full disclosure of fees, and we strongly support enforcement of the prohibited transaction rules generally banning conflicts of interest. But the regulatory disclosure rules that I've just described serve neither purpose, and should be deleted.

While the Council agrees with the Department that plan fiduciaries should be made aware of excessive gift-giving, we request two clarifications to the rules. First, the disclosure rules should be appropriately targeted so that disclosures are only required where there is a clear and direct relationship between the so-called gifts and the plan. Second, the final regulation should include a de minimis concept, such as the $50 threshold in the Form 5500 instructions to avoid the problem with the logoed coffee cups and occasional sandwiches that are provided in connection with the rendition of the services.

Lastly, effective date. One of the most important issues for Council members is the proposed effective date of 90 days after the publication of final regulations. Implementation of the final regulations will require immense effort by plan fiduciaries and service providers, and very little of this work we believe can be done in advance of the issuance of the final rules. The 90-day period is simply not sufficient for service providers because the rule as proposed would require significant modifications to computer systems, the training of operational and administrative staff, the preparation of new communication and administrative materials for plan fiduciaries, as well as the development of actual disclosure documents. This work, of course, is in addition to the modification and renegotiation of agreements with plan fiduciaries and service providers.

The Council recommends that the final regulation be generally effective for new service contracts and material modifications of existing service contracts beginning at least 12 months following publication of final rules. Notwithstanding our recommendation, if the Department requires an earlier effective date, we strongly recommend a delay in the effective date for outstanding contracts that have not been materially modified. Any revisions to outstanding contracts again will be an enormous undertaking and would be in everyone's best interests if there was time to facilitate an orderly transition.

Thank you again for the opportunity to be here today. And Jan and I will be happy to answer any questions.

CHAIRMAN CAMPBELL: Well, all right. Thank you very much.

This time, let's start over here and go in this direction.

MS. WIELOBOB: I want to ask you about your suggestion that health and welfare plans and DBs be dealt with on separate tracks. Can you get into that a little bit? Tell us why you think that's the case.

MR. CHAMBERS: Well, as I mentioned, there are four or five different things we think that distinguish between the different types of plans. And I think that there is probably going to be a need for different kinds of disclosure requirements for, for example, health and welfare plans compared to defined contribution plans. Just different things are going to be needed to be disclosed.

There is often an insurance element that is not generally involved in most defined contribution plans. And again, since most employers -- certainly our members -- contribute to many different kinds of plans, it would be extremely difficult, particularly in connection with the very quick effective date that's currently proposed for them to try to deal with all of those different kinds of programs at the same time.

MS. WIELOBOB: And it may be a question more fairly asked of the insurance experts in the crowd that are here on behalf of insurance entities solely, but I'm just trying to get my arms around it. I understand categorically what the differences would be. You mentioned fee structures. But what exactly are we talking about? Why do those

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fee structures differ in such a way that it wouldn't work under the current arrangement -- the current proposal?

MR. CHAMBERS: Well, I think your best off speaking to them about that.

MS. WIELOBOB: Okay. Correction mechanism -- you mentioned that you would support some sort of correction mechanism. How do you envision that working? The reason I'm asking is again, that's one of those things that's going to be potentially retrospective. If the disclosure hasn't been made, the agreement may already be in place. The service provider may be rendering services to the plan. How would you envision as compared to the draconian penalties -- as many call them -- under the proposal? Mechanically how would you see a correction scheme working?

MR. CHAMBERS: We have found over the years that it's really tough to be perfect. All right? Not that we haven't succeeded all of the time. But it's very

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difficult. And the same thing is going to apply here.

Again, often I should say, particularly in light of as other folks have spoken about this morning, the depth and breadth of the relationships that have to be disclosed and therefore that need to be in writing and the various elements of all of those different arrangements, there are invariably going to be mistakes that are made. And I understand that there's a good faith provision that's in there. But proving good faith in light of either litigation that's spawned by this, or in light of an audit from your organization, it would be very simple if someone could come up with a program similar, for example, to the employee plans compliance resolution system whereby voluntarily organizations could come forward and get the papal dispensation essentially that you receive through a program like that. I would think that your organization would be in the interests of voluntary disclosure with a minor slap on the hand of some sort, particularly if something's been allowed to continue for a number of years where you have a potential prohibited transaction excise tax that's compounding on an annual basis. I think that that's something that probably people would be interested in not disclosing for that reason.

MS. WIELOBOB: Thank you.

MR. CHAMBERS: Is that fair?

MS. WIELOBOB: Yes. Thank you.

MS. ZARENKO: Can you just touch for a minute on to what extent -- understanding that there's some clarifications about indirect compensation and conflicts that have been requested -- but are we breaking a lot of new ground in this proposal just in terms of the kinds of information that we're going for versus what's currently being disclosed to plan fiduciaries?

MR. CHAMBERS: Well, I think that as other folks have already said, you have to look at it from several different perspectives.

I think that from most large employers' perspectives, this is information that most -- not all -- but most large employers already have. They have asked for it. They have to be able to mandate it. They have people in-house whose responsibility it is to get this information and to help to figure things out.

As you move down the food chain in plan sponsors in terms of size, we have some clients of my law firm that are quite small that have very sophisticated in-house capabilities in this regard. And so, I don't know that there's a lot of new ground that's being broken for them.

But I would say on average, unless someone like me, or someone from a consulting firm has sat down with small- and mid-size companies and explained to them that as was previously pointed out there's more to it than

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just making your contribution, that there are other payments out there that you really need to be focusing on. Most people really do think that there's not a lot more that they need to know. So for them, this is breaking new ground.

MS. ZARENKO: Especially I think when we're talking about those small- and medium-sized markets, I think there's a variety of reasons that have been brought to our attention as to why there might be less information that's going back and forth. They don't know what questions to ask of their service providers, or sometimes service providers are less forthcoming with detailed information that they don't believe they're required to disclose.

So one of the reasons that we structured this as a prohibited transaction was because that would incentivize a service provider to come forward with information that they may or may not otherwise be providing.

If it's a prohibited transaction, it's a PT for both of the parties -- both on the plan side and the service provider. Do you think that was a good way to go?

You can think for a minute before you answer.

MR. CHAMBERS: Well, in 30-plus years in doing this, I'm trying to decide whether I've thought that any government rule was a good way to go.

MS. ZARENKO: Taking that as a given.

MR. CHAMBERS: I'll put it this way. It's been a better way to go than some other things that I've seen.

I'm concerned -- since you talked about this primarily from the small- and mid-sized plan sponsor perspective -- I'm concerned that the way things are set up that there are going to be a lot of what we have referred to internally as gotchas, that there are going to be a lot of organizations who

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truly are using their best efforts and good faith to comply with this and to provide meaningful benefits for their participants who are not going to have the level of sophistication necessary to review the materials that might be coming in to make meaningful decisions. And therefore they're suddenly going to be responsible for paying a prohibited transaction fee and subject to audit and things like that, as well as potential law suits. I'm very concerned about that.

Obviously, your organization and certainly the American Benefits Council are very interested in promoting plan formation and plan maintenance. And we need to make sure that these rules when finalized are not going to be getting small- and mid-sized companies out of the business of providing retirement benefits for fear of the additional risk that they're going to be asked to be assuming.

MS. ZARENKO: Okay. Going to the format issues that we talked about with our last panelists, the way our proposal was set up there was a little bit of flexibility to incorporate other materials by reference, trying to avoid duplicative disclosures, understanding that there are already materials out there. On the other hand, it would be useful to a plan fiduciary some argue to have everything in one summary document. Again would you think mandating some kind of a format for that disclosure is a good idea? Would the Department of Labor be the entity to do that? What are you views on that issue?

MR. CHAMBERS: I think that that's one of these pie-in-the-sky opportunities that sounds really good, but I think that when you sit down and try to put something together that is meaningful and that also -- remember, the service providers have some say here. They really do. And it's my understanding from among our members and also from some

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other organizations that efforts to do this have already been undertaken. And as someone suggested to me earlier today, this is by people who actually like each other. And they cannot agree. They cannot agree on a format. They cannot agree on a standard format. So it seems to us that the best methodology is to say tell us what information we need to provide, and then we will put it together in a format that is appropriate on a case-by-case basis.

MS. ZARENKO: One last question that's an investment-related disclosure. I'd asked an earlier panelist from a plan sponsor perspective, how effective is a mutual fund prospectus as a tool. In your view, what do the plan sponsors think of the prospectus? What other kinds of information about investments do they get? What's useful? What's not?

MR. CHAMBERS: Our plan sponsor members typically are very large employers.

They can hire very expensive lawyers, and they already have very expensive lawyers on their in-house staffs. And they recognize the realities of dealing with the world of prospectuses. And that is that a prospectus is generally as complicated and as mind-numbing as it is because of legal ramifications. And they understand that any effort to try to dumb it down -- to try to make it more understandable -- is invariably, or could invariably lead to additional risk at some level, whether it's the employer level or the plan sponsor level -- whoever it is who's trying to do that.

So they understand that number one, they have the wherewithal to have in-house people who are trying to analyze the materials that are there. And number two, I don't know that necessarily anyone who they would hire would be able to do it any better. And again three, there is this significant exposure to risk by having people take very

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carefully legally drafted documents and reformatting them in a way so that by cleaning out a lot of the legalese that's there intentionally, and thereby perhaps incurring liability for doing so.

MS. ZARENKO: Would you say all those concerns are true as well about whatever disclosure is provided about non-registered investment products?

MR. CHAMBERS: Sure. Sure. Because if you're investing in a particular stock -- say, for example, one of the things that really hasn't been brought up today are self-directed brokerage accounts and how all of that's going to fit in with the fund final rules. But if my organization has a self-directed brokerage account where I could invest not just in mutual funds but also in individual stocks and bonds, there will be prospectuses or other disclosure information out on virtually all of those. The more difficult situation is where you're investing

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in something where that kind of publicly-available -- or that information is not available publicly.

MS. ZARENKO: Thank you.

MS. DWYER: I have one question. And it's limited to compensation relating only to defined contribution plans.

Your comments really focus on various protected mechanisms that you would like to see inserted into the proposed reg. Assuming they were all to be accommodated, do you think --

MR. CHAMBERS: You mean they may not be?

MS. DWYER: Well, my question goes to the substance of the compensation that the regulation encompasses. Do you think that the regulation captures the compensation that fiduciaries would need to assess the reasonableness of compensation for those types of plans?

MR. CHAMBERS: It goes back I

think to the comment that was made previously which is you need to tell us whose compensation we need to obtain.

If I understand your question correctly, the situation was previously posited where some of the plan assets -- I'm sorry -- some of the fees associated with the investment of plan assets are used to run a cafeteria. It could be a day care center. It could be the water cooler. To what extent do we have to get that information?

I think that the compensation should be -- I think we think that the compensation should be provided on the basis which enables people to decide whether the particular arrangement is reasonable. And I frankly don't think that it should be part of any employer's prerogative or need to decide well, I'm not going to be hiring an investment firm which has an in-house cafeteria, or which has an in-house day care center because if they didn't have that, maybe they could save some money. You have to look at it from a reasonable perspective.

So bottom-line numbers, I think, are very important. And so it's getting the baseline number, not so much who is it who's receiving it, other than people who are actually performing services directly to the plan or on behalf of the plan.

MS. DWYER: Thank you.

MR. CAMPAGNA: I guess in the interests of time, we'll move on.

MR. CHAMBERS: I've bored everyone.

MR. CAMPAGNA: You made a comment about the conflicts provisions and the particular provision that said the service provider should have to disclose whether they're influencing the fees that they receive that they have some control. Many service providers are fiduciaries, and are being hired as such.

Don't you see a need by the plan

sponsor to know that his fiduciary may be in that role that they could actually influence the fees that they receive? Despite the prohibited transaction nature of doing that, shouldn't plan sponsor --

MR. CHAMBERS: Don't they have to disclose that anyway if there's a prohibited transaction?

MR. CAMPAGNA: Well, to the plan sponsors is my question. This is the disclosure to the plan sponsor.

MR. CHAMBERS: All right. So you're suggesting that if we were to limit that just to fiduciaries, and whether the fiduciary would have to explain we have the flexibility and therefore our having that flexibility is a prohibited transaction. Is that what you're saying we should be disclosing?

MR. CAMPAGNA: Basically. Shouldn't a fiduciary who hires a fiduciary disclose to a plan sponsor whether they have this power? And that's basically my question.

MR. CHAMBERS: But I think that that is part of these contractual relationships that people have been talking about already.

MR. CAMPAGNA: Okay.

MR. CHAMBERS: I mean, does it have to be specifically set out in that fashion? I think our suggestion is it seems odd to expose again something that is probably already being exposed. You all have ruled on this in connection with floats, for example.

And I think that yes, there's information out regarding floats, for example, that you are required to provide. And there's a best practices that you've provided as well. I think people are doing that.

Do we need to put stars next to it and underline it -- put it in italics? It seems counterproductive.

MR. CAMPAGNA: Going back to your comment letter, you talked about the need to keep a lot of the class exemptions that have been granted the same, and kind of leave them out of all of this. One particular class exemption I have in mind is PTE 84-24 that talks about insurance brokerage where there's disclosure of commissions. However, what we're getting in this regulation is what the broker may receive on top of that.

Do you see any need to go beyond 84-24's requirements when in fact what we're talking about here is receipt of indirect compensation or other conflicts that a service provider such as a broker might be receiving?

MR. CHAMBERS: I was not involved in drafting that particular part. Do you have anything you want to say about that?

MS. JACOBSON: And actually, if I remember, it's more related to the -- we have members that are both plan sponsors and service providers. And we got input on that from our service providers that are insurance companies. So I would actually like to get back to you on that question.

MR. CAMPAGNA: Okay. Also, going to your comment letter, you state that requiring annual fees, direct commissions and loads, maintaining a brokerage account and charges related to an investment transaction should be disclosed, but that any further disclosure be adequately covered by the securities laws. So there seems to be that you have a line that you have in mind here. But it relates to investment transactions and fees related to investments, but you see something that the SEC does, and something that we can have a role in. Do you mind elaborating a bit on that?

MR. CHAMBERS: I think both of us are confused by the question.

MR. CAMPAGNA: Okay. All right.

I read the comment letters. In the interest of time, I'll go to Joe.

MR. PIACENTINI: I have nothing.

CHAIRMAN CAMPBELL: All right.

Well, thank you very much.

MR. CHAMBERS: Thank you.

CHAIRMAN CAMPBELL: And next up is Mr. Ashton representing ASPPA.

MR. ASHTON: Good morning. My name is Bruce Ashton. I'm a partner with Reish Luftman Reicher & Cohen in Los Angeles. And I'm here to testify on behalf of the American Society of Pension Professionals & Actuaries, and the Council of Independent Recordkeepers.

ASPPA is a national organization of over 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. And the Council of Independent Recordkeepers, or CIKR, is a national organization of 401(k) plan service providers.

The Department's proposed 408(b)(2) regulation will cause a sweeping change in how plan service arrangements are

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made and documented in the future. That said, we must disagree with some of our colleagues who have testified earlier, because in our view the change is not substantive.

Fiduciaries are already required to know and understand all of the information in our view that must be disclosed under the proposed regulation. Rather, the regulation will result in a shift of focus -- a shift of responsibility. That is, the regulation will take the responsibility to find out information off of the plan fiduciaries whose day-to-day real job is often to run a business, and place the responsibility to disclose the information on the experts whose day-to-day real job is to service plans.

Some may argue that the changes are too sweeping, that the Department has gone overboard in the proposed regulation. We disagree. In our view, the proposed regulation only requires service providers to tell the truth. And how can that be bad?

A number of people have commented that the amount of disclosure that's required will overwhelm the poor plan fiduciaries as though they were all Blanche Dubois who had to rely on the kindness of strangers. In my view, that is not giving plan fiduciaries enough credit. After all, in my experience, they are business people who are used to looking at business transactions and ought to be given the credit that they can ferret out. Once they're given the information, they can ferret out what's important to them and make a decision.

We believe there are a number of areas in which the proposed regulation, as well conceived as it is, can be improved. We have submitted a lengthy comment letter with our extremely cogent and well-thought out views on what ought to be done. Let me just highlight some of our proposals.

It is critical that responsible plan fiduciaries understand the aggregate costs being borne by their plans. It is equally critical that they understand the compensation being received by service providers, and by those who have an interest in transactions involving plan assets. As the Department has pointed out in prior guidance -- the Sun America opinion comes to mind -- the amount of compensation being received by a party may have a material impact on its recommendations, actions or judgment. Thus, in our view, the responsible fiduciaries must understand the transaction costs such as commissions, finders' fees and the like being paid to third parties in connection with the plan's investments.

One of the principal requirements of the proposed regulation is the disclosure of conflicts of interest. An important element of that disclosure is the transaction fees, first because of the issue of self-interest versus participant interests, and second because the transaction fees often

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impact the value of the plan's investments and ultimately the funds available for participants at retirement. We urge, therefore, that distinct disclosure of transaction fees be retained in the final regulation.

Second, ERISA makes it clear that only the shares of mutual funds held by a plan are assets of the plan, and that the assets of the mutual fund themselves are not plan assets. ERISA also makes it clear that investment managers of mutual funds in which a plan invests are not fiduciaries, nor even parties in interest of the plan. Nevertheless, in today's 401(k) environment, mutual fund investment managers are clearly providing an indirect service to plans because their actions directly affect the value of plan assets, that is, the mutual fund shares, which are plan assets. Accordingly, we submit that direct and indirect compensation of the fund manager should have to be disclosed.

As a practical matter, however, except where the fund manager is affiliated with the plan record keeper, trustee or other covered service provider, there does not seem to be a mechanism for making that disclosure except through another service provider, such as an independent record keeper. Thus to the extent information regarding the direct and indirect compensation of the fund manager is required to be disclosed, the final regulation should make it clear that the party making the disclosure -- in our example, the independent record keeper -- may rely on information provided by the mutual funds without any duty to verify the accuracy of the information beyond commercially reasonable efforts.

In this connection, we also suggest that the Department issue a prohibited class exemption similar to that proposed for responsible plan fiduciaries, exempting the record keeper from excise taxes under 4975, if the fund manager fails to provide accurate or complete information to the covered service provider. And it would also seem reasonable in this context for such an exemption to include the requirement that the covered service provider notify the Department if the fund manager fails or refuses to provide the information.

We also encourage the Department to require compensation disclosure in three general categories: 1) investment-related fees and expenses; 2) transaction-related fees and expenses, for example, commissions, 12b-1 fees, finders' fees and the like; and 3) record keeping and administrative fees and expenses. We also submit that this type of disclosure should be required of all providers whether or not considered a bundled provider under the proposed regulations.

To respond to Ms. Zarenko's question earlier, we have attached to our written comments a suggested form of our form of disclosure. And if anyone in the audience would like a copy, I'd be happy to take your card and send it to you.

An element of the proposed regulation that has received limited attention is the fact that the responsible plan fiduciary will be required to do something with the information they receive, that is, make a prudent, informed decision. In this context, uniform disclosure will, we believe, help facilitate the outcome in that it would make the disclosures uniform, which would facilitate consistent comparisons among providers, and it would provide the responsible plan fiduciary with information and categories that are most relevant to its decision to engage or replace a service provider.

Such uniform disclosure would not replace other written materials, other disclosures, or formal contracts, but would in our view provide a single comparable source for the extensive disclosures through which a

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responsible plan fiduciary will need to sift in order to make a decision.

We also encourage the Department to require a consolidated form of disclosure for all service providers even where other forms of disclosure are provided and additional documents are incorporated by reference. In our view, a consolidated summary of the information required by the proposed regulation would be more readily usable by a fiduciary than, for example, a stack of 25 or 50 prospectuses -- even summary prospectuses -- and would make the process of comparison of service providers both clearer and simpler. In the small plan market, we believe this type of disclosure would be essential to provide the most meaningful disclosure to the decision makers.

Uniformity could also help service providers by ensuring that they do not inadvertently omit a disclosure item, and by making compliance less burdensome for the service provider.

Let me just touch on a few of our other comments, and then I would be pleased to answer your questions.

Failure to satisfy any element of the final regulation would appear to cause a prohibited transaction. This could be a harsh result in cases of inadvertent or immaterial breaches, and we urge the Department to consider including a materiality standard for all disclosures, or alternatively a substance compliance exception. Further, we urge the Department to provide for a cure period for inadvertent failures and clarification that correction of a failure would only apply to compensation related to missing information and not to all compensation received by the service provider.

Finally, it may be appropriate to add correction of a failure to disclose to your already highly successful BFC program.

Finally, with respect to the

conflict-of-interest disclosure, we recommend that the Department provide greater clarity regarding the types of relationships that it believes should be disclosed in order to assist covered service providers in meeting this requirement.

Thank you for the opportunity to present these remarks. I'd be happy to answer your questions.

MR. CAMPAGNA: Do you want to do the same order?

MS. WIELOBOB: I don't have anything.

MS. ZARENKO: I first want to follow up on allocating compensation and fees into the different sort of service categories -- the investment, the record keeping, and the transactional. I think from a regulatory standpoint, when you try to do that it often gets difficult to draw lines, and sort of define your way around it. Do you think that would be easy for us to do? It seems like those categories might get a little fuzzy in some instances.

MR. ASHTON: Well, let me put it this way. It took a group of people involved in the industry about a day to come up with a form. So, I anticipate that the folks on this Panel and others in the Department are equally as sophisticated, and with our help could come up with such a categorization.

Do I think it's easy? No. But do I think it's possible? Yes.

MS. ZARENKO: Part of the reason I'm asking the question is just as you know, we have a model plan fee disclosure form on our website, and some people find it to be very useful. Some people find it to be very non-useful for that exact reason. They don't think their particular services or the way they structure and charge their fees -- even that three-page form -- they can't make it fit.

MR. ASHTON: I guess our view is

that the three broad categories that we've outlined -- that is, costs or compensation related to the investments, costs and compensation related to the record keeping and administration of the plan, and costs and compensation related to the transaction whereby the plan enters into the arrangement -- with those broad categories, that in my view and our view should cover the deal.

MS. ZARENKO: To the extent there would be --

MR. ASHTON: And may I add just one more thought? And that is suppose somebody gets it in the wrong category? So what? As long as it's --

MS. ZARENKO: Well, that was going to be my next question. If there were fuzzy lines that were hard to draw and somebody -- a service provider or whoever -- was doing their best to try to fit it into those three tranches, would there be any competitive reason in having any cost allocation go to one

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of those categories over the other?

MR. ASHTON: Sure. I mean, you've probably heard as I've heard from plan sponsors, well gosh, we don't have to worry about that. That service is free. Well, nothing's free. I don't remember the last time I got something that was free. And nothing's free in this area by a long shot.

So yes, there could be competitive issues that come about, which suggest to me that people will be very careful to make sure they're getting stuff into the right category.

MS. ZARENKO: In the model format that you submitted as the attachment to your letter, I noticed that there's a section there for disclosure of employer-paid fees, which has been something we've heard a lot about in comments. And I know elsewhere in your letters, you say you do not think that employer-paid fees should be subject to the requirements of the regulations. So if I try to put myself into the shoes of plan sponsor, I would certainly want to know what I was paying. So is it that that information is being disclosed? As a legal matter, you don't think that the disclosure of those fees should be subject to the requirements of our rule?

MR. ASHTON: I don't think they should be subject to the rule. I think they are probably being disclosed because the plan sponsor is going to write a check and they're going to want to know what kind of a check they're writing. So I think that the marketplace in fact does take care of that aspect of it.

But it doesn't seem to me that it's appropriate to be included in the proposed regulation. So yes, we would urge that plan sponsor-paid expenses and compensation not be covered by the proposed regulation.

MS. ZARENKO: Okay. And my final question is you requested clarification. Specifically, you said it would be helpful to

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see a lot more examples of the kinds of relationships and arrangements that service providers have that would need to be disclosed to plan fiduciaries.

Can you just talk for a minute or two about what you think those relationships and arrangements are that would be relevant to a plan fiduciary?

MR. ASHTON: Well, let me first address what isn't clear to us. And that is the proposed regulation talks about referral relationships. I'm not quite sure what you're getting at. So it would be helpful to have some examples.

In other words -- and I'll just use my law firm as an example -- if I get substantial referrals from -- and we're not a covered service provider because we don't get any indirect compensation -- if my law firm were in that position and got lots of referrals from a specific third-party administrator or record keeper or broker/dealer or investment advisor, but there was no economic relationship between us other than they refer us, where can we refer them work? And if we get the business, that's great. And we'll charge our clients appropriately. Always charge our clients appropriately. Is that a referral relationship that's material that would need to be disclosed? I don't know. Maybe yes. Maybe no.

So it's that kind of issue that I think is somewhat confusing in the current version of the regulation. And it would be helpful to have further clarification of what's meant by that.

MS. ZARENKO: Thank you.

MS. DWYER: Hi. My question goes to compensation and fees relating to mutual funds. What specific information do plan fiduciaries need that is not in the mutual funds' SEC disclosures? And why do they need it?

MR. ASHTON: Well, I think they need it because it does have an impact on the plan asset. That is, it impacts the net asset value of the mutual fund shares held by the plan either directly or indirectly. That impacts what the participant has at retirement.

Probably the information is in the prospectus. I'll grant you that. I don't know the last time you went and looked at a mutual fund prospectus. I'm a reasonably sophisticated lawyer, I think. I don't find mutual fund prospectuses particularly transparent. And I suspect that it is not useful as I said in my comments earlier -- as we've said in our written comments -- it is not particularly useful to hand a plan sponsor 50 prospectuses if that's the number of investment options that are available and say here, you go figure it out. And it strikes us that it would be useful to have that information consolidated for the plan sponsor

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so that they can make an informed decision.

MS. DWYER: Within that consolidation, do you contemplate that there would be additional information in that consolidated information that would substantively not be in the SEC disclosures?

MR. ASHTON: No.

MS. DWYER: Is anything new?

MR. ASHTON: No.

MS. DWYER: No. Thank you.

MR. CAMPAGNA: Your testimony is at odds with other commenters in the area of transaction costs and the need for disclosure regarding investment-related fees internal to the fund. And you believe it's important.

Could you elaborate on that, particularly in the area of these portfolio transaction -- portfolio brokerage fees? I think you're thinking that that also is an important part of information.

MR. ASHTON: Again, as I've said, the costs inside a mutual fund are material to

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the net asset value of the mutual fund, and therefore have an impact on the plan's assets. And if I'm a responsible fiduciary, I want to know is it appropriate to put this particular mutual fund on the list that I offer to my participants? Is that mutual fund being managed appropriately? Or is it not? Am I better off going to some other type of investment collective trust fund or an ETF or something else where the internal costs may be cheaper?

And maybe it's not appropriate. Maybe there are very good reasons for putting a particular mutual fund. I'm not bashing mutual funds by any means. I don't intend to. But if the point is to provide information to the fiduciary so the fiduciary can make an informed decision, it seems to me that the fiduciary needs the information in order to be able to make the informed decision. And the costs borne by the fund itself are, we believe, material to that decision about the fund.

MR. CAMPAGNA: Now, a model that you laid out in your comment letter was the record keeper maintaining a platform with unaffiliated funds -- be it mutual funds, be it other investment vehicles. And we asked a previous person what kind of screening process do you have.

How do you evaluate the particular funds that are going to be on your platform, particularly in the unaffiliated areas? How do you come to a determination who to put on your platform?

MR. ASHTON: Well, I think there's a couple of different models. In one model, which may be more typical of insurance companies than record keepers, but may not, the record keeper will -- the plan provider, if you will -- will do a screening process. And I have several clients that go through a very detailed screening process -- hopefully a fiduciarily-appropriate screening process --

to select a fund, to make sure they're suitable for retirement plans in general, and suitable for inclusion in 401(k) plans in particular. And so there is a screening process.

In the so-called open architecture arrangement, where essentially any investment that is compatible with the record keeper or service provider's platform can be included in the platform, the record keeper doesn't do a screening process other than to find out is it compatible versus the other financial advisors to the plan who would do that screening process to make recommendations for the inclusion of the thousands of funds that are otherwise available on that platform.

MR. CAMPAGNA: An earlier person who testified said that there could be agreements between the fund -- be it mutual fund or non-plan asset fund -- and the record keeper to provide some of this information through to the plan fiduciary.

Do you see that as a possibility? Are there those types of agreements now? And is there a way of coming to some kind of standardization regarding a type of agreement that could be reached?

MR. ASHTON: I think it is certainly possible. I'm not personally aware of any because I haven't seen any of those agreements. But it wouldn't surprise me that there are such agreements.

And it strikes me that if the regulation proceeds as we have suggested that we will see those agreements. And I anticipate that it will keep lawyers busy for a little while, and then we'll have to move on to something else.

MR. CAMPAGNA: In your comment letter, you spoke about if one member of a bundle is responsible for a disclosure failure, then only that member should be subject to the excise taxes associated with it.

How would that work, particularly in a bundled package where a plan deals directly with say, the record keeper up front, or a broker, or a TPA?

MR. ASHTON: Well, clearly if it's the bundled provider that is the provider of the package of services that fails to make a disclosure, unless it can demonstrate that that failure was because it was not able to get information from a member of the bundle -- if you will -- it strikes me that the bundled provider would be responsible.

On the other hand, if it is one member of the group that failed to provide information that was material, the provider of the service acted to the best of its knowledge and should not be -- even under the regulation as currently proposed -- should not be subjected to penalties. It acted as the regulation says to the best of its knowledge.

MR. CAMPAGNA: Thank you, Mr. Ashton.

MR. PIACENTINI: Okay. I guess I'd like to finish by going back to the beginning.

At the opening of your oral statement, you said that you thought a major -- maybe the major -- effect of this policy would be to shift responsibility for gathering and processing information from plan sponsors who might have some other expertise than that to service providers who are expert at that perhaps.

So I guess a couple of parts to the question, when you say the responsibility would be shifted, do you also mean that the actual activity would be shifted? If the plan sponsor is legally responsible for that now, it still might be that somebody else is doing it for them for a fee. Or would the actual activity shift?

MR. ASHTON: The shift that I'm talking about is the shift in responsibility to disclose the information as opposed to ferret out the information. Under the Frost and Aetna Advisory Opinions, the Department makes it very clear that one responsibility of the fiduciaries is to know and understand. And there's been other materials published since then that makes it clear that it's the responsibility of the fiduciary to know and understand the costs and the compensation of service providers.

In our view, what this regulation does -- in my view appropriately -- is to shift the burden of finding out the information onto the people that have the information, to disclose it the fiduciary. So now the fiduciary has it. They still have the responsibility to understand it and to make a decision with respect to the information, but at least now they've got it. So that's the shift that I was talking about.

MR. PIACENTINI: So then in terms of downstream consequences, does that mean that then getting this information to the

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fiduciary will be more expensive or less expensive than if the fiduciary were still responsible? And ultimately, would it be done more effectively or less effectively?

MR. ASHTON: Let me go to the second part first. I think it will be done more effectively. And I'll make the same distinction that many of the prior speakers have made.

In the very large plan market the fiduciaries have every bit of information they want. They've got experts in-house, and hired experts to help them get information that they don't know to ask for. That is trending downwards in the size of plans. But at the small plan market, it is still not typical that there is the type of voluntary disclosure of the type that is typical at the large plan.

So in terms of your question would it be more effective, yes, I think it would be more effective in the small- to mid-size parts of the marketplace.

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Would it cost more? Perhaps a little bit initially. But I think once procedures are in place to make the disclosures -- which after all, people at some level are already making in some parts of the marketplace -- I think that expense will be amortized over a large number of plans and won't be material in the long run.

MR. PIACENTINI: Thank you.

PANEL MEMBER CAMPAGNA: Okay. That concludes our morning testimony.

We're about 15 minutes -- oh, no I'm sorry. We have one more. We have the American Council of Life Insurers.

MR. SZOSTEK: Thank you. Good morning. My name is Jim Szostek. I'm the Director of Pension Policy for the American Council of Life Insurers.

To my left is Jason Bortz from Davis and Harman. Davis and Harman has worked with us on these proposed regs.

ACLI very much appreciates the

Department's work in addressing issues regarding plan services and fees. The Department's fee disclosure initiatives reflect an enormous amount of hard work and thought. ACLI strongly supports the Department's work, and we share the Department's desire to enhance transparency in plan service arrangements.

The manner in which services are provided through ERISA has changed significantly over the years. ACLI agrees that it is appropriate to revisit 408(b)(2) to ensure that its regulatory requirements are reflective of those changes.

We are also mindful that the service arrangements are likely to continue to change in the future. Plan fiduciaries and plan service providers need a clear and concise regulatory framework that sets forth principles for disclosure. These principles should be readily understood and easily applied in the context of today's employee benefit plans, the designs, and of those designs in the future. To those ends, we welcome the opportunity to present testimony to the Department.

Our comment letter details a number of suggestions for improving the regulation. My comments today focus on a few of these suggestions, namely the need to separately address the different types of plans, the unique considerations related to the multi-state regulatory system for insurance contracts, and the importance of providing for a smooth transition to new rules.

Regarding the role of insurers in ERISA plans, ACLI represents 373 member companies. These member companies account for 93 percent of the life insurance industry's total assets in the U.S.

ACLI member companies began issuing group annuity contracts to employer-sponsored retirement plans as far back as the early '20s. Today, group annuity and other forms of insurance contracts are used to fund and service a wide range of ERISA-covered plans, including defined contribution plans such as 401(k) and 403(b) plans. Insurance contracts hold a significant portion of all tax-qualified retirement plan assets.

In addition to retirement plans, ACLI member companies issue contracts to guarantee payments from and provide services to health plans, life insurance arrangements, long-term care programs and disability insurance plans. As employers, ACLI member companies also sponsor ERISA plans for their employees.

As for the scope of the regulations, this draft of the proposed regulations would apply broadly to individual account plans, defined benefit pension plans and health and welfare plans. We recognize the policy needs to provide rules under Section 408(b)(2) that apply to all employee benefit plans. However, we urge the Department to reserve on the issuance of any of these final rules with respect to the defined benefit plans and health and welfare arrangements and instead consider first the individual account retirement plans such as 401(k) plans.

Individual account plans have been the focus of public policy discussion for some time. Essentially the same level of discussion and analysis simply has not yet been undertaken with regard to the other types of employee benefit plans.

Our member companies have many new questions about the application of the proposed regulations to these other employee benefit plans. These questions concern the application of the principles and technical requirements in the proposed regulations to insurance contracts issued in connection with these plans, plans that have different purposes and different fee structures than individual retirement accounts.

We believe the Department, employers and plan service providers need sufficient opportunity to focus on the unique characteristics of these plans and arrangements. Rather than delayed guidance for such efforts, we believe that the employee benefits community would best be served if the Department proceeded first with guidance exclusively on individual account retirement plans.

As for the multi-state regulatory system for insurance contracts, ACLI member companies are also concerned that the final regulations may require changes to the terms of insurance contracts. As you know, the insurance industry is a state-regulated industry, and the insurers have to obtain approval of their contracts from each state's insurance department. This approval is typically necessary on a state-by-state basis, and it is not unheard of for the approval process for a single state to take up to a year. It is critical that the final regulations clarify that the disclosure rules may be satisfied without a need for changes to be made to insurance contracts.

More broadly, we urge the Department to reconsider the requirement in the proposed regulation that a contract between a service provider and a plan fiduciary itself include a provision requiring the service provider to make the required disclosures. As issuers of insurance contracts, ACLI members have significant concerns with the use of the term "contract." Again, any changes in approved contracts must be resubmitted and re-approved by state regulators at a significant cost to both our member companies and the various states themselves.

In lieu of the contractual requirement, we urge that the final rules allow required disclosures to be made in the form of a notice to the plan sponsor or appropriate fiduciary. Compliance should be determined on the basis of whether the requisite disclosures were actually made. ACLI members need the flexibility to satisfy the disclosure requirements without making modifications to the terms of the underlying state-approved insurance contracts. Any other rule would impose an unnecessary burden on insurers and slow implementation.

Lastly, on the transition to new rules, one of the most important issues for ACLI member companies is the proposed effective date of 90 days after the publication of final regulations. Service providers and plan fiduciaries need sufficient time to ensure that they fully understand and are capable to implement the new regulatory regime. An appropriate transition period is important as even an inadvertent violation of these rules would result in a prohibited transaction.

We recommend that the final regulations be effective no earlier than one year following the publication of final rules. We suggest this time frame giving our member companies' knowledge both as a sponsor and as a service provider of the practicalities involves. Insuring that agreements and processes conform to the specifics of the new regulations will take time. Service providers and plan fiduciaries will wait for the final regulations before making changes to existing disclosures, modifying current processes and procedures, gathering new data elements, refining existing data elements, and investing in systems changes. Of course, these activities can be undertaken after they've had an opportunity to fully understand the final regulations, and determine an appropriate approach for implementation.

We note that if the Department does not adopt our comment regarding that the disclosure obligation be in the form of a notice, ACLI member companies will need significantly more time to conform to the final rules.

We very much appreciate this opportunity to present our views on the need for separately addressing the various types of plans, the unique considerations related to the multi-state regulatory system for insurance contracts, and the importance of providing for a smooth transition to the new rules. And I would be happy to answer any questions.

MS. WIELOBOB: Hi, Jim.

Regarding the state insurance commission approval, you spoke a little bit about that, and I've read about it in some comment letters from other insurance entities.

When we're talking about you say perhaps a 12-month process in getting approval of any change in the contract language, are we talking about per insurance product that an insurance company would offer? I can't find any detail on that. Are you talking contract-by-contract, customer-by-customer approval?

MR. SZOSTEK: They're typically on a form basis. So if you offer today 10 different forms of insurance contract, each contract would then need to be re-filed with each state.

MS. WIELOBOB: And how often is that typically done in the normal course?

MR. SZOSTEK: It would typically only be done where a change was made to the contract itself. So you've got state approval to use the contract. You're at that point. You're fine to sell that contract. If you make a change to the contract, you'll need to file it for pre-approval.

MS. WIELOBOB: Okay. That was just sort of a simpler question I can't really find the answer to elsewhere.

Now, insurance contracts issued to health and welfare plans are different than those you say not issued to defined contribution plans?

MR. SZOSTEK: In some respects, yes.

MS. WIELOBOB: And what would those be?

MR. SZOSTEK: It's a premium-based product where -- I mean, to say that they're different, they're different types of programs, if you will. So you're talking about for the most part a fully insured welfare plan where the plan no longer has liability for the payments. They've purchased the insurance contract, and the insurer will handle both the insurance aspect of the program and then the claims processing part of the program. There may be other things that the insurer's doing as well under that contract.

You may have situations in, say the 401(k) marketplace, where it's a contract that covers both -- in this respect they could be similar -- as a contract that covers both investment, if you will, and other services that are provided to the plan sponsor.

I think our comment really is about the fact that the health and welfare community really hasn't been thinking about what do these rules mean to us. And the 401(k) community has been spending quite a bit of time over the last year-plus thinking about disclosure, fees, compensation flows.

MS. WIELOBOB: Because the argument's been made that these rules are in opposition to the way sales of insurance products work. And I just haven't been able to get my arms around exactly why.

MR. SZOSTEK: I'm not sure what you mean by that.

MS. WIELOBOB: Apples and oranges. That insurance entities have made the argument that they're compensated in a manner which is so different than the way DC-side service providers are that really the regime doesn't work for welfare plan providers.

MR. SZOSTEK: I know that we haven't argued that it doesn't work. I think we just haven't had a chance to really kind of vet it out and think about it.

MS. WIELOBOB: Okay. I wanted to ask you a question about indirect service providers and disclosure there.

In your comment letter, you suggested that there be a standard for disclosing indirect service provider compensation other than which is in the proposal. And I think one of the standards that you were concerned with was sort of the remoteness of indirect compensation, as are many commenters. And I think that you said the principle should be something along the lines of unless subcontractor fees are allocated to plan assets or are based on plan assets, they shouldn't have to be disclosed.

MR. SZOSTEK: Right. We looked at the bundled rule in the reg, and thought that that rule is a good rule and it could be applied sort of across the board that unless there's some variation in the fee based upon plan assets that the fact that there's this indirect service provider that may be preparing benefit statements, for example, that there is no need to allocate indirect compensation to that provider.

In many cases, it's quantifiable, as was everything. It's quantifiable. But I'm not sure that it provides any benefit to the plan sponsors purchasing the product. They kind of know what they're paying overall for the product.

And then to go into and having us sort of de-construct products and show all these various arrangements and different compensations that are being paid, I'm not sure what benefit that has for the plan sponsor. And it is a bit of work. There's clearly a lot of work in some respects.

So we thought your bundled rule made sense to us, and that was a rule that could apply generally.

MS. WIELOBOB: Okay. Can we talk just one minute about how insurance brokers and agents are compensated? Can you comment on how you see those forms of compensation fitting into this proposal? I understand that there are fees. There are commissions. There are some incentive compensation. Does ACLI have any position on that?

MR. BORTZ: I don't think that this is an issue we've focused on -- representing insurers rather than the brokers --

MS. WIELOBOB: Right.

MR. BORTZ: -- and consultants. But certainly one thing to think about in this area is that there's sort of a robust history of class exemptions in the area of 84-24, which was referred to before. And we just think it's important that the Department think about how these pieces all fit together. And we haven't seen a lot of sort of how 408(b)(2)

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can interact with 84-24 and the other exemptions.

MS. WIELOBOB: Okay. That's all I have. Thanks.

MS. ZARENKO: I just have one question.

It's kind of a scope issue. I think what we're hearing is a request for clarification about when is an insurance company just selling an insurance contract or product, and when is it a service provider. And I think it might be easy to spell that out in certain cases, but nowadays things are often packaged and lots of entities have affiliates. And so the distinction starts to blur.

I would just appreciate your comments on when does it rise to the level of being a service provider, and not just sale of a contractor product?

MR. SZOSTEK: Okay. I think that that's a question we have for the Department.

When you read through the regulation and think about its application to various investment products, it's almost as if the argument is an investment product is a service product.

If the insurance contract merely provides for -- for example, if all the insurance contract provides for is a rate of return on monies that the plan invests, is that a provision of services? That's a question we would have for the Department.

So we saw in the preamble sort of a blanket statement about the fact that there are these insurance contracts and that there are no service provisions. But we're curious as to where the Department wants to go with that.

MR. BORTZ: One way to think of it is the 408(b)(2) reg doesn't apply to all service arrangements. It only applies to certain ones -- ones where you all think disclosure of sort of indirect compensation

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would be meaningful.

One way to look at the world of fully-insured arrangements is not to say are there really services here in addition to insurance, but really to ask are these the kind of arrangements where disclosure would be helpful -- so like a fully insured life plan.

Maybe it doesn't make any sense to have disclosure there where all you're doing is purchasing term life insurance. It may be easier to go at it through a scope reg than a sort of slice-by-slice service reg.

MS. ZARENKO: Would you make recommendations on how we would do that?

MR. BORTZ: No. No. That's all in your court.

MS. ZARENKO: Thank you.

MS. DWYER: I have no questions.

CHAIRMAN CAMPBELL: I guess one question I do have is looking at the perspective of a fiduciary who's going out to acquire some benefits -- provide some benefits.

What would you say the distinction is and what's being looked at -- the types of issues they need to consider when looking to get a service performed in connection with the DC plan versus some sort of welfare benefit plan?

We've seen a lot of comments saying well, we're not sure that we're prepared to go down the road of having this be more broadly applicable. But we've not seen a lot of comments as to what the real distinctions would be, other than the assertion that they are. And I'm curious what from a fiduciary's perspective do you think some of those differences might be.

MR. BORTZ: Well, I think they're a lot. I mean, one of the goals of this reg is to identify the fees that are paid for services.

In fully-insured arrangements, there's typically a premium that's paid. Some of the premium will go to insurance. Some of that will go to services. It's a big question under this reg how someone would identify what piece is allocable to what, and whether or not there would be any benefit to be gained from that kind of an exercise.

Similarly, in the health and welfare context, insurance typically provides both services and benefits. And again, it doesn't make sense to necessarily crack out which piece is what in an arbitrary way where there's sort of no market delineation.

So I think a lot of the issues are really about how you divide premiums, if you should, if it makes any sense to do that, and how you divide what's provided under the contract. And I think those are really the big distinguishing factors between insurance in general, and certainly insurance in the health and welfare context.

MR. CAMPAGNA: Just one question. You mentioned the class exemptions that are currently applicable to insurance and insurance brokers, et cetera.

Do you have any sense as to your position on the effect that 408(b)(2) should have on that, or whether it should have any effect?

MR. BORTZ: Well, I think one threshold question here is whether or not you all see issues that should be addressed in the context, or whether or not 84-24 has been serving the need to which it's been put since it was put out what -- I guess the predecessor to 84-24 was in '77 or '79 -- whether you all see a perceived need to sort of change the landscaping. Certainly our sense is that 84-24 has been doing a good job.

MR. CAMPAGNA: Okay.

MR. BORTZ: The other thing to say on the health and welfare context that's a tricky issue that we haven't heard vetted is this sort of, what is it, the '92 tech release, and this relief from the trust

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requirement. It's one of the issues that you all are going to have to grapple with is are payments paid by an employer out of its general assets for services subject to the 408(b)(2) disclosure regime.

Insurance, and particularly health and welfare plans, are often paid for out of the employer's general assets. And to the extent they're not, they're sort of paid out of this quasi-plan assets under the tech release. And I think that's just a whole set of issues that needs to be vetted here.

MS. WIELOBOB: You might see that in the self-insurance sort of discussion. But do you have any comments on that?

MR. BORTZ: I think the comment is that it needs to be thought about, and we need to gather information. We need to make sure the right people are thinking about these issues and getting the same kind of grappling that you've gotten in the individual account context.

MS. WIELOBOB: I think we really got one comment on that issue. So I'm glad you brought it up.

CHAIRMAN CAMPBELL: Okay. That does now conclude our morning testimony. And we're only five minutes behind. So if we could resume testimony now -- not gathering -- just testimony at 1:05. Thank you.

(Whereupon, the above-entitled matter went off the record at 12:04 p.m. and resumed at 1:04 p.m.)

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PANEL MEMBER CAMPAGNA: Our first party will be Express Scripts, Inc., for Pharmaceutical Care Management Association -- Bill Kilberg.

MR. KILBERG: Thank you very much.

Good afternoon. My name is William Kilberg. I'm appearing here today on behalf of Express Scripts, Inc., for the Pharmaceutical Care Management Association, which is a trade association of pharmacy benefit managers. The PCMA submitted comments in a letter dated February 22 from Barbara Levy, General Counsel of PCMA.

I am joined this afternoon by my colleague, Paul KILBERG.

Our purpose today is to expand a bit upon the central point that was made in PCMA's February 22 letter. The proposed rule should not be applied to pharmacy benefit managers, because PBMs simply do not present

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the types of concerns targeted by this rulemaking.

As we understand it, the proposed rule would address the Department's central concern that plans and plan sponsors lack sufficient information about the fees and expenses being imposed on plans by service providers, because pricing structures used by those providers, particularly by bundled service providers, are too complex and opaque.

The proposed regulations are at least in substantial part a response to a report on plan fees and expenses issued by the Working Group of the Department's ERISA Advisory Council. That report focused on the lack of transparency in fees and expenses incurred by participants in 401(k) plans investing in pooled investment vehicles like mutual funds.

The Working Group emphasized that, with the emergence of the defined contribution plan as the dominant form of retirement plan, a dramatic change has occurred in the way fees are charged. In particular, the Working Group's report emphasized that management fees and other expenses of mutual funds are levied at the fund level and not easily identifiable by plan fiduciaries and/or plan sponsors, and further, that the prevalence of bundled arrangements with plan providers with the costs of administration such as trustee or record keeping fees are offset by payment to those providers in the form of Rule 12(b)(1), sub-transfer agency, marketing or finders fees, or revenue sharing payments. And that this has complicated the ability of plans and plan sponsors to fully appreciate the fees being paid indirectly to providers.

It's consistent with the opening remarks of the Assistant Secretary this morning, where he explained that the purpose of this proposed regulation and this hearing was to deal with issues involving the financial services marketplace.

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The Working Group's report found that perhaps 70 to 80 percent of plans and plan sponsors were unaware that providers were receiving these indirect payments. The PBM business model, on the other hand, operates in a far different manner. Here the FTC has found that market forces have functioned to provide a substantial amount of transparency -- the very transparency that the Working Group found absent on the retirement side.

The PBM model is not difficult to describe. PBM organizes retail, typically brick-and-mortar pharmacies, into networks. The PBM bargains with the retail pharmacy. For each participant who fills a prescription there, it will reimburse the pharmacy a set amount. This amount is less than the pharmacy otherwise would charge for the drug. But in return for providing the discount, the pharmacy expects to get an increased volume of customers from the PBM.

PBMs also generally operate their

own mail-order pharmacies. Here PBMs negotiate directly with pharmaceutical companies or with wholesalers. The companies provide drugs to the PBMs for a reduced price, again in return for expected increased volume of business from the PBMs. The PBMs then sell the drugs directly to the plan participants.

PBMs negotiate the terms of these purchases on its own behalf. PBMs also perform the claims administration process for plans, and often also perform a variety of other services for manufacturers.

This model is well known and well understood. Plans and plan sponsors are aware of how PBMs operate. PBM clients are often large, sophisticated companies that negotiate arrangements with PBMs with the assistance of consultants knowledgeable about the market for PBM services. Smaller companies often are represented in negotiations by third-party administrators, who act on behalf of a number of separate plans in order to enhance their bargaining power.

Negotiations are hard-fought. Plan sponsors generally bid out contracts for PBM services, so that PBMs must compete with each other.

There are 40 to 50 PBMs in the United States. The FTC has found that this competition among PBMs is vigorous. Competition takes place on both price and non-price dimensions, including benefit design, size of network, quality of service.

In addition, different plan sponsors have different preferences for formulary design and pharmaceutical payment-sharing. With respect to pricing, PBMs and plans or plan sponsors negotiate extensively over the payments to be provided to the PBM, which take two basic forms -- flat fees for administrative processing services, and index-based pricing discounts on the pharmaceuticals the plan participants purchase.

The plan sponsor can negotiate to

pay a specific, index-based charge less a stated percentage amount for brand-name drugs and generic drugs. Alternatively, on the retail pharmacy side, plan sponsors can negotiate for pass-through pricing where savings extracted from the retail pharmacy are passed through to the plan.

Further, plan sponsors can and inevitably do negotiate for a share of the volume rebates that the drug manufacturers provide to the PBMs, which would otherwise reduce the PBM's cost of goods sold.

Because there's no free lunch, PBMs are likely to charge plans more for administrative services where the plan has negotiated either or both pass-through pricing and a share of volume rebate.

By using a PBM, everyone wins. Plans and plan sponsors gain access to discounts. Participants get cheaper co-pays or payroll reductions and get access to enhanced distribution channels. Retail pharmacies and drug manufacturers get increased business. The PBM gets a reasonable process.

The FTC has found that there do not appear to be any significant barriers to negotiation between health plan sponsors and PBMs over -- and I'm quoting -- all the terms of their agreement, including how PBMs are to be paid for their services and the disposition of any rebates.

Furthermore, the FTC has found there is no indication that clients of PBMs lack accurate information on the price and quality of the service that they intend to purchase. Indeed, in the FTC's view, vigorous competition in the marketplace for PBMs is more likely to arrive at an optimal level of transparency than would regulation.

Imposing the proposed disclosure regimes on PBMs is not neutral, but may well have substantial adverse effects. The FTC studies have expressed concern about tacit collusion among manufacturers in the event that formal disclosure were mandated.

Because the FTC has comprehensively studied the PBM industry and has determined that extending additional disclosure mandates onto PBMs would have a net anti-competitive effect, the Department, which has not specifically studied PBMs but has instead focused on service providers to defined contribution plans, should defer to the FTC's determination, at least, unless and until the Department conducts its own investigation and determines otherwise.

I have left with you a copy of all of the FTC studies. There are a number of individual letters that the FTC has sent, which we've cited in our materials and Barbara Levy's letter of February 22, as well as some specific studies on the PBM industry.

I'm happy to answer any questions you may have about anything I've said here this afternoon, or about anything in Ms.

Levy's letter.

Thank you very much.

MR. CAMPAGNA: Let's start down there.

MS. WIELOBOB: Hi, there.

MR. KILBERG: Hi.

MS. WIELOBOB: I am familiar with the FTC study, and it's robustly cited in your comment letter.

As to the notion that disclosing, sort of, the behind the scenes the ways that PBMs do business -- disclosing rebates and so forth to plan sponsors -- I see the assertion in the FTC's conclusions, and one that, I think, that you echo that they would have anti-competitive effects. Can you tell me mechanically, why do you think that would be the case?

I'm not an economist. I'll leave that to others on the Panel. But I kind of understood sunshine is beneficial to the consumer. The more we know, the better competition gets. So to hear that disclosure would lead to higher prices, I find it to be a little confusing. I'm supposing it's something that I've missed.

The other issue, I know the FTC actually used their words. They did say tacit collusion. That's something we can't disprove or prove. There could be collusion going on right now. And so I'm not sure how one could avoid that conclusion going either direction. But if you could talk about the marketplace points a little bit, that'd be great.

MR. KILBERG: Sure. First, I think what's important to note is that the FTC has found that sunlight does exist now. Plan sponsors are well aware of rebates -- that the rebates are not a secret in the industry -- and are able to negotiate for those rebates. In fact, many large employers simply get the entirety of the rebate passed through to them.

So the issue is not whether there is sunlight and whether participants -- or more importantly plan sponsors -- are aware of the information they need to have. The bigger question is whether, if you formalize in a written document, information that would allow manufacturers to determine what rebates other manufacturers are giving on specific drugs.

Remember there's a big, vigorous competition, both with regard to brand-name drugs, because you have competing drugs by different manufacturers -- for example among the statin drugs -- but also because you have many, many producers of generic drugs, for which there's a very vigorous market. And indeed if you explore into this industry as the FTC has done, you'll learn that the way pricing goes, typically PBMs lose money on brand-name drugs and make their profit on generic drugs, because there is so much competition.

The concern is that, if any manufacturer knew what other manufacturers were discounting with regard to particular drugs, they could then adjust their price accordingly. And the concerns are that this would result in higher pricing. It would be disadvantageous to participants and beneficiaries.

MS. WIELOBOB: The competition there wouldn't have the opposite effect?

MR. KILBERG: No. Because if you know that somebody else is discounting less than you are, you know that you can sell this drug at X pennies rather than Y pennies. And that's the concern that the FTC has.

The argument we're making to you is a very simple one. If it ain't broke, don't try to fix it. The burden should be on the regulator to show the need for regulation. And if the FTC is right -- we believe they are right, and this is not something that they just came up with -- this is something resulting from years of study, both the FTC and jointly by the FTC and the Antitrust Section of the Department of Justice. Then, let's not regulate it.

MS. WIELOBOB: Well, in fact, aren't a number of states actively considering -- I know you're here to talk about federal law -- but aren't a number of states now in the process of -- some have passed, and others are enacting or it's going through state legislatures -- regulation of PBMs?

MR. KILBERG: Considering it. And that's what a number of these FTC letters that we provided to you relate to. The FTC has been asking the states not to regulate in this area because they believe that regulation would in fact have an anti-competitive effect along the lines that I've just described.

MS. WIELOBOB: Okay. Now as to the trade secrets, you mentioned in your comment letter that trade secrets may be at issue.

If the 408(b)(2) disclosure regime was promulgated as is, what sorts of trade secrets are we talking about? Formularies?

Would it benefit companies -- the pharmaceuticals?

MR. KILBERG: There may be individual formularies that would be confidential. First and foremost, of course, would be the rebates themselves by drug. And that's much of the letter that Ms. Levy submitted on behalf of the PCMA is the result of a comment by a series of PBMs.

So you've got people focusing on different parts of the regulation, or different aspects of the regulation, but really honing in on the same larger point, which is why I've chosen to focus on that larger point here. And that is that there is confidential information which can be worked out by plan sponsor by plan sponsor, but which should not be made generally public.

MS. WIELOBOB: Okay. And you mentioned in assessing the quality of a variety of PBMs that customers may -- plan sponsors -- will look at a variety of things

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MR. KILBERG: Yes.

MS. WIELOBOB: -- quality of services costs and so forth. And I think the FTC -- you're probably more familiar with this study than me -- but the focus on competition there seems to be on pricing?

MR. KILBERG: Yes.

MS. WIELOBOB: And the Department has said in our guidance -- you're probably familiar with it -- that cost is the only one aspect of a fiduciary's consideration in evaluating service providers.

MR. KILBERG: Right.

MS. WIELOBOB: So I believe the Department's position -- I don't want to misstate it -- is that the lowest cost provider is not always the most prudent choice. So if it's acceptable to view the FTC's conclusion in terms of economics -- finance, that is, dollars -- the disclosure regime has other qualitative effects as well.

If we can set aside competition and dollars, how do you think the disclosure regime could harm other aspects of the quality of service presented by particular PBMs?

MR. KILBERG: I don't know if it would harm it or not, quite frankly. But it goes back to the point that there's no evidence here, as the Working Group found, there was on the financial side -- on the retirement plan side -- that there is a lack of information or that anything is complex or opaque.

I think in this industry, generally, the competition is understood. It is vigorous as the FTC found. And it occurs across a variety of service aspects, as well as price.

MS. WIELOBOB: Okay. And one question -- just indulge me one more.

I saw mention of some dated material on Medicaid. And I know Congress had a debate about whether -- what PBMs' role with

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respect to Medicare, Medicaid would be. What is it? I didn't have time to look into that. Do PBMs work for those programs?

MR. KILBERG: Yes. And there is the same issue, or at least I know of this issue. I don't know if there were others.

But in that context, there also was a question as to whether there should be more regulation. And the conclusion was not, that it would in fact be more anti-competitive than it would be pro-competitive.

MS. WIELOBOB: Thank you,

MS. ZARENKO: I just have a couple quick follow-ups.

When I read your submission, what I thought the position was, was that there's sufficient transparency. There may be slip-ups here and there in the PBM marketplace, but that this regulation wasn't the way to solve that or go after those problems. But now I almost feel like what I'm hearing is, in your opinion, when we're talking about the ERISA plan marketplace, there are no issues with transparency in the information that's provided from PBMs to the plan clients?

MR. KILBERG: We're not aware of any issues that would look to regulation to fix them.

The point of a letter was just that. That was the first section. We then go on to say but if you want to do something, then here are a whole bunch of other issues, but they really go to very much the same point, which is that regulation might have an anti-competitive effect insofar as it would seek to regulate and disclose individual rebates.

MS. ZARENKO: As you probably know, the definition of a fiduciary under ERISA is a functional definition. You either are or you aren't, based on what you're doing.

MR. KILBERG: Right.

MS. ZARENKO: And I know contracts sometimes spell out that you are one or not.

MR. KILBERG: Right.

MS. ZARENKO: But I would just appreciate your practical viewpoints on the extent to which PBMs consider themselves to be fiduciaries to their ERISA plan clients.

MR. KILBERG: Generally they do not consider themselves to be fiduciaries, because generally they are not dealing with a plan or providing services to the plan. They are providing services to the plan sponsor to the employer. And there are no plan assets involved. There are strictly payments from the employer to the PBM.

There are instances, as we indicate in our letter, where PBMs have agreed to provide claims services where they in fact may make claim determinations. That's quite rare in my experience. But it does happen. In those instances they would be functional fiduciaries, and sometimes they agree to be a named fiduciary for that purpose.

MS. ZARENKO: Do you think plan

sponsors have the same view, or do you think there might be instances where a plan sponsor does think of a PBM as a fiduciary service provider?

MR. KILBERG: I'm not prepared to answer that question.

MS. ZARENKO: I didn't know if you would have a view or not. Thank you. That's all I have.

MS. DWYER: I believe you're saying that this proposed regulation merely formalizes disclosure that's already there on an informal basis, and that the formalization would have an anti-competitive effect. Why is that? Why turning this disclosure into a written document -- why is that going to increase the chances that the information is going to be out there more than it is now?

MR. KILBERG: Well, a few points along the lines of my prior answers.

If there's no need for the regulation, why engage in it? If you don't have the problem, why regulate?

Secondly, the disclosure that you've got is going to be on a per plan basis. There's going to be an amalgamation of information with regard to rebates for example, that will refer to the rebates for a particular plan based upon its usage so that you can calculate -- the PBM can calculate for any particular employer the drugs that were purchased and the rebates that are owed with regard to those drugs and the quantities that were purchased by participants in that plan.

What we're concerned about is putting that information out generally into the marketplace, so that someone can unravel it and make determinations as to which manufacturers are providing, or which wholesalers are providing what kind of rebate on which drugs. The more you formalize it, the more you put the information out into the marketplace, the greater the risk that that information will be used for purposes that are anti-competitive rather than competitive. And if you don't need to regulate, and you don't need to run that risk, why do it?

MS. DWYER: Another question I have is that the information now that's being disclosed will be disclosed after the fact. Am I correct on that?

MR. KILBERG: Generally, the negotiations that will take place will take place before the fact. The negotiations that will take place will say that you will provide us with all of the rebates or some percentage of the rebates. You will provide us with all of the pass-through or some percentage of the pass-through in exchange for which administrative fees will be leveled at this level or that level. That's the nature of the financial negotiation that takes place.

The dollar amounts will only be determined after the fact because they're usually determined based upon the prescriptions that were actually written during the period in question.

MS. DWYER: And substantively, do you see a difference of the information that would be disclosed formally through the proposed regulation, as opposed to what's being disclosed now voluntarily?

MR. KILBERG: Well, a good portion of our letter deals with the issue of the definition of compensation in an effort to avoid getting into some of these traps and providing information that would taint the process.

But again, I'd come back to the initial point, which is that, given the studies that have been done by a sister agency that have said that none of the problems which allegedly exist on the retirement plan side exist over here, why would you want to include this in a regulatory framework?

MS. DWYER: Thank you.

CHAIRMAN CAMPBELL: Let's say hypothetically that our investigations that we

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conducted on an ongoing basis do show a trend that causes us to have a concern for absentees, that there is an informal disclosure going on and that there are rebates that aren't being passed through in any shape or form. Is it your view then that the structure of this regulation just fundamentally is at odds with the business model for this industry, such that even in that circumstance this would not be an appropriate response?

MR. KILBERG: The regulation as presently structured, yes, is in competition with the business model. The definition of compensation as we point out is one that would be very difficult for us to live with,and we would suggest that compensation ought to be defined in its usual business sense as payments received in return for goods or services provided, rather than payments received in connection with or -- we're almost into the preemption language in relationship

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to -- we think it's too broad, too vague. And if you were to regulate, you should regulate differently.

But we would also say, before you regulate, we would prefer that you adopt the position of the FTC. If you choose not to adopt the position of the FTC, then we would urge you to do more homework, get more knowledgeable about the industry before you conclude that there's a need for this kind of regulatory approach.

CHAIRMAN CAMPBELL: Do you think the situation facing pharmacy benefit managers is different than that facing other forms of -- I guess you wouldn't say they are service provider plans -- but other types of service providers? Or is this a problem that we would anticipate seeing in other areas?

MR. KILBERG: Well, I think the problems that you've got on the retirement side are quite different, as a general proposition, than issues on the welfare plan side.

I think that on the retirement side, you have third party payments that are very different than what you have in this program, or typically in the welfare plan side where third-party payments go to cost of goods sold, not to actual compensation. You're dealing with a very different kind of structure. Furthermore, I don't think you've got the kind of opaqueness -- as the Department refers to it -- on the welfare plan side that you have on the retirement plan side.

So as a general proposition, I would urge the Department to give some more thought to the issues before it regulates. I believe that you simply lack the kind of information and in the kind of depth that you should have it in order to provide a disclosure regulation of this breadth on the welfare plan side as a general proposition, and certainly with regard to PBMs.

CHAIRMAN CAMPBELL: Okay. Do you have a question?

MR. CAMPAGNA: My question is, how do small employers figure into this business model. Are they provided the same kind of transparency and in your experience, are they able to judge the information that they're given regarding the rebates and the information regarding the compensation or rebate systems that PBMs negotiate?

MR. KILBERG: Typically, small employers are represented by third-party administrators. They may use a different consulting arrangement than you see large employers making. They usually come in groups through a TPA and negotiate on that basis.

You also see more smaller employers on the insurance side where the insurer is in fact negotiating for them and providing the PBM services.

So it's somewhat of a different structure either in terms of the negotiations or sometimes in terms of the program itself when it's done through the insurance mechanism.

MR. CAMPAGNA: Thank you.

MR. BUTIKOFER: You've talked about this tacit collusion and the problem that comes if we disclose the rebates. But what disclosures that are required by the proposed regulation could actually be disclosed, and not harm or cause this tacit collusion?

MR. KILBERG: I haven't tried to look at it from that perspective.

Part of our problem is that the definition of compensation seems to be so broad that I'm not sure where you're drawing the line.

MR. BUTIKOFER: All right.

MR. KILBERG: It's hard to see what it is -- a) we don't have a problem to regulate; b) the regulation itself is so broad as to be uncertain as to where you're drawing the line.

In our letter, we tried to provide you with our expressed concerns, both as a general proposition, and secondly, if you were to go ahead with the regulation, with specifics in the regulation. But I don't know that I could draft for you a regulatory structure that would work.

The FTC has looked at various disclosure regimes. As indicated, the states have had a number of proposals floating about. And they've looked at the Medicaid approach. And they found all of them wanting. So I don't know where you -- how you draw the line.

MR. BUTIKOFER: All right. Thanks.

MR. WILLIAMS: How in your mind do plan fiduciaries currently meet their fiduciary duties for welfare plans, their holding plan assets, and have to comply with the 408(b)(2) regulation?

MR. KILBERG: I can speak best to

PBMs and again, the disclosure is broad.

Where you might have the plan assets, for example, in the case of a Taft-Hartley plan, and I could debate that. But let's assume for the moment at least that there, you have plan assets. I would think that they'd be able to meet their obligations quite easily because there is as much transparency and competition. And typically, they would engage in a bidding process and sit down and negotiate with a variety of PBMs, usually with a consultant in tow.

MR. WILLIAMS: So they can get enough information to meet their fiduciary duties to determine whether the PBM will get reasonable compensation for the service?

MR. KILBERG: Absolutely.

CHAIRMAN CAMPBELL: All right. Thank you, sir.

MR. KILBERG: Thank you.

MR. CAMPAGNA: Next is WellPoint.

MS. LANGER: Good afternoon.

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Thank you for allowing me the opportunity to appear before you today and to provide input.

My name is Judith Langer, and I'm Public Policy Manager for WellPoint, Inc. I'm joined today by Matt Haddad, Senior Counsel at WellPoint.

WellPoint is the health benefits company with the largest commercial membership in the United States. Many of WellPoint's business units and subsidiaries function as service providers to ERISA health and welfare plans, furnishing third-party administration, wellness programs, pharmacy benefits management, and many other types of services to ERISA health and welfare plans.

In evaluating these proposed rules, we have worked with our trade associations, America's health insurance plans, the BlueCross/BlueShield Association, and the Pharmaceutical Care Management Association. And we fully support their comments and testimony on this rule. However, we feel so strongly about these issues that we felt it would be important to testify and express our concerns about the proposed rule.

We should start out by saying that we do support the goals of the proposed rule to increase transparency of compensation and relationships of service providers. However, we believe the proposed rule as drafted will create, rather than ameliorate, problems in the health and welfare benefits industry.

First of all, we urge the Department to withdraw the proposed rule, or to delay finalization of the final rule with respect to health and welfare plans, and to conduct a comprehensive study of the health and welfare benefits plan industry to determine whether there are in fact problems in the industry that need to be addressed by guidance or by a proposed rule.

As others have mentioned, the studies done by the Department and the

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concerns that have been raised by Congress over the past several years focus on financial service providers, such as investment management companies and pension consultants, that provide services to traditional defined contribution or defined benefit plans.

It is evident from the preamble to this rule and from the rule itself as drafted, that this rule is primarily intended to target problematic issues concerning financial services providers in the pension industry. To the best of our knowledge, these same concerns have not been shown to extend to the health and welfare benefits industry. Therefore, we believe that this proposed rule as drafted is simply not a good fit for health and welfare benefit plans and their service providers. We encourage the Department to study the health and welfare benefits industry and to tailor any proposed rule to any specific existing concerns about service providers to health and welfare plans.

However, if the Department declines to withdraw their proposed rule or to delay issuing a final rule, we strongly urge the Department to grant affected entities in the health and welfare benefits industry an extended period of time within which to comply with the final rule. As has been mentioned before, it will be extremely difficult for plans and service providers to comply with the final rule within 90 days after it is issued.

We are concerned, and very concerned, that a too-short compliance timeframe will significantly stress and disrupt the normal business activities of ERISA plans and service providers subject to the rule. This is particularly true for health and welfare plans and their service providers, as we are struggling to understand how the proposed rule impacts all parts of our industry.

As drafted, the proposed rule will require health and welfare service providers

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to make substantial changes in their business practice and information systems. This rule represents a major paradigm shift in the health and welfare benefit plan industry.

The change represented by the detailed disclosure requirements in the proposed rule is analogous to the one that occurred when the HIPAA privacy rules were issued where existing general privacy law was replaced by a very detailed, complex and completely new regulatory scheme. Such a substantial change in business practice requires a substantial period of time for plans and service providers to fully analyze and understand the rule, work with others in the industry to create a common understanding on how to comply with this rule, perform a GAAP analysis, modify information systems, create new work flows and information-gathering procedures, train personnel, create and implement policies and procedures, and amend contracts.

When the HIPAA privacy rules were promulgated, covered entities were given 24 months to comply and were assisted every step of the way by the Department of Health and Human Services Office of Civil Rights. Assistance from the regulatory agency permitted affected parties to achieve compliance. We suggest that the Department look to HHS' experience with HIPAA privacy rules compliance in creating a similar timeframe for compliance in similar but compliance assistance for affected entities.

We also strongly encourage the Department to develop compliance assistance to assist plans and service providers in complying with the final rule. Based on preliminary discussions of the proposed rule within the health and welfare benefits plan industry, it is clear to us that different stakeholders already have different interpretations of what types of compensation and what relationships that may constitute conflicts of interest will have to be disclosed under the rule.

Similar questions about how to interpret the regulations arose in HIPAA privacy rules compliance process. And in that case, covered entities greatly appreciated HHS' compliance guidance consisting of FAQs, informal guidance, model forms, educational teleconferences and presentations and the like.

Now we understand that the Department of Labor has conducted many compliance assistance workshops on laws and issues within its jurisdiction, and those have been very helpful. However, in this situation we suggest that the Department allocate resources to holding workshops before the compliance date of any final rule in addition to after the date compliance is required. Compliance guidance will assure that both plans and service providers are aware of the Department's interpretation of terms and practices in the final rule so that the industry will have similar interpretations of what the final rule requires and will experience less confusion about how to comply.

Additionally, working with the health and welfare benefits industry, the Department should develop model forms for compensation disclosure as well as for disclosure of relationships that would constitute what the proposed rule calls a conflict of interest. And we do note that the Department has done this before. The Department has developed a form to assist fiduciaries of individual account pension plans. Use of model forms within the health and welfare benefits industry will ensure that all affected entities have a common understanding of what disclosures these rules require.

Now all of these compliance activities will take time. Therefore, we strongly urge the Department to give health and welfare plans and their service providers two full plan years after the final rule is issued until January 1, 2011, assuming the final rule is issued this year to comply.

We also believe that this proposed rule is not a good fit for health and welfare service providers, which is evident by the definition of compensation, which again appears to be designed primarily to apply the financial service providers. As applied to health and welfare service providers, the definition of compensation is overbroad. We don't believe that it will result in the disclosure of additional practical information over and above what plan fiduciaries already receive designed to permit plan fiduciaries to assess the reasonableness of their contracts for service providers. We do believe that it will generate much information of no practical use to plan fiduciaries in making their decisions.

We do have additional concerns

about the definition of compensation as applied in the context of PBMs. Due to variations in plans' sponsor requirements. In the PBM industry, the definition of compensation differs from one plan to another. Thus there is no common definition of what constitutes compensation to a PBM. We encourage the Department to work with the PBM industry in establishing clearly defined and consistent benchmarks for compensation within the PBM industry so that there is a level playing field in which plan fiduciaries can obtain the same information from each PBM with which they contract.

We are also concerned about the conflict-of-interest provisions in the proposed rule. The requirement that service providers disclose potential conflicts of interest is vague, subjective and open to misinterpretation. The requirement that service providers disclose potential conflicts of interest puts service providers in the difficult position of trying to identify which of its relationships with other entities may in the future become a conflict of interest for the plan. This is unrealistic and unworkable. It also leaves service providers open to unintentionally committing compliance violations.

We suggest that the Department modify the proposed rule to require service providers to disclose only actual existing relationships with entities, leaving it to plan fiduciaries to decide whether or not those relationships constitute conflicts of interest, and we suggest that the Department give further study to the issue of potential conflicts of interest.

Finally, the proposed rules requirement that a service provider identify and disclose to the plan its relationship with another of the plan service providers creates a very difficult standard for service providers to meet. A service provider's ability to meet the standard completely depends on the plan disclosing to the service provider about all of its other service providers. A plan's inadvertent failure to disclose all the service providers may cause the new service provider to unknowingly violate the rule, with consequent penalties. We do not believe that it is the Department's intent to penalize service providers in this manner. We believe this provision should be omitted from the final rule.

As has been stated previously by other testifiers, we're very concerned that the compensation disclosure requirement under the proposed rule will have an anti-competitive effect in the health and welfare benefits marketplace. When the proprietary compensation of the service provider becomes available to its competitors, as it inevitably will, prices charged by service providers will smooth out as tacit collusion occurs amongst service providers. The highest price charged by a service provider will then become the norm, as the ones who are choosing to charge lower prices will realize that the market bears a higher price. Plan fiduciaries will then no longer be able to get the best price from service providers competing against each other for business. This will ultimately harm plan participants and beneficiaries.

Disclosure of indirect compensation such as pharmaceutical rebates will similarly have an anti-competitive effect on the industry as the Federal Trade Commission found in its study of the PBM industry. As the FTC has said, pharmaceutical manufacturers' knowledge of their rivals' prices can dilute incentives to bid aggressively and facilitate tacit collusion which ultimately raises prices for plan sponsors and plan participants.

We submit that the Department should narrow the proposed rule to eliminate the requirement that service providers disclose indirect compensation, or at the very least tailor it to require disclosure only on indirect compensation that is directly related to the plan.

In conclusion, WellPoint believes that the proposed rule does not address any demonstrable problems in the health and welfare benefits industry. As the FTC has stated regarding the PBM industry, there is no reason to suppose that competition is less likely than government regulation to produce efficient levels of information disclosure.

Before this detailed, burdensome regulatory procedure is implemented for health and welfare plans and their service providers, we strongly urge the Department to perform further study of the health and welfare benefits industry so that any future regulation, if such regulation is even necessary, can be more closely tailored to evident problems in our industry.

Thank you for your time, and we

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will be happy to answer any questions you may have.

CHAIRMAN CAMPBELL: Okay. Why don't we start down here this time?

MR. BUTIKOFER: You've listed off some challenges that are unique to health and welfare. But is there something else inside that, that would be especially challenging for the small business, especially the independent brokers to deal with?

MS. LANGER: Well -- and Matt, please chime in if you need to.

Small businesses by and large have insured plans, and they do not always and typically use service providers. So the relationship would be between the health insurer and the small business to provide the health insurance.

Premium quotes are given, of course, before a small employer decides to buy that particular plan. So there is already by state insurance regulation a requirement that

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the health insurer disclose what the premium
costs will be per employee and for dependents
for that small employer.

MR. BUTIKOFER: So you're saying
it's actually a smaller burden for the small
ones because of these prepackaged --

MS. LANGER: Yes. And we do not
believe that they would have service providers
that would be subject to this rule, and that,
if they would, it would be the exception
rather than the norm.

MR. CAMPAGNA: The point of the
408(b)(2) regs was for fiduciaries to know
about indirect compensation, so that they
could judge the reasonableness of the
compensation they're paying directly to their
service provider.

I'm still struggling with how --
and I could have asked this question to Mr.
Kilberg as well -- I'm still struggling to
understand how the PBMs obtain rebates from
the drug manufacturers. Isn't it an important

part for plan sponsors to understand the reasonableness of compensation that they give and pay to the PBMs directly as an effect on that reasonableness?

MS. LANGER: Well, I'll try to address that. But I'm not a representative of the PBM industry.

But it is my understanding that a PBM would have an arrangement with a pharmaceutical manufacturer to get a rebate for a certain, particular drug. And the rebates would be at a certain percentage depending on market share. And it can be a very detailed program. It can be very simple.

But when a PBM is supplying information on a pre-contract basis to a plan sponsor, this usually happens in the manner of negotiating the formulary, so that if a particular drug is placed on a -- let's say it's a generic drug, and it's placed in the most preferable place in the formulary -- the plan sponsor would already know that they could be getting some of that rebate passed through to them.

MR. CAMPAGNA: Okay. Thank you.

CHAIRMAN CAMPBELL: Okay. You've commented as have several other folks, in the context of welfare plans, that the disclosures there would somehow be different -- that there are different issues to consider. We've had a lot of comments to that effect, as I said earlier, but not a lot of detail as to exactly what those differences might be and sort of evidence and examples to back up that assertion.

So I was just trying in my own mind to think of an example. Take for example, you as a fiduciary were trying to hire a TPA for your self-insured plan -- welfare plan -- health benefits plan. How is that really different in terms of what you're evaluating and looking at than hiring, say, a record keeping platform in your DC plan. From the fiduciary perspective, what are the real differences that I'm looking at? What is the nature of that distinction?

MS. LANGER: Well, again, I'm going to not speak at all to the defined contribution or defined benefits industry. I don't know anything about it.

But from a health and welfare plan perspective, the third-party administrator would provide a quote to the plan sponsor. Usually the price is on a per member, per month basis. So if there are 500 employees in the plan, it would be whatever charge it is per member per month, and the employers can fluctuate.

The third-party administrator might provide a lot of different types of services, all of which would have a price tag, which would be disclosed up front before the contract is signed to the plan sponsor. So for instance, the third party administrator might process claims. They might have a disease management program for chronic

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diseases. They might have an employee assistance program. All of these come with a price tag. And up front, the plan sponsor and plan fiduciary will know, here are the various services, and they will choose which ones they want. And so there is a lot of negotiation that goes on up front.

CHAIRMAN CAMPBELL: And I guess where I'm having trouble is seeing how that's necessarily different than what occurs in the DC context where you would be talking to a particular record keeper about what additional services might be provided as part of the bundled or unbundled arrangement.

MS. LANGER: Okay.

CHAIRMAN CAMPBELL: Again, you don't have knowledge of the DC side, so it's hard to do a direct comparison. I'm just having trouble understanding why, from the fiduciary's perspective, the analysis that they go through, the information they need to make the decision is so fundamentally different.

MS. LANGER: Well, that I can't speak to. But I can say that as far as we are aware -- and again, we are the largest health plan with the largest commercial membership in the United States -- we do not know of any problems that plan sponsors have with the information disclosed by third-party administrators, at least the ones under our control.

And again, as Mr. Kilberg eloquently said, if it ain't broke, don't fix it.

CHAIRMAN CAMPBELL: Well, the reason I ask again is just looking at your other comments, they seem to be comments that were perhaps more broadly applicable crossing various types of benefits -- questions about the conflict of interest, questions about what compensation means, how far down you go. It seems to be comments that we've heard in other than just the welfare context. So I'm kind of

wondering what there is uniquely to welfare
other than those issues.

MS. LANGER: Well, and again, our
bottom line is we do not think that this
regulation is a good fit for health and
welfare benefit plans. But if the Department
decides to proceed with it, there are broader
concerns that we have about conflict of
interest and compensation, and you enumerated
the other ones.

MR. WILLIAMS: I have another
question before we move on. Sorry.

I assume you would agree with the
general proposition that if a TPA firm was to
charge a fee for a service that that fee
should have been disclosed.

MS. LANGER: Yes.

MR. WILLIAMS: Okay. So for
instance, if they were going to terminate the
contract, and they were going to charge them a
fee for moving the records to another TPA
firm, that that should have been disclosed to

the plan fiduciary?

MS. LANGER: Yes. And there is a very detailed contract between the plan sponsor or the plan and the TPA that specifies all of the consequences of contract termination.

MR. WILLIAMS: So currently, there are contracts -- written contracts -- that provide fee disclosures to plan fiduciaries for that service provider charged those fees?

MS. LANGER: Absolutely. Whatever service the TPA is going to provide.

MR. WILLIAMS: So when you say you don't see any problems, or you don't hear about any problems, you're saying, well, these contracts are working then. Right?

MS. LANGER: Yes. As far as we are aware, yes.

MR. WILLIAMS: But they do require disclosures of fees that are going to be charged because that's just good business. Right?

MS. LANGER: Absolutely.

MS. DWYER: I have no questions.

MS. WIELOBOB: Actually I want to follow up Fil's question.

What sort of information is currently provided on the welfare plan side? You've got these disclosures and contracts.

MS. LANGER: Well, based on my knowledge -- and please Matt, chime in. He's our primary attorney.

Let's take a large firm of 1,000 or more employees. They or their consultants will send out an RFP, a request for proposal, to a number of different health plans. Now, these are very voluminous documents, and they don't talk about just price. They talk about do you comply with the HIPAA privacy rules? Do you comply with the Department of Labor? Do you comply with COBRA? How do you handle this? They're very voluminous. And believe me, our marketing area spends a lot of time in responding to these RFPs as we bid on the

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business.

MS. WIELOBOB: Okay. In your comment letter you indicate there's a whole variety of types of services you all provide, from dental to standard medical. You have almost everything on the welfare plan side. Yet in your letter, I think a lot of your discussion -- really the centerpiece is that FTC study.

MS. LANGER: With respect to the PBM.

MS. WIELOBOB: Right. With respect to the PBM.

So what portion of your business is PBM?

MS. LANGER: We do have the fourth largest PBM in the United States. And I can't tell you what percentage of business that is.

MS. WIELOBOB: Are you saying that the rationales articulated by the FTC in their study really apply to all the other aspects of your business as well?

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MS. LANGER: Yes.

MS. WIELOBOB: For the same reasons?

MS. LANGER: Absolutely. Absolutely.

And on the insurer side, in particular, antitrust is a huge concern, because rating formulae, for instance, are proprietary. So whenever we as an insurer have to disclose rating information such as a rate filing to a state insurance regulator, that is held as proprietary information by the regulator.

And again, it is a competitive business, and you don't want your competitor to know what price you're charging so that they could undercut you or find out your secret actuarial formulae for rating a particular block of business.

MS. WIELOBOB: So one of your remarks was that the compensation that would be required to be disclosed, you think, is sort of a better description would be indirect compensation directly related to the plan?

MS. LANGER: Well, if the Department decides to go and proceed with this rule and keep compensation in there, then at least that would be an element that would tie it directly to the plan.

MS. WIELOBOB: Can you give me an example of indirect compensation directly related to the plan in the welfare setting?

MS. LANGER: I'm just trying to think.

MS. WIELOBOB: I'm just trying to get my brain around what she's --

MR. HADDAD: Would that be related to the plan?

MS. WIELOBOB: Well, she said indirect compensation -- if -- yes. Go ahead.

MR. HADDAD: Well, I guess the concern we have from sort of a broad perspective is the rule isn't very clear to us about what is compensation, what's not

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compensation.

MS. WIELOBOB: Sure.

MR. HADDAD: Part of our business is that we contract with healthcare providers for discounts. Those discounts are negotiated. They would apply to -- all for booking business. And theoretically, I guess if we're insuring group A and we are paying claims at a contracted rate that is something less than fair market value, have we received compensation, which is the difference between the charge and the rate? I don't think we have. I don't think the rule is clear that that is a compensation to us. It's a difference, but I'm not sure it is compensation.

There are a lot of sort of instances in the rule that I don't think are very clear.

MS. WIELOBOB: Yes. I've seen other commenters have provided illustration in their written comments. I just wanted to know what you all meant on your side of things.

MS. LANGER: Well -- and it is very difficult to think of such an incidence of indirect compensation. My gut reaction is that it's very, very rare.

But again, until the health and welfare benefits industry understands the full impact of the rule and we have a chance to analyze it and do a GAAP analysis, we can't really come up with some of these examples.

MS. WIELOBOB: Do you think plan fiduciaries are getting good information now?

MS. LANGER: Yes.

MR. HADDAD: I think in the welfare, especially on the health side, you have sort of the mega-employers who have consultants. They are fully engaged in the process. They have tons of information. And sort of as you move down into the smaller groups, you have insured plans where the rates that are charged are regulated. So it's a little different.

MS. WIELOBOB: Thank you.

CHAIRMAN CAMPBELL: All right. Thank you very much.

How are you?

MS. KANWIT: Good afternoon.

Good afternoon. My name is Stephanie Kanwit. I'm Special Counsel for America's Health Insurance Plans, better known by the acronym AHIP.

As many of you know, AHIP is a national association representing nearly 1300 health insurance plans in the United States, providing coverage to over 200 million Americans. We're here to express our concerns regarding the proposed rule.

I have here with me today Mr. Bill Kowalski, who's an in-house attorney for Aetna. And Bill has been with Aetna for eight years as head of National Accounts, and I thought it would be useful to have him here today to answer some of the specific questions this Panel has proposed to date.

Also in the front row, we have Mr. Tom Wilder from AHIP, who's are Senior Regulatory Counsel.

I wanted to assure everyone on this Panel that AHIP is truly on the cutting edge of this whole concept of transparency. We're working right now with government agencies, physician groups and members to assure both quality and price transparency in the area of medical services. Transparency is very, very critical to us.

We believe this rule has a lot of purpose. But we also believe that it's ill suited -- as you just heard from Ms. Langer and Mr. Kilberg -- to the health and welfare area, and Mr. Kilberg's testimony on the PBM area. We believe it must be withdrawn and revised to more accurately assess and address the specific needs of health and welfare plan fiduciaries.

And there are two key issues here -- just in a nutshell -- because we have submitted very extensive comments to all of you and thank you for reading those.

Number one, we believe it attempts to fix a nonexistent problem for health and welfare plan fiduciaries. The question was just asked, do they have information. The answer is yes. They already receive or can request from service providers a comprehensive laundry list of information related not only to the type but the quality and cost of services.

Number two, even if this rule were deemed necessary, would the current disclosure requirements contained in the proposed rule accomplish what the laudable object is, which is transparency. And we say no. We say that the disclosure requirements in their current form will impose additional costs on health plans and their service providers and at the same time fail to provide additional material information that will be useful to the health and welfare plan sponsors. And simultaneously

-- we had a lot of questions about this issue -- creating the risk of disrupting what we believe is a highly competitive marketplace.

My point number one, it's fixing a nonexistent problem here. There is no evidence in the record that plan sponsors of health and welfare benefits are somehow lacking material information. So our question would be why propose such sweeping and truly revolutionary regulations without any evidence that they're needed to correct some well-documented problems of some sort here.

Again, our extensive comments go into this in great detail. But we believe that plan sponsors obtain an enormous amount of information right now about services and prices at multiple stages of the contracting process: in response to RFPs, as part of contract negotiations and services, contract documents in post-contracting, reporting and auditing requirements that are included in many of these agreements -- extensive auditing reporting.

In addition, the contracts are typically renewed on an annual basis, giving fiduciaries -- giving the plan sponsors -- the ability to change service providers should the cost and quality not meet the needs of the plan and the beneficiaries.

Secondly, and this is critical, and Mr. Kowalski from Aetna can back me up on this, the plan sponsor is always free to obtain and request additional information from the health insurer as the contract is ongoing, and will provide -- always provide -- they want to keep the customer happy -- sufficient information to allow a fiduciary to determine for example whether a service provider's compensation or fees are reasonable for services performed. And the only exception to that rule, and this has come up a couple of times this morning, of items that health plans do not routinely share are sensitive or proprietary information. And the example I give in my short paper is rates paid to physicians and other health care providers.

Aetna does not want to reveal to everyone in the State of Illinois what it is paying providers in Chicago for specific procedures. And the reason is, as we've just discussed a little bit in the questioning, is because that proprietary information first of all isn't needed by the sponsor to evaluate reasonableness, and secondly, public disclosure of that information would be anticompetitive and ultimately result in higher costs for everybody.

And as you just heard from the testimony of Ms. Langer and Mr. Kilberg, that's why we all have blind bidding. That's why RFPs go out. That's why we don't want to share information in responses to RFPs with all your favorite competitors out there in the market.

The market works. We believe that the market needs to maintain flexibility to allow parties to contracts to create terms that meet their needs and to meet the needs of their particular cohort of beneficiaries and participants. What we don't want to do by excessive regulation -- especially regulation that hasn't been demonstrated to address a specific problem -- is calcify that marketplace to the detriment of everybody.

What we believe is missing from the proposed rule is the recognition of the enormous power -- I call it empowerment in my written testimony here -- but the enormous power that plan sponsors have to work with their service providers to get the very best cost and terms that they possibly can.

My second point -- general point -- is that the proposed rule will impose additional costs on health plans and at the same time disrupt the system rather than add benefit to the system. As I just noted, we believe -- and we can answer questions on this as we go forward -- that the current system works well, that plan sponsors are able to access exactly the kind of information they need when they need it from their service providers.

The breadth of the language in the proposed rule -- and you've had a couple of examples just addressed here -- and the inapplicability of certain sections to health and welfare plans will impose unnecessary and sometimes costly administrative burdens on our members, on the health insurance plans, which service these ERISA plans. And those costs are ultimately going to be passed on to plan sponsors.

We're very concerned that the information required here would require plan fiduciaries to demand reams of information from their service providers because of the penalties, and for our plans to submit that information -- even information that the service providers do not need or want -- and that the result will be there will be a sea of

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information with no benefit down the road here.

One quick example -- and we go into detail on this -- is the application of the proposed rule to the insurance products. We feel that that's absolutely unnecessary. There's full risk out there already on the insured products.

Secondly, as you all know in the McCarran-Ferguson Act, those products are heavily regulated by state insurance departments, which by the way have inconsistent and conflicting rules already that many of our insured members have to deal with on a day-to-day basis. This would add an additional unnecessary layer of regulation and rules.

Long and short of it -- it's telling me to sum up here -- we support the principle of transparency, but we'd like you this Panel to do three specific things here.

Number one, determine whether

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specific issues exist with respect to the adequacy of disclosures made to health and welfare plan fiduciaries.

Number two, determine whether there are gaps in existing requirements. And I'm particularly referring to ERISA disclosure requirements such as the Form 5500.

And number three -- and here's the key and the difficult question -- how meaningful transparency of material information useful to those plan sponsors can best be provided to them without, at the same time, requiring disclosure of competitively sensitive information that will just raise costs for all.

Thanks very much.

CHAIRMAN CAMPBELL: Let's start on this side.

MS. WIELOBOB: Okay. I guess this is something you might be better equipped to answer -- or maybe both of you.

How often are the policies

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renegotiated or the contracts -- typically?

MR. KOWALSKI: I think it depends on the employer or the plan sponsor.

Typically, in the national accounts self-funded marketplace, which is the marketplace at Aetna that I'm employed in in addressing, it can vary anywhere from three years, five years. Many of the contracts are evergreen so that if the plan sponsor is satisfied with the terms of the contract -- if it's meeting their needs -- what ends up happening every year is a renegotiation over the fees and a renegotiation over things like the performance guarantees. So the basic terms of the contract remain.

They can be amended if necessary -- an addition of services, a change in the way a particular service is provided. But I would say on average, large plan sponsors don't go in every year. It's multi-year contracting.

MS. KANWIT: But there's

consistent give and take. Am I right?

MR. KOWALSKI: Yes.

MS. KANWIT: Between the plan sponsor and Aetna, say, in a self-funded context?

MS. WIELOBOB: In what sense give and take?

MR. KOWALSKI: Well again, every year at the time of fee negotiation, there may be inquiry around a particular product. There's an audit -- typically a claim audit -- every year, every couple of years. There may be an implementation audit at the beginning of the process. So there's inquiry around overpayments to the extent that if there's overpayment made, there's an investigation and a discussion with the plan sponsors.

Plan sponsors are also examining other aspects of the services with their consultants. Again in the national accounts arena, most plan sponsors have multiple consultants who are also advocating their interests.

So the give and take is ongoing. The contracting process is more formalized on a plan-year basis.

MS. WIELOBOB: Well, today we talked a lot about negotiation on the part of plan fiduciaries. What do we really mean? Most contracts these days seem to me to be contracts of adhesion. You're talking about plan fiduciaries' ability to negotiate. What are they able to do? How deep does it go?

MR. KOWALSKI: You mean adhesion on the part of the plan sponsor, or the TPA?

MS. WIELOBOB: The TPA.

MR. KOWALSKI: I would disagree with that statement. I think quite frankly it's a very -- at least again in the large national accounts arena -- at Aetna defined as 3,000 lives or more, multiple jurisdictions -- it's a very sophisticated marketplace. And quite honestly, I think the business people -- if you have business people from the industry here -- might view it as a contract of adhesion in the other direction.

MS. WIELOBOB: Direction? Yes.

MR. KOWALSKI: It is a robust marketplace. The demands that plan sponsors place on TPAs for individualized, unique arrangements specific to that particular plan sponsor -- fee concessions.

MS. WIELOBOB: So it's all on the table?

MR. KOWALSKI: It's all negotiable.

MS. WIELOBOB: Okay. I'll have to switch gears for a moment.

On disclosure and education, one of the things in your written comments you suggest that perhaps there are alternative means by which the Department could pursue educating plan fiduciaries -- getting them information to assist their decision making. And I asked this question earlier this morning to another witness.

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One of the things that you cite to is the 5500. Now some might say that's after-the-fact information. That's not really going to be useful to fiduciaries. Can you react to that notion?

MR. KOWALSKI: I'd make maybe a tangential comment, but I think it ultimately gets to your point.

The way the draft regs can be interpreted today is to say that every service provider is required to disclose all of its relationships -- its potential conflicts -- whatever term, both of them bandied about today -- with all of the other service providers that may be serving a particular plan sponsor, as well as all of its subcontractors and third parties. And this may go to your point as to how this marketplace is unique from other service providers.

And like everyone else on this side of the industry, I can't speak to the

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specifics of the pension industry or the finance industry, but what I can tell you is the modern health benefits industry requires a significant cast of players to provide health benefits.

And yesterday on the computer I just sat down and started to type out in an average national account how many different types of plan service providers there might be. And I came up with a list of 20, which I can read you if you like -- everything from a managed care, product provider, fully-insured indemnity plan, insured PPO product purveyor, an HRA, an HSA, consumer-directed health plan, administrator in the executive med program, a med sup plan, a pharmacy benefit, a stop-loss policy, a subrogation vendor. It goes on and on. The way the regs are drafted today, you could argue that Aetna would be responsible and some poor plan sponsor -- particularly a less sophisticated plan sponsor -- would be responsible for reviewing all of those relationships with all of those parties and all of their subcontractors, and trying to determine if there is an actionable conflict of interest there.

So I know the Department had said in the draft regulations that they anticipated 1,018,000 service contracts would be impacted by the regulations. I think that was part of the evaluation of the impact. If that's the case, and if you're looking at, for example, this hypothetical plan sponsor who's got 20 service providers on the health care side of their benefits administration, and those 20 vendors -- or those 20 contracts -- those 20 services are all out to bid say to three competitors, you now have 60 parties who may feel the need to submit lists of all of their subcontractors and their vendors and their relationships with each other as part of an RFP, for example. It can be a massive amount of information, and as some of the other witnesses had indicated, potentially a massive

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amount of information that's not necessarily relevant to the determination of whether or not this is a reasonable agreement that's being entered into.

So I think one way that this industry may be unique is that it is multi-faceted to a fair degree. And there are a significant number of players involved in providing basic health care services today. And I think if you do move forward with the regulations, you've got to find a way unique to the health benefits industry to eliminate that deluge of information because your 1,000,000 contracts -- your 1,018,000 contracts in the draft regulations can -- if everyone's got 20 different contracts being put out to bid to three vendors for each contract, you end up with 600 million pages of information. Is that really what you want in this industry?

And I think -- do you want my suggestion, for what it's worth? If you clarify that whatever documentation, whatever information is required to be provided, post-award of the business, but prior to signing the contract, you then winnow down that massive deluge of information to one service provider's submission -- one service provider's disclosure. And it becomes the last step in due diligence as opposed to what may be a pro forma piece of an RFP.

I have to tell you, last week I received an RFP -- Aetna receive an RFP -- from a large national company -- international company -- in which in the RFP they cut and pasted part of your proposed rule around conflicts of interest. Now at some level, that's terrific. They're aware of what's going on. But that may be the canary in the coal mine. That may be an indication that every RFP is going to contain this information because plan sponsors are going to be afraid that if they don't do that, the DOL will find them out of compliance. And that just starts this massive wall of paper.

MS. WIELOBOB: Okay. I have one more quick question, and I hope we have time for it.

We've heard health and welfare folks today -- and others -- but really I'm focused on you all -- deferring to state regulators. Transparency is there because we're already subject to regulations. Someone else is doing it.

What is that accomplishing? And I really am asking. I just don't know. What is that accomplishing if your plan fiduciary -- what transparency through that means? I mean, the way it's been talked about is if it's meeting our interests in this regulation but just in a different way, how is it doing that?

MS. KANWIT: What we're saying is we don't really have a choice in complying with that -- that the state regulators are very jealous of their prerogatives. How do I put this? The NAIC monitors it carefully.

That many states have exhaustive requirements about how, when and where you disclose A, B, C and D.

MS. WIELOBOB: So they're regulating how plan fiduciaries get --

MS. KANWIT: They're regulating insured ERISA products. Yes.

MS. WIELOBOB: And information getting to fiduciaries?

MS. KANWIT: And information on -- and it fits in with the concept of what is the business of insurance within the meaning of the McCarran-Ferguson Act. They've been extremely aggressive.

Right now we're dealing with the issue of discretionary clauses. How much does a state have a right to even discuss what the measure is when an issue comes to the court system? So the states are inching into areas that some of us would argue are the Department of Labor's responsibility.

But what we don't want to have to

deal with in the health insurance industry with 1300 of our members is figuring the how, what and where, and have an additional layer of duplicative and perhaps unnecessary "disclosure regulations" imposed on us when we already have the state regulators to deal with. As Bill can attest, it's a problem.

MS. WIELOBOB: Thank you.

MS. ZARENKO: I just have one question.

A lot of the discussion on the health and welfare side today has focused on the contractor arrangement between the service provider and the plans. But I'm just wondering, apart from that flow of information and all the paper we're talking about and the information that has to be disclosed and the questions about what exactly is required to be disclosed, does anything about the proposed rule if it was finalized as it is go so far, in your opinion, to actually affect the way services will be provided in the future, or affect the way benefits, participants and beneficiaries will be provided?

MS. KANWIT: We'd be guessing. Right, Bill?

MR. KOWALSKI: Obviously, there's the issue of costs.

And again, looking to the proposed regulations in the December 13 Federal Register, there's some reference to the Department's assumption that for plans this would take a half an hour of service for a certain segment of the plans to update their disclosure information. And for those larger TPAs making in excess of $1,000,000 a year, there was another calculation of an hour of time or something to that effect. I may be having the dollar amounts wrong. I'm not citing them precisely. But I can tell you it was vastly, vastly underestimated as to what would be required to implement these regs if they're promulgated and applied to the health insurance industry.

I can just tell you the amount of time we've already spent in analyzing this, talking to our business people, talking to the trade associations, probably exceeds the estimates of the Department in those draft regs.

So this type of information, with this many participants, and then the allocation -- the determination of an accurate allocation of costs that are at this point potentially across the book of business, applied, calculated down to the specific plan sponsor for thousands of plan sponsors with potentially hundreds of different vendors who each have their own stables of subcontractors is extremely difficult -- verging on impossible -- to do with precision the way it's drafted today. The burden I think is too onerous on this particular type of industry. They're just too many players, and too much detail would be required.

MS. ZARENKO: Okay. Otherwise

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since the proposal came out you haven't been hearing from other associations or members -- providers going back and saying wow, this is just going to change the way I do business, or this is going to change the way that we deal with plans apart from what has to be in our contract and how that has to be --

MS. KANWIT: No, but we've heard mostly negative comments from everybody. They basically want to be left alone to have the flexibility they have now to make the disclosures that the customers -- the plan sponsors -- want made. The plan sponsors have enormous power in this particular marketplace and can call the shots -- can get this kind of information if they need it, including, as I mentioned in my testimony, proprietary information at least in selected areas.

For example, for an audit, Aetna and many of the health plans will give them selected proprietary information. So their auditors at KPMG, for example, can ascertain if exactly the terms of the contracts are being met.

Am I correct, Bill?

MR. KOWALSKI: This is on the provider contracts?

MS. KANWIT: Yes.

MR. KOWALSKI: Right.

MS. KANWIT: Yes.

MR. KOWALSKI: Yes, I just think you need to do an industry specific cost benefit analysis because I think the onus of compliance both by us and by the plan sponsor in this particular industry may be greater just because of the way the industry is structured than it is on the pension side. You've got to do that comparison because we don't know the pension industry.

But it seems to me, again from the list of parties who would be involved, it's a massive amount of information that would have to be digested, disseminated, and then re-digested by the plan sponsor for fear that they might miss something.

And maybe one point more on that, the unanticipated consequence of being deluged with that information may be leading a plan sponsor unintentionally to just choose the service provider with the smallest amount of information that they are disseminating as part of their disclosure, because it's the path of least resistance or it appears they have less potential conflicts. And that may be entirely the opposite case in a given situation. So you may be motivating plan sponsors to make the wrong decision in an attempt to have fulsome or too fulsome disclosure, and just motivating them to choose the easiest document to digest.

MS. DWYER: I have no questions.

CHAIRMAN CAMPBELL: I just want to say it's not the position of the Department of Labor that your contracts are contracts of adhesion.

MR. KOWALSKI: Okay. I'm glad to

hear that.

MS. KANWIT: Thank you.

(Laughter.)

MR. CAMPAGNA: My question is two parts.

How do plan sponsors and fiduciaries become aware of particular plans that may be available to them? Do they get those through brokers or otherwise? And do any of these plans have any particular arrangements with the brokers regarding who is going to be recommended to a particular plan? And could you tell me a little bit about that?

MS. KANWIT: Bill?

MR. KOWALSKI: I know that that was a topic of investigation from various attorneys general over the past few years -- around potential marketing abuses. And for the record, I think we've come through that without problem. But I can't speak to what other plans do.

Generally, I can tell you that most large plan sponsors hire consultants -- the Hewitts, the Mercers of the world -- who, as Stephanie was saying earlier, submit RFPs, R5s, RFPs and put them out in the marketplace, and plans provide responses to that. And as Stephanie indicated, they're massive documents. They go into not just rates, but services, geographic areas of coverage, plan designs, options, et cetera.

So how a particular plan broker determines which TPAs to provide the service to, I can't speak to that specifically, but I can tell you that from what I know, it's a marketplace that benefits the plan sponsor with more competitors. So the more TPAs that know about a particular RFP -- and we want to know about those RFPs so that we can place the business or try to place the business -- the more favorable the result typically for the plan sponsor.

But as a general rule, brokers

represent plan sponsors. They're retained by, paid for by the self-funded plans. Agents represent and work on commissions mostly for fully insured products -- work for the insurance companies.

MR. CAMPAGNA: Are you aware of any types of arrangements between the brokers and the plans so that they're maybe first on the platform or first to be recommended in the particular menu that's being offered to the plan?

MR. KOWALSKI: I'm not.

MS. KANWIT: I'm not either.

MR. CAMPAGNA: Okay. Thank you.

MR. BUTIKOFER: So you mentioned information upon request. Is there certain information that's normally put in that information upon request? What is it? And then who is it that's typically accessing this additional information? Is it these large plans that are on top of things? Or is it information that these smaller fiduciaries are trying to access as well?

MR. KOWALSKI: I guess I would say virtually any information is available. And we get a myriad of requests for information from plan sponsors from every aspect of the plan's operation.

To Stephanie's point, I think most plans are particularly sensitive around sharing their network negotiated rates with their providers for obvious reasons. That's what we compete with our competitors with primarily -- our network discounts.

I would say larger plans are more sophisticated than smaller plans in terms of what they ask. I would also say they can afford to analyze and pay for consultants to analyze a greater amount of information -- a greater depth of information.

So like your SPD regulations, you potentially have got the opportunity or the obligation -- however you see it -- to structure any disclosure requirements to suit the sophistication of the particular market because the information available -- to use a prior statement's example -- the sophistication of an IDM is going to be greater than of 100-person machine shop. And so to the extent that we inundate the IDMs with a massive disclosure, you can be sure we're going to inundate the machine shop if that's what's mandated.

MS. KANWIT: But if their accountants -- the machine shop's accountants came to you, Bill, on the product and said we need X, Y and Z, there's no reason not to release it.

And the difference between that and the questions that were asked about proprietary information is that oftentimes that information -- for example in an audit -- is given subject to confidentiality strictures. So Aetna would only give pieces of that information to company A, but sufficient for company A's accountants to understand how the product was priced and where the money went and how -- so that they could audit and do their due diligence, but at the same time not violate what we keep talking about which is this proprietary information problem.

MR. BUTIKOFER: We've talked about that these large plans can take care of themselves. But is there any kind of educational -- I guess you could say information -- that you're passing to these small plan fiduciaries that provides helpful information to them in trying to understand this information being given?

MR. KOWALSKI: I'd say most medium-size plants -- for lack of a better term -- also use brokers. They also buy less pedestrian plans. So the wellness benefits, the top-hat plan, the MEDSA plan, may not be something that's affordable by a medium-sized or a smaller sized plan sponsor fiduciary. So by definition, they're going to be buying the less sophisticated product with less bells and whistles and I think less information potentially that needs to be provided.

But I think our marketing folks would be more than happy to give a plan sponsor anything that they're looking for in an attempt to sell them on the Aetna product.

MR. BUTIKOFER: All right. You also had a list of your 20 service providers. Is that typical, or is that kind of an extreme end?

MR. KOWALSKI: I'd say it's typical for again this segment of the marketplace -- the larger national account plan sponsors.

And you may have variation. There may be multiple services here provided by one TPA. You may have every service provided by a different TPA. It will vary. There may be three bidders per service contract. There may be 15 bidders per contract. It varies, but I would say it's not an extreme example in this

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marketplace.

MR. BUTIKOFER: Thanks.

CHAIRMAN CAMPBELL: All right. Well, thank you very much. We will take our break now. We'll probably be back around 10 to 3:00. It'll give us time while still keeping us close to being on schedule. Thank you.

(Whereupon, the above-entitled matter went off the record at 2:37 p.m. and resumed at 2:51 p.m.)

MR. WILLIAMS: We're going to start.

Before we introduce the next speaker, let me just announce a point of procedure. If anybody has written testimony, could you make sure I get a copy so that we can have it all in one place? Thank you.

MR. CAMPAGNA: Next person to testify -- Self-Insurance Institute of America.

MR. GILLIHAN: Good afternoon.

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MR. CAMPAGNA: Thank you.

MR. GILLIHAN: My name is Ashley Gillihan. I'm here on behalf of the Self-Insurance Institute of America obviously to submit comments on the proposed compensation and fee disclosure regulations.

I want to first thank you for being receptive to allow us to come here today and to make those comments.

Let me first give you a quick overview of the Self-Insurance Institute of America so that you can better understand our audience.

Self-Insurance Institute of America is the only national association dedicated exclusively to protecting and promoting the self-insurance and alternative risk transfer industry such as stop-loss. Since its founding in 1981, the Association has grown significantly and now includes members from across the nation and several countries around the world.

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Major membership constituencies include self-insured employers, group self-insured workers compensation funds, third-party administrators, managing general underwriters, excess stop-loss insurance cares, and a variety of other companies that are involved in self-insurance in the alternative risk transfer business.

First let me say that our members generally view the proposed regs as consistent with their interpretation of the statutory requirements, as well as the preceding regulations. But in response to the request for comments, we are here today to express a desire for additional clarification, in particular regarding the application of the rules relating to compensation received by individuals who assist plans and plan sponsors with the placement or purchase of insurance, such as insurance agents and brokers.

It is our view that in order for plan fiduciaries to make informed decisions to

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best protect plan participants, it is important that the playing field between providers of self-insured plans and providers of fully insured plans have a level playing field.

As you know, an insurance broker or an agent to a fully-insured plan will often receive his or her compensation in the form of commissions from an insurance carrier. Those commissions are typically a percentage of the premiums that are paid by the plan or plan sponsor to the insurance carrier, but oftentimes they are a volume of overall sales of that particular carrier's insurance product or just an overall sales closed by the service provider. We often refer to those as contingent commissions.

Historically, disclosure of commissions regardless of how characterized -- whether they're characterized as contingent commissions, specific sale commissions which are the percentage of premiums paid to the plan -- has been problematic. Anecdotal evidence from our members has suggested that disclosure is still somewhat problematic.

For example, contingent commissions were the focus of the Department's Advisory Opinion 2005-02A, in which the Department clarified -- as you know -- that the portion of any contingent commissions earned by a broker or agent that are attributable to a plan must be reported on the plan's Form 5500 Schedule A.

While it seems clear to Self-Insurance Institute of America and its members that the Department does not intend to include premiums paid to an insurance carrier in the definition of compensation and fees that are subject to these regulations, we do believe it is the intent of the Department to require individuals such as insurance brokers and agents or any other individuals who assist plans and plan sponsors with the purchase of insurance that they disclose any and all compensation related to the placement or purchase of that insurance. Nevertheless, despite the breadth of the regs, we have some concerns that the current language does not effectively convey this intent for the reasons that I will discuss in a moment.

Consequently, we respectively request that the Department consider to attach the proposals that we've submitted to the proposed regulations that we believe will clarify that intent and further solidify those who assist with the placement of insurance or purchase of insurance are also subject to these regulations. And again, let me reiterate, our concern is that plan fiduciaries and that plan participants be protected by being able to make a reasonably informed decision by having all the information.

As you know, the definition of compensation and fees set forth in the regs is very broad, and would seem to encompass any and all compensation received by a service provider with respect to the services it provides for the plan or plan sponsor. There does not appear to be a distinction or any differential treatment for self-insured versus fully-insured plan service providers.

Although broad in scope, the proposed regulations do not identify specific types of compensation other than to identify certain types of non-monetary compensation. As many of us do in that situation, we often look to the preamble for clarification. And there is in particular one particular statement that we believe may result in an erroneous conclusion or misconstruing the interpretation of the Department.

In the preamble, the Department notes that "The purchase of insurance is not in and of itself compensation to a service provider for purposes of these regulations." We fear that such a statement may lead service providers of fully-insured plans to

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erroneously conclude or misconstrue the regs such that compensation received by individuals who assist in the placement of insurance and who receive these fees from insurance carriers or other third parties will not disclose that compensation.

Similarly, we fear that service providers of fully-insured plans may view contingent commissions -- those that are based on the volume of sales for a particular insurance carrier -- they may view those payments as made as a result of the service provider's relationship to the carrier, and not with respect to its relationship to the plan.

Last, we also have concerns that plan fiduciaries who engage individuals to assist in the placement of fully-insured products or fully-insured and self-insured administration will be unable to identify any conflicts of interest unless such individuals are required to disclose not only the

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compensation they will actually receive with respect to the insurance contract chosen but also the compensation that they would have received if the other insurance products brought to the plan fiduciary would have been chosen.

Again, we believe that these issues can be resolved by revising the definition of compensation and fees as we have set forth in the attached exhibit that we previously provided.

On behalf of the Self-Insurance Institute of America, I would like to thank you for allowing me this opportunity today. And I'll open it up for questions.

CHAIRMAN CAMPBELL: Great. Let's start down there.

MR. CAMPAGNA: I'm just trying to understand your comment regarding the purchase of insurance, and why you find that confusing. Is it that we don't make a distinction between the payment of premiums associated with the purchase of insurance versus the brokerage commissions that would be received in connection with the purchase of that insurance? Is that kind of the issue that you see?

MR. GILLIHAN: Well, I think that's part of it. I don't think that distinction is made in the preamble or in the proposed regulations.

But if you look at it, it's a fairly broad statement. I know you guys know what it is. We do not believe that the purchase of insurance is not in and of itself compensation to the service provider. And our fear is that that is a fairly broad statement and will allow service providers of fully-insured plans to construe any payment that they receive that's related to the purchase of insurance as being outside of these regulations. And without that distinction in the preamble, we feel that that further supports their argument that it would not be included.

MR. CAMPAGNA: So you do see a distinction between a broker selling the insurance product and the provider of insurance providing insurance?

MR. GILLIHAN: Yes.

MR. CAMPAGNA: So that the broker is a separate service provider in your mind who should be disclosing the commissions that they receive as well as anything else they receive from the carrier such as these contingent commissions?

MR. GILLIHAN: That's correct.

MR. CAMPAGNA: Okay. Could you go into that a little bit more about what other potential payments that that broker may be receiving in connection with the purchase of insurance so that we can make sure that we would capture that idea?

MR. GILLIHAN: Sure. Sure.

There are bonuses that are often based not only on the volume of sales of a

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particular insurance contract, but you might also have bonuses related to the purchase of a contract by a particular entity. For example, in a small area, you may have the purchase of insurance by a major hospital in that area for its employees. And that might result in a bonus, obviously the contingent commissions that are the volume sales.

Just for clarification, when I say contingent commissions, what I mean by that are those commissions that would be paid to me. Say I was selling insurance carrier X's policy, and I sold X amount during the year -- or over X amount. Then I might receive an additional commission because I sold over X amount of volume commission.

The other, the most simple one, is a specific sale commission. That's a straight commission that is a percentage of the premiums paid to the plan.

And if you've not reviewed the language then, I'd be glad to go over that here. The language that we've suggested would result in the disclosure of any compensation received that's directly or indirectly related to the purchase of insurance.

MR. CAMPAGNA: Now, are you aware of any other types of payments that brokers may receive in connection with sales of insurance? Anything other than commissions, any to be on the platform say of a particular broker and their recommendations to a plan? Is there anything else that we should be aware of?

MR. GILLIHAN: Well, and actually some of these were addressed in 2005-02A. Oftentimes you have someone who manages an agency and they might receive service fees or some type of managing fee for managing that agency. And if you recall from that Advisory Opinion, those were not considered to be commissions and not includable on the Schedule **A.**

Outside of those general

categories that I provided to you, I'm not aware of any other general categories. They may be characterized differently. But I think those categories encompass most of the compensation.

MR. CAMPAGNA: In connection with the provision of insurance itself, how would you draw the line between what is actually being provided under the policy and services that may be provided to a particular plan such as participant communication information regarding the policies -- those kinds of things? Would you draw that distinction? How would you kind of set that up?

MR. GILLIHAN: Well, let me step back even a step further if you don't mind.

I view that statement in the preamble, and perhaps I've misconstrued it maybe, or members have misconstrued it, as referring to the premiums and only the premiums that a plan sponsor or plan might pay to an insurance carrier. And so it seems to me that we would not be including that in the definition of compensation and fees.

However, anything else paid by an insurance carrier or through a third party to an individual that relates to the purchase of that insurance should be disclosed. So I wouldn't draw the line in terms of -- perhaps the line is drawn between whether the insurance carrier provides it itself, or perhaps that might be where it's viewed where the insurance carrier provides those services itself as a result of that premium, or whether it's paid to an independent third party. I believe the idea that we had in mind when we submitted these comments were the independent agents and brokers that receive something from the insurance carrier.

MR. CAMPAGNA: Okay. Thank you.

MR. WILLIAMS: So are these disclosures currently being made -- the ones that you're proposing? You seemed enthusiastic about it. I'm just curious.

MR. GILLIHAN: I'm just a hyper guy.

The anecdotal evidence -- and I'll leave it at that -- from our members suggests that they are not being disclosed. I do not have statistics to give to you today. And I do not have personal observation of that. I just know that our members who are out in the field issuing self-insured administrative services-only agreements, the anecdotal evidence they've provided to us is that they're not being disclosed.

MR. WILLIAMS: So you favor more disclosure than is currently being provided in the interests of --

MR. GILLIHAN: I favor more disclosure than what is being provided in the market today consistent with what you've put in the proposed regs. Yes.

MR. WILLIAMS: In many cases, you're talking about agents who are not fiduciaries. I take it they're service providers?

MR. GILLIHAN: That's correct.

MR. WILLIAMS: Okay. Thank you.

CHAIRMAN CAMPBELL: Were you here for the previous series of testimony from some of the other groups addressing welfare plan?

MR. GILLIHAN: I was here for the last about an hour and a half.

CHAIRMAN CAMPBELL: Okay. I was just wondering if you might have a reaction to some of the testimony we heard previously regarding the burden that the regulation might present to welfare plans and whether the welfare plan area is suited for this regulation.

MR. GILLIHAN: I think that health and welfare plans often do not -- they're not funded plans. And therefore, you don't have the direct correlation between plan assets being used to pay service provider fees in the same manner that you do with pension plans. Pension plans almost all -- all are funded through a trust. Plan assets from the trust are used to administrative fees. You don't have that as often. Rarely do you have that in the health and welfare field.

I think that makes it perhaps more difficult for health and welfare plans. Obviously these regs are not limited to payments that directly correlate with plan assets. But I do think that could put an additional burden on health and welfare plans to have to disclose those fees or have to deal with those fees when oftentimes they're coming straight from the plan sponsor.

So do I think it could add additional burden? Yes. How significant is that burden? I don't know. We've spent several of those last few years advising clients to disclose compensation when it was received by them with respect to services provided by the plan. So I think it can be done obviously. But yes, I do think health and welfare plans may have a greater burden than pension plans.

MS. DWYER: But following up on Mr. Campbell's question, do you see any regulation with regard to health and welfare plans?

MR. GILLIHAN: Do I see any regulation?

MS. DWYER: Yes. Do you see a need for regulation? You've given us a revision that you would propose in the regulation, but would you prefer we just don't do the regulation for health and welfare plans, or just delay it? What is it that you want?

MR. GILLIHAN: Well, I would have a lot less work to do if we didn't have it on the health and welfare side. That doesn't count for anything I'm sure.

But I think I see a general need for that. Sure.

MS. DWYER: I guess my question would be better put saying do you think there's adequate transparency in the health and welfare arena at the moment? Obviously you've given the one piece that you don't think is transparent. But what about other areas?

MR. GILLIHAN: Other than this one piece, I think you have a lot less indirect compensation than what you have on the retirement plan side. And that would go back to Mr. Campbell's comment and when I talked about the pension plans. Those pension plans are funded through a trust. Those trust funds are invested. You get the investment fees. You don't have that in the health and welfare arena.

Oftentimes, it's a direct payment from a plan sponsor and the plan sponsor's general assets to the service provider, and you have less of the indirect compensation. And I view these regulations as being at least slanted toward the indirect compensation that's received. I think that's a fair

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statement. And I think you have less than that in the health and welfare world.

So is there a need for these types of regulations for the health and welfare plans? Conceptually, yes. Less of a need? Yes.

MS. DWYER: Thank you.

CHAIRMAN CAMPBELL: Just to follow up one more time.

So unlike some of the other witnesses, your view is is not that it ain't broke, so don't fix it, but it might be just slightly bent? Is that kind of where you're --

MR. GILLIHAN: Slightly what?

(Laughter.)

CHAIRMAN CAMPBELL: Putting in a slightly colloquial way, you're saying it's slight bent, but not broken?

MR. GILLIHAN: Yes. Correct.

CHAIRMAN CAMPBELL: Okay.

MS. WIELOBOB: All right. My

questions kind of go to the practicalities of -- I'm sorry. She's passed. She didn't tell you that. But she told me she didn't have any questions.

MR. GILLIHAN: That's okay. I was going to stare at her until you --

MS. WIELOBOB: Until I got the point?

(Laughter.)

MS. WIELOBOB: Reporting these compensation arrangements or commissions. I understand that the commission paid to -- and I understand your position. You just want the level playing field for self-insureds and you think that this modification to their clarification that the definition of compensation would capture some compensation that the fully-insureds get. Is that correct?

MR. GILLIHAN: Correct. Can I tweak that slightly?

MS. WIELOBOB: Sure.

MR. GILLIHAN: It is a level

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playing field. But it's in an effort to ensure that the plan fiduciaries have all of the information that they need.

Our concern is not so much for the self-insurers -- I mean, these clearly apply to self-insured --

MS. WIELOBOB: Right.

MR. GILLIHAN: -- service providers. If they're making the disclosure about the compensation fees they're receiving -- both direct and indirect -- and it's not happening on the fully-insured side because they're able to take advantage of a somewhat ambiguous provision in the preamble, then they don't have all the information that they need to make an informed decision.

MS. WIELOBOB: Okay. So as a practical matter, I understand that some commissions are maybe always, sometimes based on what the premiums ultimately are and then the take-up rates. Is that right? Some can be, or some form of overcompensation?

MR. GILLIHAN: I think it varies. Sure.

MS. WIELOBOB: Okay. So that varies.

MR. GILLIHAN: The standard is a percentage of the premiums paid to the plan and then there are variations from that.

MS. WIELOBOB: Okay.

MR. GILLIHAN: Resulting in contingent or volume-type commissions is, I would say, the end of the reins on that in bonuses and what have you.

MS. WIELOBOB: So how would those be made known to a plan fiduciary in a meaningful way in that they are really after the fact? Some commenters say we realize that contingent commissions are after the fact. Really we would recommend that incentive compensation is disclosed categorically just to let plan fiduciaries know --

MR. GILLIHAN: In other words, you mean that we get contingent commissions and

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that would be it?

MS. WIELOBOB: And this is the base for it. I mean, would that --

MR. GILLIHAN: Not to I guess sound like I'm brown-nosing -- for lack of a better legal term -- but you guys did give a nice provision for formulas when you don't know the amount in advance. And I think that these types of -- the specific sale commissions, obviously that's just a percentage at the bottom-line.

As you go up, I don't know that it's any more difficult to provide a formula for the variations from what I would call specific sale -- the variations up from that. And then it is for any of these other situations on the pension side for investment fees or 401(k) fees, or any of those where it's fairly complicated where I have to provide something in advance -- a formula in advance. It gives you some idea, I think, that it can be done here as well just as

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practically.

MS. WIELOBOB: One of the arguments you see is that wouldn't just be meaningful because it's just a formula. It's not a hard and fast number. But you're saying that that would be possible?

MR. GILLIHAN: Yes. I think it would be. I think it would be possible to make that a meaningful disclosure. It all depends on obviously how this ends up in the final regs and whether there's any more detail required when you provide a formula.

But the regs currently say a formula has to be provided that will allow the plan fiduciary within some reasonable certainty to determine whether those fees are reasonable or not.

And to be honest with you, I think almost any disclosure of -- not just contingent commissions, but anything that might give me some idea about what that's going to be -- would be meaningful.

MS. WIELOBOB: Thank you.

CHAIRMAN CAMPBELL: All right. Thank you very much.

MR. GILLIHAN: Thank you.

CHAIRMAN CAMPBELL: And next up is the Chamber of Commerce.

MR. JOHNSON: Well, unlike the prior speaker, we're glad to brown-nose any time.

(Laughter.)

MR. JOHNSON: Well, thank you for the opportunity to testify before you today.

I am Randy Johnson. I'm Vice President of Labor, Immigration and Employee Benefits for the U.S. Chamber. And I'm accompanied by Aliya Wong who is the true expert in this area but is the pension policy for the Chamber.

And we appreciate the concern for greater transparency and plan fees and the effort to address these concerns embodied in the regulation. And we support full

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transparency up to the level of what's practical. And of course, like everyone else who's testified today, we know there's a difficult balance to be struck between full disclosure and what plan sponsors and providers can actually do in the real world.

Now we have submitted comments with a variety of other groups for the record. And we all realize I think as other ones have noticed, as more workers become dependent on individual account plans for retirement, it obviously becomes increasingly important to provide participants with information that would allow them to make well informed decisions.

Just as importantly, employers must be aware of fees associated with the plans they're sponsoring in order to fulfill their fiduciary duties. But given the very complicated nature of plan fee arrangements -- and they become more complicated the more I dig into this reg and talk to Aliya and our

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members -- it's not a simple task obviously to discern what information and what format will prove most meaningful to either employers or participants.

And so, in our view it's going to take more input and dialogue from all these different parties and experts. And as such, our primary recommendation today is that EBSA gather further information to respond to questions and concerns that were made.

I want to emphasize here that while we appreciate this hearing and we appreciate all the work that's gone prior to this hearing with the ERISA Advisory Council going back to 2004 and this opportunity to submit comments, we do sincerely believe that the process would be immeasurably helped if the Agency would hold more informal round table-like discussions with those to be governed by this regulation.

Comments in hearings are useful, but certainly at least in my experience as the

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Special Assistant for Regulatory Affairs here at the Department of Labor back in the mid-80s and other employment, there is much to be gained and much to be learned by the regulators in really a more informal give-and-take about what are the real world problems that those who are to be regulated face when attempting to comply with a new government mandate.

Now let me emphasize to you that contrary to what many may think, the Administrative Procedure Act does not prohibit these kinds of informal gatherings. And of course, ERISA provides for informal rule making under Section 505 as distinguished from formal adjudications or formal rule makings.

Now forums need not be public such as this, nor everyone involved be invited to every meeting and every discussion. The Agency has broad discretion to structure these meetings to gather input as it sees fit. Indeed the courts have not just allowed these

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kinds of meetings to occur, but they've in fact encouraged them. And in the case of Sierra Club v. Costle, the court noted by reversing the earlier Home Box Office decision which went the wrong way on this APA issue, it noted that ex parte communications could be considered in many instances to be beneficial when an agency issues a proposed rule.

I do want to take one second here to quote from the court. "Oral face-to-face discussions are not prohibited anywhere, anytime in the Act. Under our system of government, the very legitimacy of general policy making performed by unelected administrators depends in no small part upon the openness, accessibility, and amenability of these officials" -- you guys -- "to the needs and ideas of the public from which their ultimate authority derives, and upon whom their commands must fall." That would be us. "Informal contacts may enable the agency to win support for its program, reduce future enforcement requirements by helping those regulated to anticipate and shape their plans for the future and spur their provision for information which the agency needs." And that's of course out of the D.C. Circuit.

In the same vein, let me just quote from a recent analysis from an expert in the area, which I'll be glad to submit for the record. "Thus the APA prohibits ex parte communications in only two types of proceedings: formal adjudications and formal rulemakings. The APA does not, however, extend that ban to informal adjudications or informal rulemakings. It would be" -- and I think this is key. "It would be no more appropriate to ban agency decisionmaking from engaging in ex parte communications in informal rulemakings than to ban Members of Congress from engaging in off the record conversations with constituents who are interested in a legislator proposal pending before Congress."

And I think we all know and are familiar with the informal give-and-take that occurs between Members of Congress and their constituents when they come in. And not all parties are represented at those kinds of meetings.

The Employment Standards Administration recently held many in-depth, informal stakeholder meetings in its development of its recently issued proposed family medically-backed regulations. While these meetings occurred prior to issuance of the proposed reg, this model is still useful to consider following here we believe.

And in conclusion, we recommend similar outreach in meetings with plan sponsors, mutual fund companies, third-party administrators, investment management companies, and in-house service providers whether together, separately or at times both and at times separate, to name a few examples. We believe these kinds of meetings will go a long way along with the kinds of forums you're holding today to provide information to you with regard to how a rule can be even more appropriately structured.

I think the summation of that is -- before I turn it over to Aliya -- is that I think we all know that if you close the doors and get behind a table and put pen to paper and you don't let people out of the room for five or six hours, you can get a lot done. That doesn't mean it's closed or it's private or anything wrong is going on. The courts have said that's okay. You still have to issue a rule. It'll still be challenged in court. Well, maybe it won't be challenged in court. You did such a great job.

But this is the kind of give and take I think in my experience -- at least at the Department of Labor -- that you really can get a lot done in addition to these kinds of forums. And so we would recommend, and we've heard it from members who would like that kind of opportunity to come in and meet with you on a more informal basis than I believe they've already had.

With that, I'll turn it over to Aliya who will go into some more substantive issues with regard to the regulation.

MS. WONG: I'd like to talk to you today about some of the things we've mentioned in our written comments that we think would be particularly useful to have as a round table discussion, or these informal conversations with.

As you're aware, we've supported the regulatory process in terms of providing guidance for plan fee disclosure. While statutory changes may later need to be made, we believe that the regulatory process provides a critical opportunity for comment and discussion that cannot be matched in the statutory process. And even with the amount of comment and discussion that has occurred thus far, there still remains significant questions and concerns that our members continue to bring up with us, and that we think need to be addressed by the Agency.

Our written comments suggest that the Department should establish a de minimis amount expressed as a percentage of assets for the reporting of investment-related fees, and a materiality threshold for reporting plan services. The regulation as written could lead to situations that require the disclosure of a large number of service providers that receive compensation as a result of their relationship with a primary service provider.

Informal meetings between service providers and plan sponsors could be used to determine and clarify the appropriate level of disclosure. And this has been brought up by a couple of people earlier today in terms of what level of disclosure needs to be provided.

Our next recommendation involves the manner of the disclosure between service providers and plan sponsors. And again, this is something that other commenters have mentioned during the day and there have been questions about during the hearing today.

In our written comments, we state that we don't believe the provision of disclosures from separate documents from separate sources is adequate for plan sponsors. And we do recommend that, to the extent a service provider is able to obtain information, that they do put that information into one single document. However, we realize that there are serious concerns about that. And here's another area where we think it would be very useful to have a round table or informal meetings between service providers, plan sponsors and with the Agency to really develop the manner of disclosure that would be useful for all parties in this situation.

Finally, we recommend further discussions concerning the term material relationships. And again, this is an issue that we've heard about several times today.

The requirement to disclose material relationships is undefined and the source a significant concern in the retirement plan community. Convening a round table of interested stakeholders to vet concerns and possible solutions would contribute significantly to finding a working solution.

In addition to these specific areas we mention in our written comments, I think there are other areas such as discussing the relationships between mutual funds and the plan itself and the disclosures that may be necessary there. A conversation concerning the disclosures required under the Form 5500 and the disclosures required under this regulation here -- 408(b)(2) -- and whether there are similarities or there are additional issues that need to be addressed, and finally, looking at the make up of the expense ratio and whether or not that provides enough information for a fiduciary to determine if the fees are reasonable.

I think all of you realize these issues have been raised today in various forms, and so we believe give the comments that have been made here today and from talking to our membership, there is good opportunity for parties to come together as Randy has mentioned either separately or together to discuss these issues further and hopefully come up with viable solutions.

On behalf of the U.S. Chamber, Randy and I thank you for the opportunity to provide you with these comments. And we are happy to answer any questions that you may have.

MR. CAMPAGNA: So you do believe there's a need for disclosure to the plan sponsor of some sort. It's just that we should talk more on an informal basis to stakeholders. Is that kind of the general idea?

MS. WONG: Well, of course we support disclosure.

MR. JOHNSON: Well, coming over here I said to Aliya, I said now is the U.S. Chamber supporting a new mandate here? Let me get this straight. And I guess the answer is we are.

We believe there is room for regulatory things in this area and the need for greater disclosure. Where that balance is struck, I --

MS. WONG: And we'd like to point out, one of the parties that we submitted our comments jointly with was the Profit Sharing Council of America that testified earlier this morning. And just to echo their comment that while we do support disclosure, we think it's really important that plan sponsors also get the tools that are necessary to make sure that they can get the information that they need to make this determination and get the information that is put out in regulatory.

MR. CAMPAGNA: An earlier commenter made the statement that it was very

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difficult to come up with this unified form because of all the different types of industries out there. Say insurance is different than mutual funds. So the breakdown of fees -- insurance products are basically inherent in the rate of return as opposed to disclosed separately. Do you see that as an obstacle to this uniformity reform?

MS. WONG: I think that's one of the reasons we encourage the use of a round table or informal discussion. I think when parties come to you one on one, you get one aspect of the conversation as opposed to having a group in the room, and as Randy alluded to, hashing it out all together.

MR. JOHNSON: And we have service providers as members of the Chamber, and we also have plan sponsors. And we tend to get more from the plan sponsors on our employee benefits committee.

But my sense of this issue is if you've got these two parties together in a

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room along with your experts, and there's probably some role in there for groups that represent participants, because obviously there's a separate rulemaking going on for participant disclosure. And you hash out what kind of form is doable that meets -- maybe it's not perfect, but it's the best one we can come up with -- rather than kind of, as Aliya said, going back and forth with these groups separately.

MR. CAMPAGNA: Thank you.

MR. WILLIAMS: Do you have a particular view about where disclosure mandates would best be suited to the current marketplace?

MS. WONG: In terms of a particular --

MR. WILLIAMS: Types of plans.

MS. WONG: In our comments, we did state that we -- as has been stated earlier by other groups -- that we think that particularly this regulation should be applied first to defined contribution plans, that it should be considered in the defined benefit context. And we did not state that it shouldn't be applied, but that it should be given further consideration for defined benefit plans, and that we do think there are issues that need to be addressed as others have mentioned when it comes to health and welfare plans.

Does that answer your question?

MR. WILLIAMS: Yes. So within the context of this regulation, or in some separate proceeding, do you have a view on that?

MS. WONG: We made the comments in the context of this particular regulation.

From our membership, I think there was general surprise that the regulation extended to health and welfare plans. There wasn't the sense that there needed to be a regulatory discussion about disclosures there.

MR. WILLIAMS: Okay. So you see

the most immediate need as being in the defined contribution plan arena. And I would assume with the indirect compensation where there is less disclosure than the direct compensation?

MS. WONG: Right.

MR. WILLIAMS: And if you could summarize your particular approach to the indirect compensation of method, you're saying it would be better if you could have it all in one place, in one document that would be understandable to the plan fiduciaries of say a small business?

MS. WONG: Right. Our concern is that the disclosures that are required for plan sponsors to look over be helpful for all plan sponsors regardless of their level of sophistication.

And again, as others have mentioned, particularly for the small- and medium-sized employers, we don't want them to be overwhelmed or look at this as yet another

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burden they have to face. So to the extent we can get this information simplified for them, and not only simplified but uniform so that they can compare it, we think that would be the best.

MR. WILLIAMS: Okay. Thank you.

CHAIRMAN CAMPBELL: Roughly speaking, what proportion of your members are sort of small- and mid-size businesses? What I'm going to do is I'm just trying to get a sense --

MR. JOHNSON: Right. Right.

CHAIRMAN CAMPBELL: I assume you're primarily speaking as a voice of small- and mid-size business plan sponsors and their interests here. Not exclusively, obviously. Your membership is diverse.

MR. JOHNSON: Right. About 90 percent of our membership is 100 or less employees. But I wouldn't say the dues structure reflects that breakdown. The dues structure tends to be -- we have a lot of bigger members who pay us a disproportionate amount than smaller members. And one of the realities of trade association work as you know is it tends to be the bigger members that can send representatives to meetings. But we try and keep in mind the small businesses' needs and figure out what they are just as good staff. We have some very vociferous members in the small business community, and they certainly speak up when they have to be represented.

So as far as our dues base, it tends to come from bigger members. But our membership is comprised largely of smaller members if you define it 100 or less employees as distinguished from the level of 10 or less employees.

CHAIRMAN CAMPBELL: Well, I wasn't trying to inquire on your dues structure. I was just trying to get the perspective that you're bringing that I assume has a certain degree of small- and mid-size plan sponsor interest in it.

And I'm curious in your communications with your members who are sort of in that category. How much are they telling you that they're having difficulty getting the information they feel that they need to carry out their fiduciary duty?

MS. WONG: We do hear from some that they would like to be able to get more information, more clarification.

I think what we hear more than the disclosure of information is that they have a tougher time negotiating their fees, and negotiating just generally for their contracts, so that one concern is that even if they're getting that information, what then becomes their responsibility once they have it if they can't negotiate for anything differently. So that's really the tension that we hear primarily from them.

CHAIRMAN CAMPBELL: Do you think the additional information that this regulation might require should it be promulgated much as it is now, provide them that information would be useful in those negotiations in perhaps achieving better terms?

MS. WONG: It's hard to say. What I think the concern is that it won't make negotiations any easier, and then they're stuck with information saying that their plan fees are unreasonable because they are a smaller employer without the kind of understanding that they don't have the opportunity -- or not that they don't have the opportunity, but that's the way the marketplace has created those fees.

So the concern and the caution is that along with making this information available, there also needs to be education. And the concern really comes out in the participant disclosure side that once participants find out this information, they're looking at their plan which happens to be a very small plan with high fees, and they compare that to a large plan that has smaller fees. If they don't understand really the market differences between those two, then that small employer might find itself subject to litigation or other liabilities that have arisen from trying to do something good.

CHAIRMAN CAMPBELL: And is that an issue you think could be or should be addressed in this regulation?

MS. WONG: To the extent it can be, I think it should.

CHAIRMAN CAMPBELL: Do you have any thoughts on how someone might do that?

MS. WONG: I'd like to get back to you on that, because I think that's something we can explore with our membership and definitely get you more ideas.

MR. JOHNSON: In an informal give and take process.

(Laughter.)

CHAIRMAN CAMPBELL: I have no

further questions. Thank you.

MS. DWYER: Just one question for Mr. Johnson.

Would you repeat for us the name of the case that discusses the Administrative Procedure Act?

MR. JOHNSON: Yes. It's the Sierra v. Costle. That was in the D.C. Circuit, and it's famous because it reversed quickly the so-called Home Box Office case that was a few years before that held that ex parte communications were in fact prohibited. And in fact, it's at 657 Fed. 2nd 298, 1981. But if you look in Davis, it's the case and it's still good law. Great, great, great decision. It's by Judge Walt.

MS. DWYER: Thank you.

MS. ZARENKO: I just want to follow up on it sounds like you were touching on some scope issues. As you know in the proposed rule, the way we went about defining which service contracts and arrangements are

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subject to the requirements of the proposal it was by categories and service providers. And it seems like you prefer more to go to a quantitative approach. Was that the plan asset threshold you were talking about, rather than the way we did it?

MS. WONG: I think within the context of the way you did it, there seemed to be a breadth there that might be even more than what was anticipated in writing the rule. And so our concern or what we would like to see in terms of conversation is really talking about the limit of that.

So in one example when we're talking about disclosing material -- when you're talking about disclosing all of the service providers involved, if there's a percentage amount for the assets there. So if you're talking about someone who gets $1 out of what's paid out of the $10 million that's paid, do you have to go all the way down to that $1? So I think within the scope of what

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you have, looking at that to impose limits on that.

MS. ZARENKO: So it's no question that all of the compensation that's paid from the plan or compensation issues have to be disclosed, you're more looking to some of these indirect compensation and how far down the line are we --

MS. WONG: Right.

MS. ZARENKO: -- in terms of who we're considering to be a service provider?

MS. WONG: Right.

MS. ZARENKO: Okay. So it's not that you want to do away with our scope provision and replace it with just a straight percentage of plan assets threshold?

MS. WONG: No.

MS. ZARENKO: Okay.

MS. WIELOBOB: She asked my questions.

CHAIRMAN CAMPBELL: All right. Well, thank you very much.

MS. WONG: Thank you.

MR. JOHNSON: Thank you.

CHAIRMAN CAMPBELL: And next up is Hewitt Associates.

MS. BORLAND: Good afternoon. My name is Allison Borland.

On behalf of my colleague, Cindy Milstead, and Hewitt Associates, we thank you for the time you're taking today to listen to us.

I lead our defined contribution consulting practice. I'm not a lawyer.

Cindy is a Senior Benefits Attorney in our Office of General Counsel.

For more than 65 years, Hewitt has provided best-in-class HR administration and consulting services to large organizations. As a market leader in benefits administration, we deliver benefit programs to millions of participants and retirees on behalf of hundreds of organizations worldwide.

As the largest independent record

keeper not affiliated with any investment management firm, we have a unique perspective to share on these proposed rules. We'd like to focus on three areas of the proposed regulations: the uniform fee disclosure, conflicts of interest, and the time line for compliance.

So we'll start with the uniform fee disclosure. Hewitt absolutely supports thorough fee disclosure to plan fiduciaries, and we always have, but provisions to the proposed rules are required so that fiduciaries can fulfill their responsibilities with respect to plan fees.

Disclosure of plan fees is critical for two reasons. First, to enable fiduciaries to determine whether the fees constitute reasonable compensation, thus satisfying the requirements for the prohibited transaction exemption under Section 408(b)(2) of ERISA; and second, to provide information needed for fiduciaries to act prudently and

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solely in the best interests of plan participants and beneficiaries, as required by Section 404(a) of ERISA.

The proposed disclosure rules fail to support the two stated goals for two reasons. Number one, they fail to facilitate meaningful comparison of costs across plan providers because of different levels of disclosure for bundled and unbundled service providers. Plan fiduciaries will be unable to make apples-to-apples comparisons.

Second, they fail to provide sufficient information for fiduciaries to fully understand reasonable changes and plan expenses over time. This is because of the lack of disclosure of fees in bundled arrangements that vary by the number of participants compared to those that vary by asset size. To determine the reasonability of costs, fiduciaries must understand the major components of plan expenses regardless of the packaging, whether bundled or unbundled, as well as the services provided by those costs.

Consider the two primary components of services needed for an individual account plan, which generally add up to more than 90 percent of total plan costs. First, investment management fees. These vary, depending on the size of the assets. These generally comprise the majority of plan costs. Second, administrative fees. This includes record keeping, communication and education. These vary. The costs for providing these vary by the number of participants, not the asset size. This is a key difference.

If you think about it, if your record keeping account balance is $1, it's the same amount of effort to record-keep a balance that's $1 million. The asset size doesn't matter.

Bundled providers generally build all of these fees into the basis point charge -- the asset base charge -- so that the fees are paid as a percentage of assets each year. While we don't argue this approach is unreasonable, the lack of disclosure of underlying expenses is a problem.

I'd like to walk through a simple example to illustrate what can happen if the underlying component costs included in the bundled basis point charge are not disclosed to and monitored by the plan fiduciary.

Consider a plan with $100 million in assets and 3,000 participants. The total fee charged and disclosed is 90 basis points. This covers 60 basis points required for investment management fees. It also includes 30 basis points for non-asset-related costs -- administration, record keeping, et cetera. This totals to $100 per participant. However, only the 90 aggregate basis points is disclosed.

Over a period of three years, assets increased to $300 million through contributions, roll-overs and investment

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return. The participant count increases from 3,000 to 4,000. Total fees remain 90 basis points. They're the same. There's no reason to trigger any concern on the part of the plan fiduciary.

However, with the growth of the assets, the fees for the administration and non-asset-related costs have now grown to $900,000 from $300,000. Per participant, they have grown from $100 to $225. The per-participant fee has more than doubled, although the services provided that vary by the participant count have not changed.

Looking at this example, it is impossible to argue that paying more than twice the per-person administrative fee over a three-year period is reasonable. If the plan sponsor was aware of this increase, it could use this information to consider alternate providers or to negotiate with the current provider and, potentially, either receive the same services at a lower cost or receive additional services for the same cost.

Under the proposed rules with a bundled fee arrangement and a lack of disclosure of the costs of the underlying services, a plan fiduciary would never have the knowledge needed to identify the issue described in this example. The result is that plan participants are paying significantly more than needed for the services provided, which erodes the value of their retirement nest egg.

Ultimately, much of the problem here resides in the fact that a significant portion of plan costs are not dependent on asset size but on the number of participants. When all costs are bundled into the asset-based fee, it is critical that the underlying components be fully disclosed in order for a fiduciary to make an informed and prudent decision.

Further, the example I just outlined reflects just one facet of the problem although arguably the most common one. Similar issues arise in other instances when various changes occur within the plan, such as changing out funds, shifting asset allocation, and bearing investment performance.

Consequently, because of the importance of complete disclosure, in order for fiduciaries to make prudent decisions about the reasonability of fees, we respectfully request that the final rules require the disclosure of the allocation of fees to affiliates and subcontractors in a bundled fee arrangement to promote uniform disclosure and a better understanding of plan fees.

Next we'd like to talk about the conflicts-of-interest provision. The conflicts-of-interest disclosure provision should be omitted from the final regulations. If not omitted, this provision needs to be tightened up with additional detail and examples. Existing law in the other

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provisions of the proposed regulations should provide employers with sufficient information to judge whether any other business relationship of a service provider will compromise its performance under a contract. Both fiduciaries and service providers have always had to be alert to possible conflicts caused by other business relationships that might result in a prohibited transaction.

Moreover, prudent business practices dictate that clients should be made aware of any outside relationship that might appear to compromise the relationship in question. Therefore, the conflicts-of-interest requirements are duplicative and unnecessary.

If the conflict-of-interest provision is not omitted from the final rules, then it needs to be clarified. The provision requires a service provider to disclose any relationship with any entity that creates or may create a conflict of interest in performing services under the contract. This requirement could be interpreted to encompass almost any business relationship the service provider may have. Given that the consequences of noncompliance may include the cancellation of service contracts, loss of business relationships and prohibited transaction penalties, most service providers may be inclined to interpret this too conservatively and overdisclose.

For example, Hewitt has over 5,500 different U.S. business relationships. Accordingly, for some services, it is possible that we will have business relationships with several hundred different business entities. Most of these entities will not be related to the provision of our services for a specific client.

However, given that our business relationships relate to the same type of service, we may be inclined, based on the current language, to overdisclose. Our clients would then have to perform due diligence and evaluate each such relationship as a potential conflict of interest, which could be a significant and unnecessary burden and also a deterrent to doing business with a large firm, which we do not believe is the intent of the regulations.

The time, effort and cost of this provision to all parties would be unjustifiably burdensome. We therefore request that this provision be omitted from the final regulations or at least better defined.

Finally, we'd like to talk about the timing of compliance. The preamble to the proposed regulations indicates that the regulations will be effective 90 days after publication. Given the amount of work that will be necessary in order to comply with these regulations, we request that service providers should be required to make a good faith effort to comply with these regulations, but these regulations are not effective for at least one year after publication.

Additionally, the proposed rules are not specific regarding the treatment of existing contracts or arrangements. For large service providers such as Hewitt, there are several thousands of contracts. If the intent of the proposed regulations is that service providers must also provide required disclosure for existing contracts on the effective date, it would be impossible to comply within a 90-day window. We therefore request that for at least one year after the effective date of the final rules, service providers will be deemed compliant as long as they make the required disclosures by the end of the transition period.

We also request that the Department provide clarification that existing contracts do not have to be amended, rather service providers may meet these requirements by providing the required disclosures only outside of the contract.

With that, we thank you again and we'll be happy to answer your questions.

CHAIRMAN CAMPBELL: Great. Start down here.

MS. WIELOBOB: I don't have any.

MS. ZARENKO: First, I want to follow up on that conflict-of-interest question.

Some of the other commenters have suggested that, instead of constructing it the way we did, we should just require that a service provider list all the companies with which it's affiliated. And I'm just -- in listening to your testimony, I'm thinking of well, that still could be a very large number.

Would that list be helpful to a plan fiduciary? Are we then shifting the responsibility and expecting the plan fiduciary to have to go research all 200 of those affiliated companies and determine if there is or isn't a conflict? I just want to hear what your thoughts are on that as a suggestion to deal with the conflict-of-interest provisions.

MS. MILSTEAD: Well, I think that that's exactly our concern that, if we give you a list of just the relationships for which we're getting compensation, that's fine. We do that pretty much now. But if it's anyone who might somehow be associated with the service we're providing and so that relationship -- because we have a relationship and we use another company to provide similar services for someone else -- if that is something that might have to be disclosed also, then you're getting into the overdisclosure.

We would like more detail, so we know where to stop, so we don't have problems disclosing the relationships we have under the existing contract. Again, we should do that, and we do do that. But it's all of the tangential relationships we have.

MS. ZARENKO: Okay. A couple questions on bundling and allocation of compensation.

You mentioned in your comment letter that some bundled providers may refuse to disclose allocation information. We typically hear about this with smaller plans. How often is that true first of all? And second, how often do you find that to be the case?

MS. BORLAND: Yes. Excellent question.

So we've heard several commenters today talk about the fact that large plan providers are extremely sophisticated. They get everything they need. Everybody discloses everything to large plan providers. And that has not been our experience. Sometimes that is true -- absolutely that's the case. Other times it's not at all true. Some providers do fail to provide additional disclosure into the depths of the different allocations.

We did a survey last year and we asked large companies whether they had even calculated the total plan costs of their plan. So had they even pulled together all the numbers regarding what fees and expenses were going toward their plan? Sixty percent of them said yes, which is up from 30 percent six years ago. But that still leaves 40 percent who haven't even done that. So I'd say maybe greater than 50 percent of the time, service providers provide complete and thorough disclosure, but nothing close to 100 percent of the time, even with large employers.

MS. ZARENKO: When you're saying complete and full disclosure, is that consistent with the kind of disclosures we're asking for in our rule? Or what's the standard by which you're saying complete and full disclosure?

MS. ZARENKO: So if we talk about a bundled service provider in the total aggregate basis point fee for example, that's absolutely provided every single time.

If an organization is trying to determine the amount that's attributable to record keeping versus the amount that's attributable to investment management, that is sometimes, but not always, disclosed. Now that's not required in your regulation. So our concern is that if the regulation goes through as currently written, that will then reinforce the bundle provider's ability to refuse additional disclosures about the details.

Now other types of disclosures like indirect compensation, typically, that is provided when asked, but it's not provided on a voluntary basis. And plan sponsors do not always know the right questions to ask to get that information.

MS. ZARENKO: Okay. In your comment letter, you generally support requiring a service provider to allocate the compensation or fees, but I didn't see any limits on that. So are you talking every penny? Or it seems like today you're talking a lot about at least the record keeping versus the investment. Could you comment on that?

MS. BORLAND: Yes. We do absolutely support a materiality threshold, whether it's one basis point -- something to that nature. We do not want to get down to talking about number of postage stamps and number of soft drinks served at meetings. So only material components of costs, I think we would ask to be included.

MS. ZARENKO: And what's your reaction to the comments that we hear that when we're talking about affiliated service groups -- these allocation numbers don't really reflect the value of the services? We do it for tax reasons. We do it for other business record keeping reasons so that it would just further confuse a fiduciary, or not really educate them. I would just enjoy hearing your response to that.

MS. BORLAND: Sure. Well, so first we disagree.

MS. ZARENKO: Okay.

MS. BORLAND: I think when you are delivering services such as record keeping and administration, the cost -- what it takes to provide that service -- doesn't depend on the size of the assets. It depends on the number of people for whom you're providing that service -- the number of account balances.

Now there are other factors like the complexity of the plan, maybe the number of loans -- other things that may impact that as well. But again, that's going to be somewhat related to the number of plan participants.

An organization knows the general costs of providing two very different types of services within its own structure. So again, we just disagree.

MS. ZARENKO: Noted.

One more question. You also

mention in your letter that plan fiduciaries sometimes perceive services as being free.

MS. BORLAND: Yes.

MS. ZARENKO: It seems like there would be a competitive edge in educating plan fiduciaries that that's not the case and saying well, you might think that's free but it's not. And here's how it really works in here. Here's how those services are being paid for.

Are efforts to try to educate plan fiduciaries about how that works just ineffective or you never get the opportunity?

MS. BORLAND: We do have the opportunity. And we've been fighting that battle for many years.

Looking at things through that lens is more complicated. It's harder. It requires a higher level of sophistication to understand the full picture. Organizations who do look at it that way, we work with them just great, and we enjoy our relationships with them. Other very large organizations aren't interested. That's been our experience.

MS. ZARENKO: Thank you.

MS. DWYER: You clearly want to break up the bundle and have the fees allocated within the bundle. Can you give more real-world examples of what information would be found if we do that, and how it would benefit plans?

MS. BORLAND: I think, as illustrated by the example, the biggest impact is that if a plan fiduciary understands the fees that vary by asset size, by participant, and also by transaction, the plan fiduciary can then understand reasonable changes in compensation over time. So if they switch out and add target maturity funds that have different fee structures, the plan sponsor can understand what would be reasonable for asset-based versus per-participant charges. It gives the plan fiduciary adequate information

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to understand the nature of the fees and how they should change over time, so that, in order to be prudent, they don't have to go out to bid every single year because something in their plan has changed and they're no longer certain that that 90-basis points is reasonable given changes that have occurred within their plan. I think that's the biggest reason.

MS. DWYER: Thank you.

CHAIRMAN CAMPBELL: I guess one of the concerns that we've heard expressed to us on the bundling versus unbundling issue is, to what extent we are favoring a particular business model, and at the end of the day how much of a difference is there between them to the fiduciary who is evaluating what's coming. The argument on one side is that, well, this one is providing three services for $100, this one's providing five for $110. As you evaluate all your RFPs, you can determine which one's the best deal by evaluating what you need and what it costs, even if some were packaged and some were unpackaged -- bundled or unbundled?

You've indicated an answer to some of that already. But how do you really respond to that argument, especially to the extent that folks on the other side say, well, even if we did unpackage it, you would find that some of our charges are unrelated to the costs of the services but are allocated among affiliates for tax reasons or all sorts of, sort of, non-service provider issues?

MS. BORLAND: Well, I think some of that is important because if you're evaluating a fund's performance and the cost of the fees related to the fund performance, if you can't carve out the part of the cost that's specifically related to the investment management fees, it's harder to evaluate the quality of the fund and the services that you're getting for those dollars.

In addition, when you're comparing

-- as someone mentioned earlier, Hewitt puts out RFPs that are hundreds and hundreds of pages. We also answer RFPs that are hundreds and hundreds of pages. It's not quite as simple as putting things on one page on a spreadsheet and comparing the two. You have to look at the scope of services being provided for the different fees. And when you can't break out the fees to compare the scope versus the fee, it becomes very difficult.

If the fund line-up was exactly the same for example, it would make it much, much easier. But the fund line-ups themselves are always different, unless the plan sponsor specifically requests a bid on a set line-up, which does occur sometimes. But that's the minority of cases.

CHAIRMAN CAMPBELL: Okay.

MS. BORLAND: Does that help?

CHAIRMAN CAMPBELL: That does. I guess the example that someone had used -- I very much hesitate to throw another car example into this debate because it's always rife with too many -- but one of the examples that someone had used was well, when you go and buy car X versus car Y, and car Y is advertising that we have a bumper-to-bumper four-year warranty that covers wiper blades on down, you're not getting that for free. You're paying it, built into the price of car Y. And you as a consumer are able to make these decisions every day.

Why in this context is that different for fiduciaries of plans when it's appropriate for consumers of automobiles? Again, I recognize this is a ridiculous comparison, but indulge me nonetheless.

MS. BORLAND: When I shop for a car, I do want to know the difference between the premium package and the regular package --

CHAIRMAN CAMPBELL: Right.

MS. BORLAND: -- and whether or not leather seats comes with it, whether there's a fancy steering wheel. And I also

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want to know the incremental costs of those additional features so I can decide what suits me best, and if it's worthwhile to go with the full bundle and get the price reduction, or buy a reduced bundle and add up features. So I argue that analogy is at least somewhat relevant, and works on our side as well.

CHAIRMAN CAMPBELL: Well, I should have wasted all our time with that, because this analogy --

(Laughter.)

CHAIRMAN CAMPBELL: -- is so flexible that's everyone's used it for all sides of every debate.

MS. BORLAND: That's right.

CHAIRMAN CAMPBELL: And with that, I think I'll stop talking.

MS. BORLAND: Okay.

MR. CAMPAGNA: Going back to your idea of uniform disclosure, and the need for apples-and apples-comparison, I go back again to a commenter that said that can't be done because there are different products. You can compare insurance to mutual funds. A lot of the fees that are based in the insurance products are basically inherent in the rate of return that they're given, so it's impossible to break it out.

So how do you compare apples-to-apples when there's apples and oranges? How would we go about doing that?

MS. BORLAND: That's a good question. And I've also heard a lot of talk today about a standard -- almost spreadsheet -- that could be used in all cases. And I'm not sure that's the right answer.

I do think more specific guidelines about exactly the types of fees that need to be broken out or disclosed would be helpful. I think sample disclosures, so sample forms that could be used would also be helpful. I think there has to be the ability to customize and flexibility in there for different fee structures, different business models, insurance versus mutual funds.

We're typically in a market where we don't see insurance providers on the record keeping side. So I'm not quite as familiar with their products as service providers in the aggregate, but I do think there needs to be a balance between flexibility and enough information to be able to perform an adequate comparison even if it's not exactly the same.

MR. CAMPAGNA: Okay. Going back -- not to belabor this bundling/unbundling business -- but in the 5500 project, we heard from the affiliates who like the bundled rule -- wanted a bundled rule -- and said that basically breaking it out really was kind of meaningless for them especially, because it's not really based on anything other than kind of a record keeping system on an in-house basis.

What basis would you use to approach affiliates for this kind of breakout? Would it be a cost basis? What basis would you use to break out those fees?

MS. BORLAND: That's a good question. And I'm not sure I have a firm answer.

I do believe it's important to have assets that vary by -- costs that vary by asset size separate from costs that vary by participant count, separate from costs that vary by transaction. So there's three categories that work very differently in the cost change over time.

With respect to affiliates, I think there's probably some flexibility there. I think the service provider would have to come up with the most meaningful way to do it within their business model, which would put them in the best competitive position compared to other organizations.

So I don't know that you can mandate the internal allocation methodology in a lot of detail.

MR. CAMPAGNA: Okay. And then --

MS. MILSTEAD: And also --

MR. CAMPAGNA: I'm sorry. Go ahead.

MS. MILSTEAD: I'll also note that for 5500 purposes, that is as someone said earlier, an after-the-fact situation. And for this purpose. we're talking more about the before-the-fact and the disclosures at the time of the contract. So there's some differences.

MR. CAMPAGNA: Okay. And the conflict provisions, you object to our language. It should be omitted or tightened up. I'm really interested in what you believe would be acceptable for this purpose.

You mentioned the idea of potential versus actual conflicts, or whether the service has to relate actually -- or the conflict has to relate to the plan service. I think you read our regulation to say that it could include things other than relating to the plan service. I just want your reaction on why you think that, and really basically what would be acceptable for this provision.

MS. MILSTEAD: We're still thinking about that, too.

But again, what would be acceptable would be relationships that exist that are related to the services provided as opposed to relationships that exist but have nothing to do with the specific contract provided. And maybe it's not that we wouldn't have any disclosure, but maybe it's saying we would make some more types of general disclosures such as Hewitt has revenue-sharing contracts with basically any number of fund families, but not with every single one, because it has nothing to do with the services we're providing to that particular client at the time. We would tell them specifically as we do now what our relationships are with the funds they have.

MR. CAMPAGNA: Okay. And lastly, I'm interested in that statistic you quoted about 60 percent of even large employers receive full disclosure and 40 percent don't. Where does this information come from? And how did you come up with this?

MS. BORLAND: Let me clarify. We conduct a bi-annual 401(k) survey called Trends and Experience in 401(k) Plans. I actually have a copy in my bag, and I'm happy to leave it with you.

We asked a question, how many plan sponsors have themselves calculated or attempted to calculate the total cost of their plan. So it's not focusing on full disclosure versus incomplete disclosure. It's focusing on the plan sponsor's calculation of the total cost of the plan. Sixty percent said yes.

We do this every other year, so back in 2001 that number was only 30 percent. So the trend is steeply increasing up, but that still means 40 percent of plan sponsors answered no.

MR. CAMPAGNA: Okay.

MS. BORLAND: And by large companies for the survey purposes, that's typically employers with more than 1,000 employees.

MR. CAMPAGNA: Thank you.

MR. BUTIKOFER: Okay. Going back to your bundled example, you want to break it out into these three different types of costs. And my question, though, is if we break the bundle up and want them to separately disclose, are we really fixing the problem because we're breaking up the bundle? What we are really trying to get is we want them to, if it's asset-based, it should be disclosed as asset-based versus if it's a head, then it should be disclosed by a head. Because if you unbundle but they still disclose it as an asset-based fee, you're never going to pick up the difference. And if you don't change that basis-point fee to an actual dollar amount, you still will never make the comparison and figure out you're paying too much.

MS. BORLAND: I agree with you. Our model is to use the per participant fee approach. We believe that is the best and most equitable model for plan participants.

However, that is a significant change from the way things are performed today, and we figure that was too much to hope for and too much to ask for. But in a perfect world, we think that's the right answer.

MR. BUTIKOFER: So are we really talking about unbundled, or do we want an actual dollar disclosure is what really is the solution?

MS. BORLAND: I'm not exactly sure I understand your question, because any basis point fee can be converted to a dollar number. Right?

MR. BUTIKOFER: True. And so in the example you're giving, it seems to me you were saying that they were not making that calculation?

MS. BORLAND: Correct. It wasn't

being provided. That's right.

MR. BUTIKOFER: But they should be able to make it on their own, should they not?

MS. BORLAND: Only if they know the basis points allocated to the record keeping and per-head costs.

In my example, only the 90-basis point aggregate fee was disclosed. The 30 versus 60 split between investment management and per-participant administration costs was not disclosed in my example.

So we did the underlying calculation, but the plan sponsor did not have the information needed to perform that calculation. So we're suggesting it's important for the plan sponsor to at least have that information so that they can perform the calculation and recognize when there's excess revenue going to a service provider.

MR. BUTIKOFER: All right. Thanks.

CHAIRMAN CAMPBELL: That'll do it?

MS. BORLAND: Thanks again.

CHAIRMAN CAMPBELL: Thank you very much.

All right. Fiduciary Risk Management.

MS. FLORES: I want to start by first saying thank you for the opportunity to address your Panel on such a controversial issue.

My name is Jessica Flores. I'm the Managing Director for Fiduciary Risk Management. And here today with me is Bert Carmody who is our Director of Fiduciary Consulting.

Fiduciary Risk Management is a firm that works with large plan sponsors on the retirement plan side of ERISA. We provide independent fiduciary services, audit and litigation support and independent employee education.

A big part of what we do is conducting fiduciary compliance reviews to

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include comprehensive examinations of service provider relationships. Through these examinations, we've identified significant areas of misleading sales practices and disclosures, which in many cases had led to participant abuse and increased fiduciary liability.

The leaders of our firm have come from the inside of some of the industry's largest service providers. We are here today in response to the issues we've witnessed taking place in the retirement plan industry, and to make certain that both the participants' and fiduciaries' interests are well represented.

Because we focus solely in the retirement side of the business, we restrict our commentary to apply to that category of ERISA plans. So that's our full disclosure statement.

We want to start today by discussing the new burdens that are placed on fiduciaries through these proposed regs. To simply execute this effectively, fiduciaries would have to understand the total inner workings of investment, consulting, administration and insurance companies, et cetera, et cetera, et cetera, to include how they structure professional affiliations, who their subsidiaries are, and then the subsidiaries of the subsidiaries and their relation to the organization, not simply their relation to the plan, as well as how the sales engineering department works with the finance and product departments to compute and manage various sources of revenue. This would have to be understood for each organization that may have a relationship to the plan. We've worked with some of the most sophisticated plan committees and have not seen anyone capable of figuring out this puzzle even if it was their full-time job every day to do so.

We actually disagree with previous statements that the larger plan sponsor has

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this figured out. We service that group primarily as an organization, and we have yet to find very many plan sponsors who have a handle on this where we would say it was much more of a handle than what small service providers have or small plan sponsors have.

The proposed regulations are written vaguely, which we understand is done so intentionally as a catch-all like many other parts of ERISA. However, with vague rules and limited understanding of sources of service provider and investment industry compensation, how are fiduciaries going to know if they're getting the whole story?

There are so many layers and sources of compensation when dealing with these various types of investment products and financial institutions. How deep are we going with these regulations? The vagueness of the rules can be interpreted many different ways depending on the fiduciaries' understanding of these service models.

Are we asking fiduciaries to be responsible for the regulation and disclosure of the investment and insurance industries? If we're not, then why would we require them to police a system that has historically escaped the requirement to disclose how they earn revenue. Who will monitor, regulate or oversee the disclosures to determine if they are accurate, reasonable and can be relied upon by the fiduciary?

Our next point is what is new about these regulations? Disclosure requirements exist now -- 5500, Schedule A, Schedule C. They've been around for a long time. We have prospectuses, statements of additional information. What has prevented service providers from disclosing before? What new behaviors are we going to expect from these regulations?

We are asking for several different buckets of disclosures when we already require disclosures. Just because we ask more questions, does that mean we're going to get more answers and more accurate answers?

We read that a prohibited transaction will occur if service providers fail to comply. However, back to our previous point of the depth of disclosure required, the rules are vague. Does compliance mean all sources of compensation in relation to running investments, and the plan platform including those investments sold directly to participants? Will key areas of compensation sources and conflicts of interest be disclosed?

Some examples of some key areas where these compensation sources can exist, we can start with investment-related. Of course, you have the expense ratios that are commonly disclosed in prospectuses. But you also have trading fees. You've got securities lending. You've got custodial relationships. There are sub-advisory level compensation. And then there's this new trend to layer trust and layer funds to create additional areas for compensation. Are we going to dig into these things through these regs?

What about product offerings that are oftentimes sold through retirement plan relationships -- through DC plans primarily? Self-directed brokerage accounts, guaranteed interest accounts -- there are significant management spreads that are built inside guaranteed interest accounts and are typically not disclosed to plan sponsors through a negotiation process making for competition that can sometimes be deemed unfair.

What about asset allocation funds? These are typically funds on top of funds, and sometimes on top of funds again. Oftentimes we see the management of the asset allocation model itself fee being disclosed, but we don't see the underlying allocation of the fund expenses being disclosed in addition, which could make these numbers much, much higher than what is being reported currently.

And then what about participant level product sales? This has been a very controversial issue of these regs. Insurance products are very oftentimes sold through DC plans. Are the compensation that is generated from these insurance product sales going to be included in this?

What about roll-over products as a result of access to these participants that come out of these plans, or roll-over other assets in the 401(k) when they call into call centers. There's an overwhelming increased focus on capturing and retaining these assets as baby boomers continue to retire. We recommend that the required disclosures include IRAs as we've seen this as a very lucrative marketplace for service providers.

What about service providers compensation directly by the plan sponsor and not through the plan? These relationships usually fall into consulting categories who will probably be the first place fiduciaries

turn with these disclosures and reporting responsibilities. It is very common for the benefit consulting houses to participate in relationships that would impose conflicts of interest. If they are not required to disclose simply because they bill the plan sponsor directly, how will fiduciaries know if they're getting their information from the right sources? We fear these conflicts will continue to permit substandard guidance to fiduciaries.

Unfortunately, there's not a requirement for independence of consulting firms at the present time. Will these regulations change this? If not, will the efforts be well served?

We believe the requirement of reporting conflicts should be irrelevant to fiduciary status. Most fiduciaries hire these experts to rely upon for fiduciary compliance and advice. They should be informed of material conflicts that exist.

We also are very concerned about the disconnect of regulatory agencies and the effects on fiduciaries. The disclosures necessary to make these regulations effective as intended fall under other regulatory purview. How will plan sponsors deal with one agency mandating the rules -- the Department of Labor -- when other agencies like the SEC and OCC may be controlling the information?

The SEC is already publicly acknowledging their inability to effective monitor investment company disclosures. This is the key reason they have not increased the depth of required disclosures already. In a statement from the SEC published recently, they propose creating a new self-regulatory organization simply to give these issues the necessary attention.

Bert actually has a handout that he's going to pass out just to provide an example of my next point.

This is an illustration of a

collective trust fund. And this is a real fund that we dissected recently.

While the OCC has historically maintained strict disclosure policies in regards to collective trusts, and these investments are frequently noted for their transparency and cost effectiveness for plan sponsors. Our team has recently directed one of these vehicles to provide an illustration to this Panel to provide the multiple areas of hidden compensation.

As you can probably already tell, this is a very complicated diagram. And it's complicated for us who look at these things every single day. Could you imagine the complicatedness for fiduciaries?

These trusts are often layered with other trusts or funds and do not report the various areas of the layered compensation that is driven from these investments, therefore making the investment vehicle to appear much more cost effective than it really

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is.

We are seeing these collective trust arrangements becoming much more convoluted in this era of plan sales than they were back when they were popular in the early '90s. We believe that much of this is due to the new pressure placed on compensation. Service providers believe they must show less compensation to be competitive, yet their own shareholders demand record returns every quarter. In order to satisfy both parties, they must earn maximum revenue on their products while disclosing a minimum portion to decision makers.

FRM is very concerned about the new areas of misleading practices being formed around collective trusts. As we've shown in this illustration, many of the trusts invest in multiple layers of other trusts, but then circle back and invest in the original trust. We see no advantage to investors who use a product that is managed like the one in this

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example, yet we are seeing these arrangements marketed very aggressively right now.

We entirely disagree that current prospectuses even come close to properly disclosing to investors. And that's regardless to which regulatory agency they fall under.

And we don't even have time today to discuss what's going with state insurance commissioners, so we'll leave that one alone.

If we're serious about getting accurate disclosures, why aren't the agencies working together? And we do have a suggestion; let's not just complain.

We recommend that the Department require a separate certified filing that fully discloses the business practices and sources of revenue of all organizations providing any service that has a relation to an ERISA plan. This will avoid the concerns that business models vary. And quite candidly, they're not varying that drastically. And there's not

that many different models. This is not difficult. This is not rocket science, as has been claimed repeatedly.

The Department should make certain that service providers describe their business models and sources of compensation to avoid the ongoing game of shells that continues to exist in this industry. This should not be done according to the proposed regulations, where a bundled service provider would disclose the compensation business arrangements for all participating firms. This has been the traditional way of gathering disclosures on the Schedule C, and for fiduciaries. And this has not proven to be reliable. This report should be provided to the Department of Labor and plan fiduciaries that are existing clients of the service provider.

In the case of the bundled service provider relationships, each participating firm should certify their own disclosures on

the form, and the form should ultimately be filed by the bundled service provider. In addition to the filing, a certified statement that shows the breakdown of allocation of such revenue that has been generated from the plan and its investments as well as the revenue produced by offering participants additional services and products should also be provided.

We suggest that all service agreements -- both existing and new -- be required to comply with these regulations in a timely manner. We do not agree that providing these disclosures is overly burdensome for these service providers. Their cost accounting and revenue departments have already computed these figures on their books of business. And yes, it is figured all the way down to the plan level prior to negotiating these fees and prices up front.

The fiduciaries' responsibility under this scenario would be to gather the disclosures and determine the ongoing

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suitability of their service provider relationships and continue to run their businesses, but they would not be responsible for the totality and accuracy of such disclosures.

The key problem with our suggestion is of course the right to have trade secrets protected. These are companies that compete against one another. However, even with the current proposed regs, we believe that most of the larger service providers will provide a degree of disclosure that meets satisfactory levels and then classify other areas of compensation under the purview of trade secrets.

We do not think these regulations should offer trade secret protection if they are to be effective. We are not requiring them to disclose how they make investment decisions or manufacture their products, but simply to disclose how they earn money from the $17 trillion sitting in America's

retirement system.

We encourage the EBSA to set the standard for appropriately defining fiduciary and service provider relationships as it relates to qualified retirement plans.

And we thank you for the opportunity to share our perspective and experience with your Department. And we welcome any questions that you have.

CHAIRMAN CAMPBELL: Great. Thank you. Let's start down there.

MR. CAMPAGNA: I'm just trying to boil down your testimony.

(Laughter.)

MR. CAMPAGNA: So up front, you believe there are misleading sales practices and many pension consultant relationships have conflicts.

MS. FLORES: Absolutely.

MR. CAMPAGNA: So our regulation attempts to deal with that.

MS. FLORES: Yes.

MR. CAMPAGNA: But then at the fund level, you're saying that the current regime of disclosure through the SEC and otherwise just doesn't work, and you're advocating this self-certification process?

MR. CARMODY: You had mentioned earlier Form ADV as an example. I think that came up in one of the conversations this morning.

But if you think about what an ADV does, it's sort of at the fund practice level, and it doesn't relate to a specific plan. And the burden to determine what the decisions are land on the plan fiduciaries. And SEC's at the fund level. So we're seeing a lot of expenses -- a lot of other things that don't make it to the plan level. We see the prospectuses. It does not provide sufficient disclosure.

MR. CAMPAGNA: What do you think about what we have in the proposed regulation? There is indirect compensation at the sales level, plus the idea that the bundler would point to where in the prospectus would be this information regarding indirect compensation. Is that helpful? Or is the prospectus just not a good document?

MS. FLORES: The prospectus alludes to the fact -- if you read an SAI or a prospectus, it'll say this fund participates in securities lending. This collective trust participates in securities lending. This trust has transaction costs. This trust may invest in other sub-advise trusts. But it does not describe how much revenue is actually generated.

We've dissected plans and collective trusts and mutual funds that are securities lending to their own affiliated products to earn additional revenue on the money in the retirement system. Now, an argument that we hear every single day about this is well, that's reflected in performance. Well, if that's the case, then why are we worried about expense ratios or anything if it comes down to performance?

There's a huge degree of variation in a fund that meets a prudent investment requirement that just says it keeps up with some benchmarks. It keeps up with its peer groups. It's got a relatively inexpensive expense ratio with something that's performing in the top quartile every single quarter. And a lot of these differences in performance when you find an allocation in the fund of similar investments can be due to the inefficiencies in the way they management these things -- the way that they handle transaction costs, the way that they address securities lending. There's a lot of inner workings going on in these funds that is not being addressed. And the SEC is looking at it but they really just don't know what to do with the information.

PANEL MEMBER CAMPAGNA: So correct me if I'm wrong again, so you're advocating at the fund level at least that there be some kind of allocation of the specific services that the fund performs down to the individual plan level, not just here's what the fund charges but tell the plan what they are paying as a result of their --

MS. FLORES: Absolutely. But it's not even being disclosed from a general investor platform. We're not asking them to take something that's a whole 100 percent of information and then allocate the percentage that's applied to this particular plan. It's not getting disclosed at any level.

PANEL MEMBER CAMPAGNA: Thank you.

PANEL MEMBER WILLIAMS: Go ahead.

PANEL MEMBER DWYER: Well, I want to follow up on Mr. Campagna's question. Give us more examples. What's happening? What is happening that is not being disclosed in the SEC disclosures? Give us one to --

MR. CARMODY: Let's use our collective fund example, because a lot of mutual funds run the same way. Okay?

If you were to look at this -- and again I'm just going to pick on a couple. But what you don't see here is how much money's being made on premium income. Again, not disclosed because what that would do, it would actually lower the price of the investment. Any of the interfund lendings, or any of the other types of securities lending, which particularly among affiliates. The accountant in me says do an intercompany elimination and determine what the real cost is. But if I'm having a cost on one side and yet another affiliate, not another reporting umbrella's getting the income on the other side at the net entity level, there's no cost. Or the cost is substantially less. This is why we get very, very cynical about -- or certainly skeptical about some of the compensation disclosures because we know they're missing the mark.

And then when you have relationships like this, Rube Goldberg could not have done a nicer job designing this schematic. This is all public information. We basically traced transactions through a variety of 5500 relationships from a very, very large financial provider. But when you've got these things, then what's a plan sponsor fiduciary going to do? Because ultimately, he's the one that's got to make sense out of all this, and he's got to have a good idea of how this works. And we're concerned about that. And we think that the providers need to basically disclose what these relationships are. Some of these are messy. Some of these are complicated. But the providers are not the ones that are facing litigation. They're actually beholden to you folks to make sure that we've got a right clue on how they should do their fiduciary duties. This is complicated.

MS. FLORES: Well, if you look at this diagram, what's most concerning is this multiple arrows that go back and go right down the path again. So it's an ongoing repeated process.

How in the world is a fiduciary going to figure out what the true underlying compensation is when if you read the prospectus on this particular collective trust, it discloses 15 basis points. And that is only the top level of collective trusts, which is a group of collective trusts that invest in other groups of a collective trust, and other groups and other groups, and then circles back and invests in the top group again and goes all the way back down the line.

Why does the investment need to be this complicated? How do they even manage these investments? How can you even dissect this investment to determine whether or not the underlying investments is prudent? There's one problem. But two -- what's the purpose of making this so complicated? And the purpose is because we are constantly pressuring service providers to be more cost

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effective and shareholders are constantly pressuring them to earn more revenue. They have got to find somewhere to put it. And so where they're finding it to put it is to layer out these vehicles to a point where it's so complicated -- and people aren't this question. They're not asking for disclosure on these underlying investments and how much they're earning on them.

MR. CARMODY: Here's another example. And we look to self-directed brokerage account, because that's essentially a nondisclosed area because most plan sponsor fiduciaries basically say, hey, you paid your money, you take your choice. Well, you have very, very high transaction charges in there. You have very, very high things all the way around.

Great -- great income opportunity for platforms. Very, very -- not at all disclosed to the plan sponsor fiduciary. And yet it's their investment. It's under their auspices. It's under their control. It's under their piece. Wonderful income place. Not disclosed.

MS. FLORES: And we're seeing conflicts of interest that exist right now with the self-directed brokerage accounts. When you call into the call center, we saw one particular plan that in less than a year of having a self-directed brokerage account -- this is a billion dollar plan -- $200 million had already went into the self-directed brokerage account. Twenty percent of assets in a year moved to the self-directed brokerage account. That is producing an enormous amount of revenue that no one even discusses.

Now, without some level of participant level pushing and advisory, I don't understand how an organization that was not that sophisticated if you look at their demographics of participants had 20 percent of their assets head there in less than a year. We find this as a significant area of abuse.

And that's why we're encouraging the Department to consider what's going on the participant level. It's not just the plan level. There is so much going on in the participant level that is yet to even be discussed in this forum.

MR. CARMODY: Another example is I heard something about free services earlier in a couple of our conversations. Nothing is free and we've all come to that rather awkward conclusion. And as Jessica alluded to earlier, one of the major things that folks do is they want to capture those roll-over assets. What kind of sales is going on there and what kind of fees?

There is some litigation on that now. But I think it's a larger question. And that is if I'm sponsoring a plan -- I'm a plan sponsor fiduciary -- and my employees are being sold product in which the service platform is getting a great deal of revenue, I should at least have a clue as to what that is

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and use that as part of my negotiation. But at the very least, I'd be at least disclosing what their practice is. What are you selling? At what share class? What kind of products? What kind of process do you have?

And that's a whole area that -- although it's not directly fee-related, it's a practice that's very, very similar to this whole issue of disclosing fees. It's all a big secret. And the plan sponsor fiduciaries are on the hook. And that's what we're concerned about.

PANEL MEMBER DWYER: Thank you.

PANEL MEMBER ZARENKO: Okay. I just want to repeat what I think I'm hearing from you. You tell me when I slip off here.

So definitely room for improvement?

MS. FLORES: Yes.

PANEL MEMBER ZARENKO: And you do think there should be mandated disclosures on the part of all service providers to plans?

MS. FLORES: Absolutely.

PANEL MEMBER ZARENKO: You don't think the proposed regulation that we issued gets it right. But do you still think the Department of Labor should be getting into this business?

MS. FLORES: Absolutely.

PANEL MEMBER ZARENKO: Okay.

MS. FLORES: Somebody needs to be.

PANEL MEMBER ZARENKO: Okay. And then to the extent -- I'm sure you realize -- some of the issues that you're talking about go beyond our statutory jurisdiction. And I think what I'm hearing you say is to a plan fiduciary, that kind of thing means nothing.

MR. CARMODY: That's right.

PANEL MEMBER ZARENKO: That you want the information so you get together with the other regulators --

MR. CARMODY: If it's the IRS or the DOL or the SEC at it's doorstep, that's the government. And if you think about it, he's not going to sit there and do the interagency who's on first, what's on second.

But we are concerned because as we see things move out as people try to disclose, where are they going to go? Are they going to try to figure out in places that have less disclosure. Gee, what are those vehicles? Things that you folks don't normally see a lot, and that lands under the OCC or the SEC, because those are not things that you normally look at in the normal deal, or we don't see in other places. So we're all kind of chasing each other.

PANEL MEMBER ZARENKO: Okay. In your comment letter, you suggest that our proposed regulation creates more problems than it solves, and the danger of trying to define what information has to be disclosed means people will just shift their business practices or call it something else to not disclose it.

So if that's true, what do we do?

You can't just have a regulation that says you must disclose everything, and we really mean it. So what do we do?

MS. FLORES: And that's part of our suggestion of why they need to be able to describe their business practices. There's not that much variation in business practices of service providers servicing this thing.

You've got very large insurance companies. You've got very large mutual fund companies. And then you've got this new arrangement of these collective trusts that have kind of come back around. It's an old arrangement. It's a new arrangement again because it's more complicated than ever.

It's not that varying between all the varying providers that -- there's no secret why wholesalers move around from one product to another. It doesn't take them that long to get up to speed on the next product at the next company they go to work for. And it's because it's not that much different.

See, what you need to start by is understanding -- I mean, there should be some sort of certification process. If you're going to have access to America's wealth -- to American household wealth -- retirement plan assets represent 39 percent of American household wealth. If you're going to have access to that money to our economy, then you must abide by these rules. You must declare how you run your business, how you get paid, what your interests are, why do you care about roll-over accounts.

Let's just be honest here. It's all about assets and money. That's why you care about roll-over accounts. You don't really care if the guy can live out his retirement for the next 40 years. It's about money. It's all about money.

And they need to be able to take what they do as a business and a marketing package and turn it into dollars and present it to the Department if they're going to service this business.

PANEL MEMBER ZARENKO: So I think it sounds like a priority and disclosure for you is not just dollars but business practices?

MS. FLORES: Exactly. Because business practices are going to tell you where the additional dollars are.

PANEL MEMBER ZARENKO: And just knowing the dollars isn't enough?

MS. FLORES: Yes. And any --

PANEL MEMBER ZARENKO: Because either it's not complete it or it doesn't explain the conflicts that are --

MR. CARMODY: It's a set up for the dollars. Let's go back to the roll-over piece. Because if I'm on a service provider side, and I'm actively selling roll-over accounts to terminating participants, that's a whole big huge income piece picked up that I don't normally disclose. That's a business practice that at the very least needs to be disclosed to the plan sponsor fiduciary.

MS. FLORES: Another big trend that we've seen all too many times, especially as independent education providers who charge a fee per head for our service, we compete everyday against major financial firms that will go in and provide 10,000 employees free education. That is very, very generous for an organization with profitability margins like these financial organizations.

They're not providing this for free. They're going in there and they're asking participants to do other ancillary business with them.

If you just looked at well, is this particular company paid a fee from the plan for providing this? No. But they have open access to the participants. They're communicating about the plan. They're providing information on the plan. And they're using that as an entree to sell additional product.

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That needs to be known to the Department if you're going to truly protect the interests of participants, because it's not just what happens to this money while it's sitting in the plan, but what happens when it's rolled out of the plan.

MR. CARMODY: Another example. Sub-TA fees. Sub-transfer agent fees.

Up until recently, a very, very large mutual fund provider that sold exclusively through brokers basically had a two-tiered fee arrangement. Twelve dollars a head went back to the service provider if they had full marketing access to the records. If they could not, only got names, Social and address just to do it, then they would pass back $3. Okay?

Now is that disclosed normally to a plan sponsor fiduciary? The answer's no. I think the comment by the lady from Hewitt basically saying that 60 percent of your large plan accounts have a clue as to what fees are, I'm surprised it's that high. Because when you see these things going on -- folks are running their businesses and trying to do something in line, folks are way ahead of them. And that makes it hard for them to do their job.

PANEL MEMBER WIELOBOB: I have one quick question. You've heard some other witnesses today -- I assume you have -- say that disclosure of business practices would hurt the market, be anticompetitive, trade secrets and so forth. How would you respond to that in this context?

MS. FLORES: We completely disagree because if you go to any national conference -- I encourage you all to go attend one -- from some of the associations, and you go and listen. There's breakout sessions, and every single advisor is running around in the breakout sessions and they're learning how to market roll-over products. And they're learning how to do best practices.

And service providers -- I don't care if you go from one to the next. One might be a little better at providing employee education. One might have a team that's all over the U.S. And one just might have 10 people in a local office. It is irrelevant. In most instances, these things are run almost identical.

These are not trade secrets. It's not that hidden. This is not trade secrets. It's not like they're manufacturing a secret recipe to a cake. We're not asking them to divulge how they get their investment returns in the top quartile. We're asking them to divulge how they earn money. And that's not really a trade secret.

PANEL MEMBER WIELOBOB: Thank you.

MR. CARMODY: Thank you.

CHAIRMAN CAMPBELL: Thank you very much.

MR. CARMODY: Thank you.

CHAIRMAN CAMPBELL: Next is Mr.

Hutcheson.

MR. HUTCHESON: Good afternoon.

Thank you. Can you hear me okay?

My name is Matthew Hutcheson, and I serve as an independent ERISA 321 fiduciary. And I appreciate the opportunity to speak to you today.

American workers who participate in qualified retirement plans are not being adequately protected, but they easily could be. Currently, plan decision makers -- whether plan sponsors or participants -- have no way of knowing much less understanding the crazy quilt of costs embedded in retirement plans. I want to speak today on behalf of the millions of plan participants who trust that we will finally enable fiduciaries of qualified plans to discharge their duties solely in the interests of plan participants and beneficiaries for the exclusive purpose of providing benefits.

Things are different now than they

were when ERISA was originally enacted. The recent Supreme Court decision in LaRue v. DeWolff casts a sobering line on today's reality. Accounts are now predominantly under the control of participants who have become decision makers with respect to plan assets. So disclosure to plan participants has never been more necessary.

Their decisions impact the retirement income security of not only themselves but also of their beneficiaries. And ERISA has always afforded equal protections to beneficiaries. And that's an important aspect of my testimony today.

If decision makers, whether named fiduciaries or simply those with discretion with respect to plan assets or operations, lack possession of and understanding of plan costs, they cannot judge whether any such cost is reasonable. Most providers of investment products and plan services claim that they have no duty to disclose costs to decision makers. Yet decision makers have a duty to know and understand those costs.

In a vacuum of information, prudent decision makers cannot assume that the cost of any service is reasonable, and therefore cannot comply with ERISA's sole interests and exclusive purpose rules. And those rules exist for the protection of participants and beneficiaries. And plan beneficiaries are almost always in the dark, even from the plan participant.

When all relevant information is available to buyers and sellers of products and services, and they freely agree to an exchange of value, then it is safe to judge that the costs reflected in the transaction is fair and reasonable. In those circumstances, decisions can be made in the sole interests of participants.

The simple solution I offer today is a method of disclosing all costs in an easy to understand format. It enables decision makers to judge prudently whether costs are reasonable in relationship to the services provided.

There are five necessary elements of full and fair disclosure. First, the disclosure of gross and net returns expressed in dollars.

Second, the disclosure of net rates of return for each fund at both the plan and the participant level expressed in percentages. These good folks here pointed out probably the most important thing you'll hear in this testimony and in this hearing, is that there is a huge difference between fund level costs and returns at fund levels, and the returns that a participant receives. And therein lies the key difference.

A comparison of the net returns for the account or a plan as a whole against -- this is the third item -- a comparison of the net returns for the account or a plan as whole against the standard index that reflects the net rate of return for that participant or the plan could be achieved through a broadly diversified market tracking portfolio. In other words, if a participant was in the market to determine what's reasonable, it's just compare what their net rate of return is to what they could have actually received had they done nothing except been broadly diversified.

Fourth, a standard report format. And fifth, a disclosure of conflicts of interest of any. And I'd like to clarify. 406(b) of ERISA says that disclosure of conflicts of interest are relating to the impact at a participant level, or to a plan. So I believe in conflicts of interest being disclosed that could be adverse to the participant or the plan.

Let me lay out each of these in a little more detail. The difference between gross and net returns is equal to the total costs for any period. It's as simple as that.

By disclosing gross and net returns with a breakdown between investment and administrative costs causing the gap between the two, any decision maker can at a glance quickly compare the costs for given services. The details from which the total investment and administrative costs are derived should also be available to any decision maker upon request. And I believe that means the fiduciaries, the plan sponsor or the participants, or the beneficiary for that matter. If they want to know what the cost is of each of the services that they're buying, they should know.

And I hate to go back to the car analogy, but I don't see it as the price of the car and all of the components of the car. I don't view it that way at all. I see the price of the car -- whatever that is -- and then the cost to drive it. I want to know the cost of the insurance. I want to know the cost of the registration to register it. I

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want to know the cost to drive the car, not just to buy it. That's what I want to know.

Cost details should be delivered in a timely and complete manner. Generally, costs are immediately known by those charging them, and could easily be provided to decision makers within 20 days following the end of a reporting period.

We should avoid a system of definition-dependent disclosure that allows providers to coin new terms or implement new techniques that circumvent the intent of regulations. We see this very game being played now in the case of revenue sharing because it by name was not specifically defined in the statute.

Let's face it. Providers of financial services will always try to be at least one step ahead of the regulators. They can hide costs faster than legislators or regulators can find them. Any method other than gross to net disclosure simply prolongs the game of blind man's bluff that has gone on too long.

This simple gross to net disclosure method catches all fees and arms decision makers with sufficient information and understanding to assess the reasonableness of the costs of operating or participating in the plan. It ends the opportunity and temptation to hide costs once and for all.

The second element is to disclose the true net rates of return expresses percentages on a fund-by-fund basis, and to clarify, at a participant level -- the real rate of return for a participant. True net rates of return mean the returns for a specific plan or participant account for the relevant period. By contrast, fund level rates of return are generally not helpful because those do not capture costs incurred at the plan level or more importantly, at the participant level. This element reveals the effects of participant choices in fund selection and also captures costs incurred at an individual level, for instance, when a participant is charged for borrowing against his or her account balance.

The third element provides context and meaning for disclosure. Everybody's grasping and struggling to figure out what we need to know. What you need to know is any cost that is charged to a participant account is dollars that they won't have for retirement income security when they're old. And so, to measure this you have to have some reasonable way of saying what could I have had had I done a simple broad market investment. And I'll explain this.

So by contrasting real net rate of returns with what could have been had the planner/participant invested in the broad market through a low-cost portfolio, this third element of disclosure is not just another benchmarking scheme. Decision makers are regularly told that more and/or better services equate into better net rates of return despite the added cost.

I'm an independent fiduciary. I am the purchaser of goods and services on behalf of the participants in the plans who hire me. And I have people come in all the time and say we offer all of these services, therefore our product offering is better than somebody else's. Well, if the performance is better and it results in greater income for the participants to spend when they're old, I agree. But that's not the case. And how do you know? That's what I'm trying to convey to you is there is a method of determining and cutting through all this.

Sponsors and participants have a right to know the bottom-line results regarding the relationship between costs and performance. Establishing a broad market tracking point of comparison enables decision makers to determine whether the net performance of a plan justifies its cost.

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Underperforming the index reveals that there is an easily avoidable problem either with poor portfolio construction, excessive costs, or both, and it enables decision makers to correct those problems to enhance future retirement income.

The fourth element is standardized reporting. Uniform disclosure enables fiduciaries and participants to compare investments with a plan and one service provider against another service provider. Appendix A -- and Mr. Williams, I'm not sure if you got my email with Appendix A, but I emailed it. It'll also be available on the internet if people want to see it. It's also included in my letter that I sent -- my comment letter.

The Appendix A is that grid laying out what I believe to be an ideal standardized method of disclosure that when delivered promptly to decision makers will enable them to make prudent choices regarding services, servicing and serving the best interests of participants. The format for disclosure accurately summarizes historical information in a manner that is easily understood by decision makers with varying levels of expertise, and therefore is useful in making decisions that benefit the plan and its individual participants.

The fifth element of disclosure is conflicts of interest. A detailed statement that clearly discloses the names of individuals or entities whose interests are or could potentially be -- and here's the qualifier -- adverse to the interests of the plan or the interests of its participants is essential. It should contain facts and circumstances and other written explanations and clarifications. For example, revenue sharing including its amount and purpose should be disclosed in this purpose because it's compensation shared between service providers.

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I know I need to wrap it up. So this hearing is not about the well-being of service providers or the financial service industry, or even about me. It's about the plan participants. And I believe that this form of disclosure as I've described to you -- those five elements -- will indeed protect the interests.

And my final comment is this. At the end of the day, we're not suggesting that we should control the industry. And we're not suggesting that plan sponsors or participants should be told what to do. All we're saying is tell them what the purpose of the services are and what the economic impact of those are, and then let them make their own decisions. But that's how everything else works. And we should demand that also.

And I appreciate the opportunity to testify. And I'll take your questions.

CHAIRMAN CAMPBELL: Okay. We'll start over here.

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PANEL MEMBER WIELOBOB: So in your example, you're looking at like a per participant illustration of net and gross?

MR. HUTCHESON: That's exactly right.

And this is an important thing. Anything that can be done at the plan level can be split out at the participant level. Anything that can be done at the participant level can be rolled up to the plan level. So saying that it's too difficult to do one or the other is not the case.

PANEL MEMBER WIELOBOB: And that was my question. So you're actually talking -- we're talking here about informing plan fiduciaries.

MR. HUTCHESON: Right. And so -- but it's both. It's combined into one.

If you can provide plan fiduciaries with the gross to net, you can provide anybody with that information if they want it.

PANEL MEMBER WIELOBOB: We've been talking is indirect service providers and their compensation. This would all be rolled into that, I presume -- into the numbers?

MR. HUTCHESON: That's right. And I want to clarify. Even though the format of disclosure is simple as you look at it, there has to be detail that backs it. And that detail is sum totaled into the simple disclosure.

We hear that plan participants will become overwhelmed or frightened or discouraged by too much information. Well, I just summarily disagree with that. I mean, people are smart. We're adults. We pay our bills. We work hard. We do what we can to get ahead in this world. And they're capable of understanding this stuff.

But it starts with a simple disclosure statement. And then the detail behind it of who's providing what services and what those services are for, and whether there's conflicts of interest is absolutely key to being able to provide something that is so simple like this.

PANEL MEMBER WIELOBOB: Thank you.

PANEL MEMBER ZARENKO: One follow up. You sort of talked through what you think plan fiduciaries need to know. Do you have any comments about the way we approached it in our proposed regulation? I just can't tell if you sort of feel like that just missed the mark, or in revising to a final rule we need to keep these things in mind.

MR. HUTCHESON: Yes. The latter.

First of all, I applaud you for the hard work that you did. Clearly, you're trying to get to the issue of this matter. And I appreciate that very much.

I didn't want to come and split hairs on the proposed regulation. What I'm saying is look, at the end of the day, we've got to provide something to participants that's meaningful and easy to understand.

The first question is, is it possible to provide full disclosure. Yes. The difference between gross and net returns is the cost, and it encompasses everything. And that cost is relevant to a lot of things -- constructing portfolios, estimating real rates of return over time, constructing a portfolio with a profit risk profile. If costs are higher and people don't internalize that, they may create a portfolio that has less risk, and to adjust you have to increase the costs because you've got to increase the volatility of the fund trading -- whatever. Those are examples.

So the issue in the regulation that I disagreed with is that bundled service providers can't be treated differently for the reasons that have been stated in the last couple -- if you disclose an expense ratio that pays for something other than fund management, that's not good. I want to know what I'm paying for. And so if there's subsidies built into the expense ratio, those need to be identified and exculpted out, carved out and reported separately. Hiding things in aggregate form, like in a prospectus for example, is not helpful to fiduciaries or participants.

And the prospectus -- the very name denotes forward-looking estimate. That's what prospectus means. It's not the real thing. What the real costs or what happened after the fees are charged, and that's why you have to get down to the plan level and/or the participant level to find out what's being assessed.

PANEL MEMBER ZARENKO: I think a lot of your discussion has focused on costs. And I want to go into a little terminology here. Our reg focuses on compensation that's received by the service provider.

MR. HUTCHESON: Right.

PANEL MEMBER ZARENKO: And I just want to make sure we're talking about the same thing. I'll give a real easy example.

But say if a participant takes out a loan, I think our contract would require if that costs $50 to take out a participant level loan.

MR. HUTCHESON: Right.

PANEL MEMBER ZARENKO: That's the compensation to the service provider --

MR. HUTCHESON: Right.

PANEL MEMBER ZARENKO: -- if the participant chooses to take out the loan. That's I think what we're envisioning. When I think of the costs to the service provider, maybe $18, or $32, or whatever it is.

MR. HUTCHESON: I see your point. I'm talking about what's charged and assessed to the plan or to the plan participant for whatever the service is. That's what I'm talking about.

The reason why I use the term cost is because just last week, I got one of these contracts that was previously discussed. And in there, there are fees defined in one category. And then the next paragraph, there are charges. And the next paragraph, there are assessments. And the next paragraph, there are allowances. They're all costs. You can call them whatever you want. I want to know what they are. And so our fees are only this? All right. Well, what are your charges, allowances, assessments and everything else? Tell me all those.

So when I say costs, we're talking about --

PANEL MEMBER ZARENKO: So we are talking about the same thing?

MR. HUTCHESON: Yes. And there's one other thing that I don't think your regulation contemplated. And that is the transaction costs.

The brokerage commissions can be quite substantial when somebody is trying to get a better than market rate of return, and they're turning over the assets within the

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funds, they're incurring brokerage commissions. And there's also other friction that's costs. And those are just as relevant. Those transaction costs can be equal to or greater than the fund expense ratio itself. In fact, a number of years ago, thestreet.com published -- they looked at a fund that had a one percent expense ratio, had a five-star rating from Morningstar, and had 800 basis points in transaction costs -- not disclosed. That's nine percent fee on one fund. The participants thought they were being charged one percent.

Now in an efficient market -- that's contested all the time -- I believe the market is efficient, therefore trying to beat the market and charging all those trading costs is a futile exercise, and participants need to make up their mind. Do they want to embrace an approach where they try to beat the market? If yes, how much does it cost?

And it has to do with the validity

of what's reasonable to an individual or to a decision maker. Because reasonable means something different to me than it does to you. But you start with disclosing the economic impact and then let the people make their own mind up about what reasonable is.

PANEL MEMBER ZARENKO: Thank you.

PANEL MEMBER DWYER: Those brokerage commissions, would they be disclosed anywhere at anytime --

MR. HUTCHESON: Yes.

PANEL MEMBER DWYER: -- under the current regulatory regime?

MR. HUTCHESON: Well, there's an SEC requirement disclosure in a supplement to the financial statement of a fund that's called the statement of additional information. These folks before me mentioned that. And they're stated in the statement of additional information as either a hard dollar cost or a basis point charge.

PANEL MEMBER DWYER: And that

would be after the transactions?

MR. HUTCHESON: That's right. And it is in addition to the expense ratio. It's in addition to any consulting fees that are passed through to the plan level trustee for payment -- the CPA audit fees that may be paid by the plan and so forth. They're in addition to those. And they can become quite substantial.

PANEL MEMBER DWYER: Another question. Many commenters have told us that it would be just way too burdensome -- very difficult -- to get information that goes beyond the expense ratio, for instance, from investment managers to funds that the plan would invest in. What are your thoughts on that?

MR. HUTCHESON: Well, that's nonsense.

PANEL MEMBER DWYER: Why?

MR. HUTCHESON: Well, because first of all, it's immediately known every

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time you buy or sell a stock, there's a $.03 to $.06 per share trade. And it's a real cost that's assessed against the participant account balance. It's immediately known.

And so what we're talking about -- you know on the 1099, there's little codes that say this is for an IRA roll-over, this is for a premature distribution. It would be so simple to assign every time a cost is done, this has got a code B. This is a brokerage cost. And you just tag it with a B, and that's what it is. And you funnel all those into a central location, or from the service provider's location down to the plan level record keeper. And shazam! You've got all of those costs.

And the record keeper knows the pass-throughs. And a pass-through is like where a CPA or a lawyer provides a legitimate service. They invoice the plan. The trustee authorizes it. And it's paid from the plan assets. Those are known by the record keeper because they have to initiate a trade to free up the cash to pay the service provider.

So a lot of this stuff is immediately known. The key is bringing it in to a centralized location where it can be compiled in the statement that I'm proposing.

PANEL MEMBER DWYER: Thank you.

CHAIRMAN CAMPBELL: Going back to the question about brokerage that you had asked. So the SAR's are all after-the-fact trades. If you were entering into -- or summary of after-the-fact information -- if you were entering into a contract you were providing an estimate up front, how would you see that being laid out?

MR. HUTCHESON: It's an excellent question.

Going to last year's brokerage commissions probably doesn't give the fair picture because as the economy ebbs and flows, fund managers make decisions as they go along. And so one year, you may have high brokerage costs.

I think the key is for participants to have enough information to understand what the purpose of the fund is. So if it's an actively managed fund and it's supposed to be trying to attain a certain output -- a certain modeled rate of return which the regulations already provide for -- I think having some measure of understanding what the historical -- maybe a three-year turnover cost is. Because transaction costs are fairly represented in the amount that a fund turns over. It's underlying securities.

Let me tell you --

CHAIRMAN CAMPBELL: It's essentially the approach the SEC's taken recently.

MR. HUTCHESON: Yes. There's a simple mathematical algorithm that can calculate reasonable cost based on turnover. And so we estimate things in the market all the time, like what the value of a publicly-traded security is. A lot of that stuff's based on all relevant information. And the market sets the price. And based on turnover, you could take a similar approach using a simple mathematical algorithm.

So transaction costs are important. I'm not saying that those are more important than anything else. I'm just saying that claiming that all of these costs are not available or as burdensome, it's burdensome to the participant not to have them. But that's about it.

PANEL MEMBER CAMPAGNA: Okay. Portfolio transaction cost brokerage. What we're hearing from funds is that it's impossible to break out what plan they're really involved in, because the broker is actually performing the service for the fund. And you think that that's a possible piece of information that can come back to the plan? Or do you agree with the arguments that it's very difficult to get that information?

MR. HUTCHESON: Well, I think that that is a hair-splitting red herring.

I appreciate you asking the question. But I don't think it's relevant. I think that you can look at the fund and see what the overall approach is to managing the fund and monitoring the turnover of the underlying securities. And that's a good reasonable way to determine what that cost is.

And like I said, whether an individual plan incurs more transaction costs -- yes, maybe. But it's not going to be material. I think you can get a good material number by looking at what the fund manager's doing at the fund level for that particular item. And I think it's relatively simple to do it.

PANEL MEMBER CAMPAGNA: But you need more than what's currently in the prospectus where the turnover ratio is actually described regarding portfolio transactions. Is that what you're saying?

MR. HUTCHESON: Well, this is where we're coming down to issues of understanding of how to construct a portfolio that is prudent. It comes down to understanding what the overall objective is. And if the funds have substantial turnover and the returns are low, that becomes immediately relevant.

And the transaction costs are not in the prospectus. They're not stated in the prospectus anywhere. They're stated after they've happened in a supplement to the fund's financial statement that they file annually with the SEC. But it's a relevant cost -- a very important cost -- and not disclosed. And that's why I propose the gross to net. It captures it.

PANEL MEMBER CAMPAGNA: And that's all in Appendix A?

MR. HUTCHESON: Yes.

PANEL MEMBER CAMPAGNA: Thank you.

PANEL MEMBER BUTIKOFER: So you're

advocating that we get this total dollar disclosure and then allow everything else to be upon request. One concern with an approach like that though is are enough people going to request it for it to be beneficial versus if we just allow the information to automatically be required and available?

MR. HUTCHESON: Well, it's a good question.

I have no objection to it all being immediately available. I don't object to that. I'm trying to provide a reasonable balanced approach that I can live with as a fiduciary. I'm looking at this from my own point of view saying what can I live with.

Fiduciaries -- and this is no secret -- many fiduciaries in the United States are asleep. They don't really understand. They're good people. They're trying to do the best they can. They may be overwhelmed with their businesses or whatever, but they're absent in their duties.

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And a lot of times, participants bring things to the attention of fiduciaries that they the fiduciaries would not have otherwise known. And so I'm an advocate of making sure that the details are available. If a participant wants those details, I think that we ought to give them those details.

If we give those details to everybody, is it going to help them create more retirement income? Maybe over three or four years once people start getting it, and it's absorbed and they start to assimilate what this means. Maybe.

But in the meantime, I'm proposing something that I believe is an incredibly simple solution. It's gross to net. The difference between the two is the cost of the plan to a participant or the plan level. You can roll it up or roll it down either way. It's getting the relevant information. And then two different people can measure whether that's reasonable for them.

PANEL MEMBER BUTIKOFER: Thanks.

CHAIRMAN CAMPBELL: All right. Thank you very much.

MR. HUTCHESON: Thank you.

CHAIRMAN CAMPBELL: And last on our agenda for the first day is Chris Thixton of Pension Consultants, Incorporated.

MR. THIXTON: Do I have to talk fast?

CHAIRMAN CAMPBELL: We will give you your full measure of time. We can't promise the audience will stay.

MR. THIXTON: As long as you do.

Thank you for the opportunity to speak. My name's Chris Thixton. I'm the Director of Vendor Services for Pension Consultants representing the firm.

Pension Consultants works exclusively with employers that have qualified retirement plans. I'm not going to comment at all on welfare and health plans.

Specifically, I work with

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employers with qualified plans in their searches, their valuation, monitoring, benchmarking, negotiations, helping retirement plan committees make decisions on their service providers. So as I listen today to everybody else in terms of what they advocate and their association and their business model, I'm taking notes and I'm thinking how in the world after this goes into effect are the plan sponsors -- the fiduciaries -- going to use the disclosures and the information? And I normally work in the trenches gathering the information. And today, we're really talking about a 50,000-foot view of what needs to be done.

There's always been a responsibility. People have commented on it already today that the plan fiduciaries have a responsibility to investigate, a duty to know, to act in the best interests of the participants to make these decisions. It's been there.

The gentleman that sat on our far right asked the question two or three times today, are plan sponsors getting the information that they need? And initially, if they don't ask the right questions, the answer's no, they're not getting the correct information.

This proposed regulation will be sweeping. December 13th -- that'll be the day that I mark on my calendar. That's when it came out. Oh my word. Look at that. That's going to be sweeping. It's going to change the way that we all do business. It's going to put it on its ear. And from my standpoint, this is going to be a good thing.

Now can we go from A to Z in one step? I don't know that that's necessarily possible. But if we get from A to B to C to D, all the way up to M and N, it's going to be a good thing for the plan sponsors and the participants.

My comments are this. First of

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all, you talk about the manner in which disclosures can be provided. There's not a manner in terms of timing. There's not a manner in how it needs to be provided. And I contend that a lot of plan sponsor fiduciaries, it's all they can do to read a record keeping service agreement, let alone every piece of disclosure that comes in.

I do think there's potential for inundation. I think that the way that it's written right now, it's open for interpretation. You've got one service provider that could interpret it a certain way and say this is how we're going to make disclosures, and boxes and boxes of information come in. You have another service provider that says this is the way that we interpret it, and we're going to provide everything really crisp and clean, and it's submitted electronically.

At the very minimum, there needs to be some type of reference document to say this is everything we're providing you. This is everything that you need to know. Under 408(b)(2), the shift that people talk about today from the plan sponsor to the service providers, the service providers in that representation need to say under 408(b)(2), this is everything that we need to provide you. Here's the source document to say here's when it's coming, here's where it's at. So at least the plan sponsor fiduciary knows that they have all the information and where they can go to get the information.

We've talked about does the prospectus give enough information. We can argue that. Is it going to be disclosed in the record keeping service agreement? In the appendix? In a trust agreement? In some type of side agreement? At least let's just get the information. That's the thing that I'm excited about with the regulation is just having more information because we do in working with service providers, we spend a tremendous amount of time just getting information. And this regulation shifting to service providers says you need to provide this information, it's going to help. It absolutely will help.

We talked a lot about fees and please, let's not sidestep the issue of services. At the very beginning of the regulation it says disclose all services. From my standpoint, it's kind of interesting -- if I may -- you had all the service providers at the top of the day, and then the people that kind of work with the plan sponsors looking at the service providers. Here we are at the end of the day, so we're pitted morning against evening.

It's not my intent to go to battle against a service provider in terms of getting information. But sometimes that happens. We want information to make a well-informed decision acting in the best interests of the participants. So we talk about fees.

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All services again. What is all services? In my seat today, I'd like for the Department to provide greater clarification on a lot of these issues. You did this right. You did this wrong. We need to do this. We need to change this.

If you'll take what you have right now and provide greater clarification so we all understand what it means as a service provider that provides banking -- does that include a simple checking account to make distributions, and then have to go through all the disclosure requirements? Where are those lines? Because whatever you put into play is what we're going to have to follow. And if we understand it, then we're all on the same page.

Right now, I've heard so many different comments in terms of their interpretation that it's not really clear. And that's the one thing when I make that next step with a plan sponsor working with a committee, I want to understand how the game is played. If we understand it, then we can work within that. Right now, we work within the 404(a), the plan fiduciary responsibility to evaluate and monitor, to make good decisions. This will help.

All services -- let's go back to that. I think it's easier to monitor and evaluate and make decisions on fees than it is services, because if you continue to press and to push and to ask information for fees, if they're a big enough plan you will get that information. Now you'll be exasperated. You'll be worn out. It'll be several weeks, even months to get the information. But you'll be able to get it.

But what about services? How do you compare and evaluate services in a way that -- education? Well, we'll do education. What does that mean? We'll outsource your loans and distribution. What does that mean? In terms of all the deliverable services to both the plan sponsor to the participant, what is that?

We talked about the car. We've worn that out already. But in terms of the actual services we're going to receive in the bundle or broken apart, how can we go down through and make a determination of what we're actually going to receive if we're just aggregating it all together?

We'll provide testing. We'll provide record keeping. We'll provide reporting. Okay. But the actual execution, the day-to-day, the benefit manager, the HR director, the CFO responsible for the plans, they'll end up going, well I thought you were going to do a lot more than that.

Please just provide clarification on what all services means. I like the idea of having all services disclosed. I think it will be helpful to the plan sponsors making decisions.

I'll concede the fact that to the

service providers, it'll take a lot of time to run through their groups and to get it all in order to be able to disclose. I do think it'll take a tremendous amount of time on their part. I think it'll be a tremendous cost on their part. But at the end of the day, it's going to be helpful. It's going to be helpful to the plan sponsor and ultimately to the participants.

So again, the all services -- we need that clarification. We need that included in the regulation, and not just broad categories. Because there's a lot of evaluation and monitoring and decision making on the services, and not just group them together.

Two. On the fees, this has been said before, and I'll echo it again. There are two major components in any retirement plan. It's the investments and the record keeping. You want to call it administration. All right?

On the investments, what's your net return? The gentleman before just talked about net return. Forty basis points, 50 basis points, 60 basis points for investment management. At a certain point it has to become a moot point if you're doing your due diligence on the investments. Net return is imperative. It's the most important thing.

There are no such things as 200, 300, 400 basis points, funds that are just outstanding that everybody's just going to beat down their door because they have great returns and they're charging a lot. It doesn't exist.

Plan committees look at the investments and they determine, that's appropriate investment. We're doing due diligence on that investment. It's good.

What are the expenses related to that money management? Separate and distinct is what is the service's -- what is the expenses, the cost, the compensation for record keeping. And I don't care if it's stated as a per participant, or an asset-based charge, or a combination thereof. There needs to be fees attributed to the administration record keeping, and fees attributed to the investments.

At the end of the day, you can wrap them all together and say here's the all inconclusive, but break it apart to be able to see just the amount on the investments and administration record keeping. I don't even mind if -- wrap it all together. Don't make the affiliates break it down, because you can still determine the fees attributable to record keeping is X amount as basis points or per head. And then that's the basis of making your comparisons and evaluations. One per head, one asset-based -- you can compare that for record keeping.

But again, if we wrap it all together, then -- and the lady from Hewitt mentioned it -- the largest portion of that fee is going to be the amount attributed to the investment management -- 40 basis points, 60 basis points. Again, it's a moot point when you look at net return. If we're really going to act in the best interests of the participants when it comes to the record keeping, focus in on that amount attributed to the record keeping. All right?

Simple point -- and in fact I'd like to answer some of the questions you've already asked today -- is what happens if there was no revenue sharing? What if there was no revenue sharing on any of the funds? I assure you that every service provider's going to figure out what it takes to provide administration and record keeping, if there's nothing to share back. So those two need to be broken apart and separated.

Now my last comment -- and the last two parties have hit it a little bit -- is my term: cross-selling. That's something that I don't believe or maybe it's not my understanding in the regulation, it wasn't addressed.

In the issue of cross-selling, I come in as a broker or an intermediary, or maybe I'm a representative of a service provider, and my job is to provide the education or to provide value added. And then in the negotiation process, the service provider says, we will provide you services for this 401(k) plan for 40 basis points. Now if you'll allow our representatives to sell additional financial services -- IRAs, college education, capture the roll-over -- then the fee's going to be 35 basis points. In addition to that is, all right, our job on site as a registered representative is to provide services to the plan. The plan is paying it for the service provider. They're paying for the representative on site to benefit plan participants.

And what it turns out to be is, 75, 80, 90 percent of the time, is selling

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additional financial services. And then you have participants that are not benefiting -- subsidizing the people that are getting individual attention, typically, the HCEs, those with high account balances.

So we have the plan paying somebody to solicit additional financial services. So I believe the issue of cross-selling -- it would be very beneficial -- should be addressed.

Now it's at the end of the day, and you have to worn out. I've been worn out just sitting there at my desk, but if I can summarize, the disclosures are going to be a good thing. Please clarify how it needs to be provided -- some reference document so that we know exactly -- specifically what we're dealing with. Otherwise, we're going to be cross-eyed. Currently, plan sponsors find it difficult to go through all the information that they get now.

Second, please clarify on the all

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services. What does that mean, and just exactly what do you expect a service provider to provide? I think that's a very good thing. I would ask for a lot more information than a service provider's going to be willing to provide. So we'd have to come to some point, but you're the ones that are going to make it happen.

And with fees, separate out the record keeping and investments.

Finally, address this issue of cross-selling. This issue of cross-selling -- and if I had more time, I would dive deeper into it -- what are the services going to be provided? All right? Who's subsidizing what? In a 401(k) plan, you've got a 457. We'll throw that in also. Because your 401(k)'s big enough. Well, who does the 457 benefit? Typically higher wage earners.

So that's a practice that I don't see in terms of conflicts of interest addressed, but it's always set out on the

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side. It's always going on. And it's not just brokers or registered representatives. It's the people within the service providers -- as the lady from Georgia had mentioned -- collecting assets. That's a big, big issue. And it's big dollars.

Thank you.

CHAIRMAN CAMPBELL: All right. Thank you. Start over here.

MS. WIELOBOB: I don't have any.

MS. ZARENKO: I'm thrilled to hear you saying that this regulation will help. But I just want to know what you mean -- help plan fiduciaries make better decisions? Help establishing a more efficient marketplace? Do you mean intangible benefits, i.e., plans and participants are going to pay less over time because of increased transparency? When you say it helps, what do you mean?

MR. THIXTON: Ma'am, I've toted this little flashlight around going, you have to do due diligence on your plan. You've just shined a huge spotlight on this issue. Okay? Now you put teeth -- you put teeth into it.

A service provider has to provide disclosures. Well, in my line of work, I ask for information. No, we're not going to provide that to you. You turn to the plan sponsor. Include them, or cut them. Well, we don't want to cut them because we really think they'll be good. How do you get information? This is going to force people to provide the information.

Now the whole open for interpretation issue, that's my concern. Please just provide additional clarification on what that is because my definition of how I read everything and what a service provider may be at odds still. But at least if we can get additional information -- all right -- regardless if the plan sponsors do it themselves or they hire somebody to help them, if you've got the information, then it's going to help provide more meaningful evaluation.

Currently -- and again, the question is do the plan sponsors get the information they need? No. No, I've got 12 projects going on right now. And of course, they send these big boxes of information and I always start off cross-eyed.

At least this provides some uniformity to say here, this is where we're going to start. And I think that once you get the ball rolling, there's going to be more guidance -- interpretative bulletins. There's going to be other best practices that have come along that provide this information.

I'm not in favor of standardizing everything. I work with enough service providers, and in fairness to them, that would be very, very difficult. But to get the information.

Another example, everybody talks about the mutual funds. There's been a little discussion on collective trusts, group annuity contracts. What about stable value accounts?

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What about the fixed accounts where you're dealing exclusively with the yields -- the crediting rates? And the service providers will say, well, there is no operating costs. Those are huge swings. Those are huge swings in terms of fees and how it affects the overall plan when it's bid out. It will help.

MS. ZARENKO: So you think possibly over time people will be paying lower fees?

MR. THIXTON: Ma'am, I have no -- I have no dreams that this regulation will get us where we need to be in 12 months, but it'll provide a huge, huge step in the right direction.

MS. ZARENKO: And of course, with benefits there come costs. Additional disclosures -- it's more time. It's more paper. It's more lawyers. It's more everything. It seems like you would support the idea that the benefits of this proposal, especially in the long term, will outweigh the burdens.

MR. THIXTON: Yes. Now, I will for the service providers' standpoint, when I read the costs to do this, they'd mentioned it several times a day, it'll be a lot more. I do this type of analysis. It'll be a lot more. There'll be a lot of costs. So anything that can be simplified -- and that comes into the clarification again -- if we're clear in terms of what it is that has to be disclosed -- all right -- then we know exactly what we're aiming at. But right now, there's a target out there, and I don't know where to aim. So if it's clear, then we can all get on the same page.

MS. WIELOBOB: Can I make a quick interrupt? When you're talking about costs of compliance, do you see that as like an initial high cost that once the industry gets used to, it would -- yes?

MR. THIXTON: Absolutely. Absolutely.

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MS. WIELOBOB: Go ahead. Thanks.

MS. DWYER: Of the bundle provision of the regulation, what's your position on that? We have -- At the moment, the proposed regulations do not require allocating. What do you think about that from --

MR. THIXTON: In terms of allocating how their compensation is defined?

MS. DWYER: Yes. A provider that offers a bundled service under the proposed regulation would not need to allocate compensation within the bundle. What are your thoughts on that? Do you think --

MR. THIXTON: I believe I understand. If I can address maybe two parts of it.

MS. DWYER: Right.

MR. THIXTON: One is, I am very much a proponent of separating out the investment costs from the record keeping.

Now somebody mentioned earlier,

okay so you get over on the record keeping, now we're going to break it down under the record keeping on all the different affiliates. I don't think that's necessary. Personally, I'd love to see it. But for what is on the table and what you're trying to accomplish, and ultimately the time versus costs to implement these things, if we just had the record keeping costs together, that's all that necessary. But -- and I go back again -- if there is no revenue sharing, we're going to get a lot of fees attributed to record keeping.

It can be done. And in fact, I can give you plenty of case examples of where it is done with bundled providers. They simply separate out the two. They don't drill down among affiliates. But they can say this much for investment management, this much for record keeping. And as the lady from Hewitt had mentioned is over time, if you know what it is on record keeping, that's what you focus on record keeping.

The investments -- you ought to be doing that ongoing -- consistently also. Reviewing investments, changing them out -- what's the fees? Determining if the net return is appropriate based on the objective. So those two should function separately, and you bring it together at the end, put a nice little bow on it to say the total cost is.

But I've done this for several years now, and I simply have no way of being able to provide counsel to a plan sponsor without separating out those two and making a meaningful recommendation.

If --

MS. DWYER: All right. Go ahead, please.

MR. THIXTON: If you're unbundled, if you're bundled, it can be done. It can be done. It's just the drilling down I think is the hair splitting. And of course, I'm not in a position to hair split anything myself.

(Laughter.)

MR. THIXTON: But I don't think that's necessary within the regulation.

MS. DWYER: Thank you.

CHAIRMAN CAMPBELL: How often in your work with your clients do you actually run across service providers who are saying this has no cost?

MR. THIXTON: Mr. Campbell, the answer would be never.

Now re-phrasing the question, how many clients come to me with a box of information where they've gone out to vendors -- service providers -- and asked for an RFP, a request for information? It comes back and it says it's free every day, every week. I mean, I always refer to the box. They send a box. They'll have five, 10, 12 different RFPs in there. And inevitably over half of them have that it's free, the zero price plan, which I love to hear that.

But when you engage in a process

and you write out we want to know what the compensation is -- and I like the gentleman that spoke just before me. I use the gross to net differently. But tell me what you want to make. Wrap it all up. You don't have to break it down on the investment side. Wrap it all up on the record keeping side. You don't have to break it down. Just tell me what you want to make, all inconclusive.

If you ask that question correctly, and then you determine the fees -- or the revenue sharing that's attributable to this particular plan, you can come up with a net amount.

But I don't care if it's small plans that are under $25 million, those that are net $50 to $100 million, or even the larger plans over $100 million, they'll still come up with the, hey, here's the zero price plan, and the all inclusive, all services are being provided. Again, that comes back to the clarification of what are those services so we can assess one group's services to another.

CHAIRMAN CAMPBELL: So going to your suggestion for kind of the executive summary or the reference document, basically you're envisioning what? Say a one- or two- or three-page, whatever length disclosure that says in the 12 boxes we sent to you, look in box 3 for page 7 and that's where you'll find this part. Is that kind of what you're describing?

MR. THIXTON: Yes. Absolutely. And in my dreams when I think about what 408(b)(2) will really look like, once there's a greater clarification on services and on fees, okay there it is. Service providers, this is what you need to provide. Okay?

They have a lot of the information already. They have it in their service agreements. They have it in the prospectuses. They have it in the supplement of additional information. They have it in the trust agreements. Why make them put together one document? You know, one big document and combine it all? Let them send it all and then provide this one source document to say, listen, we have to comply with 408(b)(2), and in doing so, these are the things that we have to provide to you, and this is what we've sent to you.

Because what's going to happen is, they're going to turn that information over to another person on the committee. It might be me. We'll do work. We'll put it in a filing cabinet. All right? Put it on the network. Then six months -- 12 months down the road, somebody's going to pick it out. All right? Well, if they had the one document, then they know how many other documents they need to pull out to find the information.

One of my challenges right now, again, and I don't deal in as much information as what you're proposing that needs to be disclosed, is just getting the information right now crosses my eyes. Do we have it?

And again, there isn't the uniformness. Well, where would it be found?

So I spent a lot of time just organizing. And I do this for a living. You provide this to the plan sponsor, they'll quit. They'll give up.

Now, this is me coming from the 50,000-foot view back down to the trenches. Once this goes into effect, how are we going to use it? How is it going to be meaningful? All right?

CHAIRMAN CAMPBELL: Okay.

MR. CAMPAGNA: Yes. What you just described, how does it differ from what we have proposed, which is that the service provider can point to the prospectus, point to other documents and say here's where the information is. Is it close to what you're proposing or do you have something else in mind?

MR. THIXTON: Sir, I think -- and again, if you allowed me to write the proposed regulation, I'd be a lot stricter. But for what I think what's needs to happen for the plan sponsor, if they point to say hey, it's in the prospectus. All right? Now, that's going to be the operating expense.

MR. CAMPAGNA: Well, what about page 5 in the prospectus and paragraph 6 -- something to that effect?

MR. THIXTON: That'd be great.

Now let me tell you what's not there. And I think some people have echoed it. It makes reference to the, well, we may engage in sub-transfer agent-types of arrangements. You're not going to find that in a prospectus. There's going to have to be another disclosure saying this is what that sub-TA is going to be.

And there's certain service providers that say, we don't engage in revenue sharing. That's not right. They all do. Now, it may not be in 12b-1. It may not be a sub-TA. It may not be a finder's fee or a dealer concession. But there are factors that are considered. And in fact the big issue there is a lot of times we'll be in the stable value product. All right? Those crediting yields will be adjusted as a factor to determine the overall pricing.

So to the extent that they don't have it in the prospectus, there'll need to be an additional disclosure, which is referenced in the source document. And there will need to be additional disclosures generated. And that's the one thing I know the service providers don't want to do. It will take a lot of time.

We ask for that right now. The one gentleman you asked about how long does it take to push things through on the insurance level. Okay? We've been working on one for 18, 24 months. All right? They can't get it through the state. And it's on a product. It's not for a particular plan sponsor. It's on a product. So it's going to be a lot of

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head banging for service providers, but eventually we get through it initially, and then it'll be better.

MR. CAMPAGNA: Thank you.

MR. THIXTON: Yes.

MR. BUTIKOFER: Two questions. You've talked about giving this box of information with this sheet, but is that still going to be too overwhelming for -- especially for small fiduciaries --

MR. THIXTON: Yes.

MR. BUTIKOFER: -- where can they actually use it or are going to have find someone to help?

MR. THIXTON: You know what? I'd actually pull it out of the preamble. You have something in there that says that plan sponsors might find more liability and may want to engage outside consultants. That's why I remembered December 13th. I appreciate that.

(Laughter.)

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MR. THIXTON: Yes, sir. I do think it'll be inundating. But right now -- as Mr. Campbell asked -- well, we've got this zero price plan. People get hit with it all the time. Zero price, it sounds great.

You asked the question earlier. Would there be any advantage of allocating costs into the investments over the record keeping? Absolutely. We do that right now in the industry with zero price plans. But at least the step we're taking provides more information.

Again, it's always been the responsibility of the plan sponsor to investigate and to know. Now again, a lot of them don't do it, but at least if they had the information, it's going to be easier for them to make that determination as opposed to well, what question do I have to ask. How do I even get the information? And some service providers right now will go, well, you're not big enough. I'm not going to provide it.

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This 408(b)(2) will at least state you have to provide a certain amount of information.

Again, I have no ideas of grandeur of they'll use it. But at least it'll be there.

So, a second question?

MR. BUTIKOFER: Yes, the question was follow up to a question you talked about there's going to be this high startup cost. And then the compliance costs -- if I caught your answer correctly -- you think is going to fall substantially.

MR. THIXTON: I believe that to be true.

MR. BUTIKOFER: And do you have a story behind that assumption? I'm assuming that a lot of the high cost is going to be learning about the regulation and how to comply with it. And I think you've also suggested that a lot of the information is actually already readily available if we could just pull it all together is what we've heard

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throughout the day.

MR. THIXTON: You said do I have a story?

MR. BUTIKOFER: Sure.

MR. THIXTON: Well, yes. Yes, I do.

I'll give you an example of a plan that's roughly $100 million, and they've got 5,000 participants. They go through their search process to find a service provider. They have a 401(k). And they narrow it down to their final two. They go through the site visits. And they go, you're the one.

So they send the service agreement. And again, through the whole process is what services do you provide -- the all services issue. Right? Well, we do this, and we do this. And the PowerPoint looks great. And they've got the interaction and they've got all the bundle material. That's great. And we ask for memos of understanding to say, well, just exactly how do you execute this. How do you implement this type of service and how's it executed and how do we measure it? All right?

So we're talking about it -- and of course, the red carpet treatment. And then when the service agreement comes in, it's indemnifications and it's the hold harmless, and it's the line items of, well, we'll provide record keeping. And we'll provide testing. We'll do signature rate of 5500. You know, those types of things.

And we raised the hand and said well, you had mentioned through this whole process that you would do X and Y and Z, and this is how you would do it. This is the service standard attached to it. And they said yes, we would. And of course, a $100 million plan, they're big enough to command that. So what we do is we start to engage in a process of putting that in the service agreement.

Sir, it was five iterations that

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took three months. So that's just one example. But it was big enough. They wanted the business. And they did it. And that was just one set of requests that we had. All right?

Now, you get into what your regulation is going to require, and then additional questions that we ask. And of course, it's got to go through compliance and legal and everything else. I actually do feel sorry for the service providers for what they're going to have to comply with.

But again, we get past the initial push, it ought to be easier to maintain.

MR. BUTIKOFER: Thanks.

MR. WILLIAMS: Just a comment. I mean, it'll be easier on the service provider if they know what they have to disclose --

MR. THIXTON: Absolutely.

MR. WILLIAMS: -- so they can get ahold of it. So then it's just a question of delivery of information. And then people like you and others that are hungry for the information, they'll hopefully know what to do with it to lead the plan sponsor to the decision that they need to make an informed decision.

And the costs associated with gathering the information will go down if we can more accurately define what the information is that has to be delivered by the service provider.

What I'm curious about in terms of writing the class exemption is whether we need to extend the class exemption concept to a service provider who through no fault of his own cannot get ahold of the information that they're required to be providing under the service agreement.

MR. THIXTON: I think that's a very good point. I think it's going to be needed. And of course, it almost becomes that out to say well, I couldn't find it.

You mentioned the preamble.

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Provide a specific monetary amount and if not, you may use a formula. That doesn't say that in the actual regulation. It does say it in the preamble. Well, I think everybody's going to use some type of formulate, unless your core business is hey, we're going to give a hard dollar amount. Everybody's going to use the formula.

I think it would be an out to say, well, we couldn't get the information. Well, try harder.

MR. WILLIAMS: Right. Well, a lot of people are worried though about these inadvertent errors and omissions. And then I view the class exemption as a way to deal with that problem.

The service provider would have a duty to do certain things to get ahold of the information. But it is foreseeable that you would have service providers in a situation where they are not getting the information as a conduit to provide for the plan. So part of the issue is how much of a burden can we put on the service provider to get ahold of information that would have to be disclosed. Do you have any thoughts on that?

MR. THIXTON: Well, yes. But I think I might defer.

I'm an advocate for the plan sponsor fiduciary, not the service provider. But if you don't treat the service provider well, if it's not fair to them, if they don't make a fair amount of profit -- which some people say they make more than a fair amount -- the onus still is on the plan sponsor. I mean, we're shifting a lot of the disclosure requirements to the service provider. I think that's excellent.

But for a plan sponsor to wash all their hands and have to do nothing, I don't think is right either. Because ultimately, they have to make a determination what's in the best interests of their plan that benefits their participants.

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Now the example given earlier about well, their fees are going to be high, and they can't negotiate. I think that's just an issue of they're small. They can't. They can't. They can't. They can't negotiate. So it is what it is. A plan sponsor's going to have to make that determination. They're going to have to make the final decision.

I don't think it's fair to push everything over to the service provider. But the same point, the thing that really makes me excited about this regulation is the business people run businesses. The service providers -- they're trained, they're skilled. Their job is to sell the plans, to get you to say yes. All right. Get them to disclose more information to make a more meaningful evaluation on the plans that are going to be offered to the participants.

MR. WILLIAMS: Thank you.

CHAIRMAN CAMPBELL: Any other questions?

All right. Well, thank you very much.

MR. THIXTON: Thank you.

CHAIRMAN CAMPBELL: And that brings to a thrilling conclusion our first day of administrative hearings on the 408(b)(2) regulation.

Thank you all for your attention and for showing up. And I'm sure we'll see some of you tomorrow.

Thank you.

(Whereupon, at 5:40 p.m., the hearing was adjourned, to reconvene at at 9:00 a.m., April 1, 2008.)

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