U.S. DEPARTMENT OF LABOR

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

+ + + + +

PUBLIC HEARING

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

+ + + + +

Tuesday, April 1, 2008

+ + + + +

The Panel met in Room S-4215 A-C in the Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C., 20210 at 9:15 a.m., Bradford P. Campbell, Chair, presiding.

PRESENT

BRADFORD P. CAMPBELL, Chair
JAMES BUTIKOFER, Panel Member
JOE CANARY, 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

c21020a4-0b71-40d1-bade-e3b09f4800dc

TABLE OF CONTENTS

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

9:08 a.m.

CHAIR CAMPBELL: I'd like to open up the second day in our two days of administrative hearings on our proposed 408(b)(2) regulation.

I won't burden you with an opening statement as I did yesterday, but since some of you weren't here, I thought I would just briefly go over a couple of the issues, and we'll also have Lou Campagna recap our procedures for how we're handling the proceedings today.

I just wanted to point out, as I did yesterday, that we are big believers in the notice and comment process. Not only is it, of course, required, but it's also a process that helps us get to the best regulation possible, and it's one where we will take and consider all the comments that we receive here today with a great deal of consideration as we work through this, because though we will complete this regulation this year, equally important, if not more important, than getting it done timely, is getting it done right. And that's certainly the paramount goal we have, as we have to always remember that ours is a voluntary system, and that we need to foster both the accessibility of plans, as well as the protection of workers covered by those plans.

So with that, we will go ahead and open up. We're open to your praise and your criticism, as I said yesterday, your arrows and your laurels; give them all to us, and we will take them and come out with a better product.

Lou?

PANEL MEMBER CAMPAGNA: I just want to go through the procedures for the hearing.

Speakers will be called in the order listed.

We ask that each speaker stay

within the allotted ten minute time period.

To the extent that members of the panels have questions for the speakers, the questions and answers part of the testimony will not be counted towards the designated time limit.

Once a speaker's opening remarks have concluded, we will allow approximately 15 minutes for additional questions from panel.

We wish to note that you should read nothing into the way questions may be phrased, and draw no inference 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 their oral testimony.

Prior to beginning your testimony, we ask that you identify yourself, your affiliation, and the organization you represent, for purposes of the hearing reporter who will be transcribing this proceeding.

For those who wish to supplement the record, the record for this proceeding will be kept open until the close of business Monday, April 21, 2008.

The official record of this proceeding will be open for public inspection, and copies will be available in the Public Disclosure Room of EBSA, Room N-1513, U.S. Department of Labor at 200 Constitution Avenue.

Let me just introduce the Panel members. We have Joe Piacentini, myself, Fil Williams of ORI, of course Brad, Adrienne Dwyer, Kristen Zarenko, and Allison Wielobob.

CHAIR CAMPBELL: All right. And with that, our first witness this morning is Paul Schott Stevens of the Investment Company Institute.

MR. STEVENS: Thank you very much.

It's a pleasure to be here.

I have with me Mike Hadley, ICI's associate counsel for pension regulation.

We're delighted to have the opportunity to share some thoughts with you today. I will take note of the fact that we're your opening witness on April Fool's Day. I hope it's not a comment on ICI or our testimony.

CHAIR CAMPBELL: We have a dry sense of humor.

MR. STEVENS: We would like to commend the Department for the comprehensive way it is seeking to address 401(k) disclosure in the Form 5500 revisions, in these proposed regulations, and the anticipated participant disclosure regulations, as well.

We strongly support disclosure rules for the 401(k) marketplace that will help assure that plan fiduciaries have all the information they need to make the decisions entrusted to them under ERISA.

My testimony will address the features of the proposal that we believe the Department should retain, as well as the features of the regulation that should be revised, in our view, to achieve a more workable and useful disclosure regime. First the good features, the laurels, as Secretary Campbell put it.

The proposal would require service providers to disclose the direct and indirect compensation they or an affiliate receive in connection with services to a plan. This straightforward requirement would fill a gap in existing regulations. It will help assure that fiduciaries understand the ways in which the fees of investment products compensate plan service providers. Let me give two examples.

First, mutual funds commonly make payments to unaffiliated 401(k) service providers to defray the costs of plan record keeping, or other administrative services.

c21020a4-0b71-40d1-bade-e3b09f4800dc

These payments go by various names; service fees, 12b-1 fees; sub-transfer agent fees, et cetera. But whatever the label, the Department's proposal contemplates that the recipients inform plan fiduciaries about all such payments. Although, in the case of mutual fund fees, these payments come from fees disclosed in a mutual fund's prospectus, the prospectus does not and cannot provide the kind of individualized disclosure to the plan that the recipient of the fees can, and we believe should, provide.

Second, a 401(k) record keeper affiliated with a financial services firm may make investment products of an affiliate available to a plan. If so, the plan fiduciary should understand the full picture of the compensation received by the firm, including the fees going to the record keeper's affiliate. The Department's rule captures this. It would require the record keeper, in effect, to tell the employer the

c21020a4-0b71-40d1-bade-e3b09f4800dc

direct charge for record keeping is X, but remember that you have selected a proprietary investment, so our affiliate will also receive Y in investment advisory fees.

This is an appropriate disclosure structure, and we urge the Department to retain it.

The Department also should retain the rule that, when a bundle of services is priced as a package, the service provider is not required to create an artificial allocation of fees for services, such as between investment management and record keeping. Some record keepers that do not offer proprietary financial products would have the Department require that their full service competitors "unbundle" investment management and administrative expenses, even if these components are not separately contracted for or priced. In effect, they asked the Department to impose their business model on the entire industry.

The Department is correct to focus on disclosure of real payments, and not require the disclosure of artificial allocations. The key for plan fiduciaries is to compare the total cost of record keeping and investments of one provider with the total costs of record keeping and investments of another provider, or group of providers.

Secondly, features of the proposal that should be clarified. These are fully detailed in our comment letter, and I will confine my remarks this morning to two key issues.

First, it's imperative that the Department make clear that this regulation does not turn service providers to mutual funds into service providers to plans. Mutual funds do not hold plan assets, and their advisors are not ERISA fiduciaries. Mutual funds have dozens, sometimes hundreds of service providers, none of whom has any idea about the extent to which particular employee benefit plans are invested in the fund. If these entities were turned into service providers to every plan that invests in the fund, it would, at the very least, become extremely costly and difficult for mutual funds to be offered to employee benefit plans. It also will exponentially expand the information that plan fiduciaries must review. And all or most of that information will not be of assistance to them. Quite the contrary; avoiding information overload is especially important for smaller plans.

And I would note what you all realize, that about nine out of every 10 401(k) plans has fewer than 100 participants.

Now this is not to say that plan fiduciaries do not need to know the fees and expenses of all plan investments, including mutual funds, to fulfill their duties under ERISA to select and monitor prudently plan investments. They do, and our letter suggests two ways the Department can reach that result

c21020a4-0b71-40d1-bade-e3b09f4800dc

without upending ERISA.

The Department could issue guidance on ERISA's general fiduciary rules, reminding fiduciaries of the need to obtain and consider fee and expense information about investment options. For example, by reviewing a mutual fund's fee table, and reviewing and comparing similar information for other investment products.

Alternatively, the Department could require that service providers offering access to investment options on a platform undertake to provide the responsible plan fiduciary with basic fee and expense information about the investment options chosen by the fiduciary. This is, in fact, a routine practice now.

In either case, the information required about mutual fund fees should not, in our judgment, extend beyond the information the SEC requires funds to provide to all their investors. In this regard, SEC regulation already assures comprehensive and consistent disclosure of mutual fund fees and expenses.

Put another way, the Department of Labor should not create special disclosure items about mutual funds that would apply just to one set of their investors.

Second, the Department should scale back the broad sweep of the disclosures regarding conflicts of interest, which, as written, would require a service provider to determine whether any relationship with anyone may create a material conflict of interest in performing services.

In our view, the purpose of this disclosure is already largely achieved by the requirement to disclose all direct and indirect compensation, as well as compensation earned by an affiliate in connection with plan services.

The conflict of interest disclosures of the Department's rule, along with the other items of the proposal, should

c21020a4-0b71-40d1-bade-e3b09f4800dc

be designed to avoid redundant disclosures that obscure relevant information. We therefore recommend the Department narrow the conflict disclosure rule to situations in which a recommendation is being made.

Now admittedly, these are complex issues, and it's important that the Department develop a final rule that is workable, and calculated to assure that plan fiduciaries receive the kind of information that assists them in fulfilling their obligations to enter into reasonable service arrangements.

We look forward to assisting the Department in this endeavor, and I would be happy to take any questions the Panel may have.

CHAIR CAMPBELL: Okay. Why don't we start with Director Piacentini?

PANEL MEMBER PIACENTINI: Good morning.

We heard a lot -- a little bit in your testimony just now, and a lot in comment letters from your industry and others that there are substantial compliance costs that would be associated with the rule as we proposed it. We didn't see as much, I think, in the written comments about what the basis for those compliance costs would be, what are the actual compliance activities, are they more of an up front kind of issue that would be defrayed in a couple of years as systems changed, and so forth, or is it an ongoing issue? Can you elaborate a little bit on what you see as the compliance challenges, and the activities that would be required to comply with a broad approach to the regulations?

MR. STEVENS: Well, you may well ask that question of the specific companies that will be testifying after me who may have looked at those in more dollar and cents terms than, at least, the Institute's had occasion to do as yet.

PANEL MEMBER PIACENTINI: Okay.

MR. STEVENS: But I would focus on

the question of whether service providers to mutual fund become service providers to plans. It is not uncommon for funds to have scores of service providers. In fact, we have a service directory for our industry that the Institute publishes. There are 175 categories of service providers in this book, which I'd be happy to provide for your review.

It is not uncommon, for example, that an individual fund may have relationships with 100 or more brokers.

So if you begin to think about all of those as service providers to the fund becoming service providers to the plan, you then begin to contemplate, as would be required under this proposal, that each of them have to have a contract with the plan. And that would be with every plan that invests its assets through the fund. And that, in turn, may be many, many plans indeed.

I don't know that anyone has yet tried to size the compliance costs that would

c21020a4-0b71-40d1-bade-e3b09f4800dc

be implicit in that. It would subject all of them, presumably, to their prohibited transaction penalties of ERISA.

So whatever the compliance regime around it would have to be very robust indeed to make sure that the requirements of the proposal are met, and when you have so many different service providers involved, I think you can see that the compliance costs begin to expand greatly. In fact, I would say so much so that it would be a tremendous disincentive for many funds to offer their shares through the retirement plan market at all, which in my view would be a shame, because, and I'll bang our drum here a little bit, of all of the investments that you see in the 401(k) universe, I don't think there's any that has more disclosure, greater transparency, than mutual funds, or a stricter compliance environment around them that's administered under detailed SEC regulations.

And that's the best I can do.

PANEL MEMBER PIACENTINI: Okay. Another question: you've proposed, in some sense, a narrower approach to disclosure. The approach that you've outlined, do you see that as a change? I mean, that's not what's going on now exactly. Would that introduce more transparency than exists now, or would that be close to current business practices?

MR. STEVENS: It might be close to the best business practices out there. I would not necessarily say that it is a uniform business practice, and I think it's important to understand that we look at the benefits of the proposal to extend beyond mutual funds to comparable kinds of disclosures with respect to other investment products that aren't subject to the kind of comprehensive disclosure regime and other regulations that we have.

So I would say it's lifting all the boats perhaps to what is an acceptable level. Elements of the industry, I think, probably do observe these kinds of practices already. And that's good.

PANEL MEMBER PIACENTINI: This will be my last question. You said that what a fiduciary needs to be able to do is compare the total cost of one alternative provider, plan provider to the total cost of another, whether it's bundled, unbundled, whatever sector the provider might come from. But it seems like part of what is challenging us in our conversation yesterday and today is, what do we mean by "total?"

You're talking about whether a broker to a mutual fund, for example, would be a service provider to a plan, but the underlying question, perhaps, is whether those brokerage costs for the broker who is making trades for the mutual fund are part of the total or not. So I guess, rather than focusing on who should be a service provider to a plan, and who should be obligated to provide the information, what in our regulation do you think, if anything, was in our total that doesn't even belong in the total, and why?

MR. STEVENS: Well, if the focus here is on brokerage costs, let me --

PANEL MEMBER PIACENTINI: That's an example.

MR. STEVENS: Let me address myself to that. And it sort of poses the question, at least in the mutual fund industry, if you're a fiduciary, and you're looking at our disclosure, what can you find out about brokerage to inform yourself in making a decision. This is not a new issue in our world, and it's one that's been wrestled with, and I think we've come to a pretty good state of providing information.

And remember, when you're talking about mutual fund disclosure documents, they're documents that are used by lots of fiduciaries already. They're not only used by ERISA fiduciaries, they're used by trustees, they're used by investment advisors who have discretionary authority over client funds, who have thoroughgoing fiduciary responsibilities, and many others in a relationship of trust, as well. So all of them would ask themselves the same question: what can I find out about brokerage from the fund's disclosures?

First and foremost, it's important to understand that the brokerage costs are reflected in the fund's performance. And in the mutual fund world, we have standardized performance requirements that treat brokerage on a standard way across the board. It's net of all fees, and brokerage costs are capitalized. They're added to the cost of acquiring a security when you buy, they are subtracted to what the proceeds that you receive from a security when it is sold, and all that then is reflected in performance.

That gives a manager a very strong incentive not to be trading wildly in the portfolio, because the most important thing that many clients are looking for is, what's the fund doing for me in terms of increasing my wealth? What's the performance that I'm getting out of the fund? So it asserts a kind of discipline, if you will.

What we find across our industry is, in fact, that the amount of trading in fund portfolios has not really increased over time. It's remained steady at between 45 and 50 percent turnover on a dollar weighted average basis across our industry, but we also know, looking at the costs of equity trading, that trading costs have been going down. So in fact, there are circumstances in the market that are making transaction costs more reasonable for all investors, not just for mutual funds.

The SEC, though, has included a specific requirement on our prospectus that we provide to investors the portfolio turnover rate as a reasonable proxy for the degree of transactional activity in the portfolio, and if you want to dig further, you can, in our statement of additional information, which is filed with the Commission and available to any investor upon request, find what the total commission costs incurred by the fund have been for each of the last three years, as well as a description of the fund's trading policies.

Now I'm hard pressed to think what more any fiduciary, including a plan sponsor here, would require to inform themselves adequately about brokerage costs than what we already provide to our investor universe at large.

So singling that out and saying, "Well gee, perhaps that's not sufficient," just seems to me to be a red herring.

Now there may be issues with respect to other investment options in a plan that aren't subject to the same disclosure requirement, and you can address yourselves to that with respect to transactional activities of collective investment trusts, and things of that nature, that I'm not competent to comment on. But I would say the regime that we have has proved adequate, both for fiduciaries, and for other investors with respect to brokerage costs.

PANEL MEMBER PIACENTINI: Thank you.

PANEL MEMBER CAMPAGNA: Thank you, Mr. Stevens.

When plans approach, say, a bundled provider, what are they told about the bundle? Are they told it's a bundle of services? What is their understanding of what they're getting when they are purchasing this bundle?

MR. STEVENS: What they should be getting, and you can ask individual companies about their practices, is a total description of what the services consist of. If it's administrative services and record keeping, precisely what the complement of services that's involved there; if it's investment

c21020a4-0b71-40d1-bade-e3b09f4800dc

products in addition, what they may be, and what the total cost that is associated with all those services that are being provided. In other words, it should be full picture, both in terms of the money that's being paid, as well as what's the benefit of the bargain that's being received.

PANEL MEMBER CAMPAGNA: I see. So the investment advisories are seen as services, as well, the investment advisory to the mutual fund, what the investment advisor does is seen as a service to the plan?

MR. STEVENS: Well, in the sense that the plan's assets are being invested through the fund, and there are expenses that are being incurred in connection.

I don't think of it, as I had already said, as services being provided to the plan. The mutual fund is an investment, it's not a plan service.

PANEL MEMBER CAMPAGNA: I just want to try and boil down your view of the reg and what it should look like. So you're thinking that the record keeper or the platform provider would be responsible for the totality of disclosures regarding the fund, but the fund shouldn't be involved in having to be a service provider themselves to be responsible for any of that?

MR. STEVENS: Well, with respect specifically to fees, what we had described in my testimony was that you could have the record keeper provide to the plan sponsor those fee elements which are disclosed in the fund's prospectus for all investors. But perhaps that addresses itself to your question.

PANEL MEMBER CAMPAGNA: Right.

And you see a component regarding section 404, how would that fit in? So there would be this component of 408(b)(2) regarding the record keeper, or the platform provider, and then there would be a component regarding 404, is that kind of your view?

c21020a4-0b71-40d1-bade-e3b09f4800dc

MR. STEVENS: You know, I'm out of my depth, you know, pretending to be an ERISA lawyer.

PANEL MEMBER CAMPAGNA: Okay.

MR. STEVENS: That's why I have Mike Hadley here. Perhaps Mike can address himself to the question.

MR. HADLEY: Yes. I think the point that we were making was that, if you're trying to ensure that fiduciaries have information about the fees of investment so they can make informed investment decisions, that's an obligation under 404. And you've said in other contexts that that's information that plan fiduciaries need. And we were pointing out that, to make sure that that happens, that you could issue guidance under 404 addressing the issue of what information do you need to make an informed investment decision.

PANEL MEMBER CAMPAGNA: Now yesterday we heard from a lot of people that the prospectus just wasn't enough. It doesn't tell -- it tells about the fees in the mutual funds, and what are the fees regarding mutual funds, and brokerage as well, as you pointed out, but not who receives them. And the focus of our reg is indirect compensation, so that is about who receives those fees. Could you react to that comment?

MR. STEVENS: Well, just to take another example. No, the prospectus won't give you the list of the 150 brokers that may receive the commissions. The prospectus may not give you a comprehensive list of all of the some 175 categories of service providers that may be working for a fund in various respects. You know, the fact of the matter, it was never intended to, and I'm not sure, particularly in this context, that all of that is very useful information.

Again, it's a question of whether you were looking at service providers to the fund as service providers to the plan, or the

c21020a4-0b71-40d1-bade-e3b09f4800dc

fund as an investment that the plan makes.

It seems to us the fabric of ERISA from the very beginning has been not to look at the fund as plan assets, and not to look at the fund's service providers as plan service providers.

So I think that it doesn't bear comparison to what you might find in other circumstances. Now you may ask, well, that's fine, but why should we think of funds differently than other investment options? Well, at a practical level, I think it's because of the complement of disclosure that you already have with respect to funds.

The issue, it seems to me, with respect to informing plan fiduciaries here, plan sponsors, is not, gosh, how can we create massive new disclosure about mutual funds, but how we can bring the disclosure with respect to other plan investment options up to the same standard that mutual funds have been meeting for a long time. It would really turn the world on its head to me to look at this project as saying, we have to multiply exponentially the amount of disclosure we have about funds in retirement plans, especially if the notion is somehow that you're going to help the employer, the plan sponsor, maneuver through all this information to make an intelligent decision.

PANEL MEMBER CAMPAGNA: So the up front record keeper, the up front service provider, would be responsible then for disclosing any indirect compensation it receives? It wouldn't be in the prospectus?

MR. STEVENS: Correct.

PANEL MEMBER CAMPAGNA: It wouldn't be coming out of the mutual fund?

MR. STEVENS: Yes.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

PANEL MEMBER WILLIAMS: Okay. I have a number of questions. I'll try to be brief.

When you talk about hundreds of servicers to funds, and the possibility, given the possibility of the number of parties of interest that you would have to a plan -- sorry about that. The system's working against me.

It seems that part of the problem a responsible plan fiduciary would have would be connecting the dots, which is, to what extent are all these service providers, that we know are service providers to plans, may have relationships with one or more of the servicers to the mutual fund. And we know that those relationships exist. And so part of what would be important to a plan fiduciary would be, you know, connecting the dots.

Now in the comment that you made on the class exemption, you were concerned about service providers serving as conduits for information that would come from unaffiliated parties. And I'm wondering in the context of really two basic questions: who should be the conduit for information that would be provided to a plan, and do you have any thoughts about how best to avoid duplication of information that could be delivered to a plan by a service provider?

MR. STEVENS: With respect to the class exemption, I think our point was simply that, if a service provider is passing along information about a third party to a plan fiduciary, a plan sponsor, that it should be able to rely in good faith upon the information that it's provided, and if it happens to be wrong, through no fault of the record keeper, for example, that is passing, that it should not have committed a prohibitive transaction, or have some liability.

PANEL MEMBER WILLIAMS: Okay. But what if there's still missing information, then who should be the conduit for that information?

MR. STEVENS: Well, I think that

our comment letter indicates that, with respect to fee information, that the record keeper could assemble that, the function could assemble that information, and provide it with respect to mutual funds, or other investment options under the plan.

PANEL MEMBER WILLIAMS: For affiliated parties only, or for unaffiliated?

MR. STEVENS: I would think it should be able to do so with both. For example, if there were a third party fund that were offered, it would receive the information with respect to fees from that third party. It could rely in good faith upon the information that is passed along, and then provide it to the plan sponsor. So it could so with respect to both.

PANEL MEMBER WILLIAMS: So how does the responsible plan fiduciary know they're getting all the information, though? Is it just relying on the one record keeper who is serving as a conduit for all the funds, or is there some other way that he can make sure that they're getting information? I guess I foresee a plan having a number of service providers, and there's a possibility that there would be duplication of information coming from various service providers. But in any event, I don't want to belabor the point. So --

MR. STEVENS: I think the whole structure of the rule, at least as I appreciate it, provides legal requirements, and potential liabilities to the parties involved with respect to making sure that all the information is passed along.

PANEL MEMBER WILLIAMS: Okay. Because I sort of see it, they may be getting duplicative information, and in other cases, they may not be getting the information at all. And assume that the service provider would say "well, it wasn't my fault," that's only part of the missing piece of the puzzle. The other piece, of course, is well now what does the responsible plan fiduciary do to get that information. And they were relying on the service provider to get it, and the service provider says they can't. So it would seem that the service provider is in a better position to get than the plan fiduciary. So they would have to rely on some other person to get that information. And if they don't end up getting the information, then we're not going to get where we want to be.

All right. I'll defer to some other people here for a moment. I might get back to you in a minute.

MR. STEVENS: Thank you.

CHAIR CAMPBELL: We heard some testimony yesterday with respect to bundling versus unbundling concerns, that at least one person testified that it's not a matter of separating out every element of a bundle, but rather dividing it into two parts, one administrative, and one investment, and looking at the aggregate totals for both.

And if I heard you correctly, you were suggesting that that's also not appropriate, and I'm just interested in how you would respond to those questions.

MR. STEVENS: Well, I think the issue is how the business model is put together, how the provisions are contracted for, and whether they are separately priced. I mean, in some business models, they in fact will be, that you could make a clear distinction between the two. In others, they are not, and it would require essentially engineering some cost allocation, pricing allocation, between an administrative category and an investment category that may not have immediate relevance to how the business is operated or managed.

I think the important point here is that they should be real numbers that are provided to the plan sponsor, and that they be put in a position based upon those real numbers to compare apples and apples. And that's possible whether you have a group of providers, in one case, and a bundled provider in the other.

So I think the real issue is how the business is run, how it's managed, and whether that's a meaningful exercise within that context to unbundle it between these two broad categories that you cited.

CHAIR CAMPBELL: And also, if I understood what you said correctly, your general view is that the disclosures provided under the rules applicable to mutual funds are currently sufficient. One of the questions that came up also in yesterday's testimony is whether all the materials separately arriving are themselves useful to fiduciaries, or whether there's some way to either create a specific document that puts them in one place, or alternatively some form of an executive summary that points you to the relevant portions of the other documents. I would just be curious what your thoughts are on that issue.

MR. STEVENS: Yes, thank you very much, because this is an issue that we have been wrestling with in the broad mutual fund marketplace with respect to the prospectus.

Today's prospectus for funds, or put differently, the totality of the disclosure that funds are required to make, satisfy two purposes. Much of the disclosure goes to a variety of market participants that may be different from investors as such: commentators, analysts, investment advisors, and the like, who really like to look under the hood in great detail at the fund. There are competing purposes, though, and they were probably the original purposes for a prospectus, and that is to inform an investor with respect to an original purchase of the fund, or with respect to an ongoing holding of the fund.

And the SEC has worked hard to accommodate both of those broad purposes through its disclosure regime. We have focused at the Institute very specifically over a period now of almost 15 years, on the need for penetrating this large mass of information to provide a quantum of high quality targeted information to investors that looks to the most useful information about the fund that helps an investment decisions, and frankly, I believe would help in this context to inform the fiduciary obligations of an ERISA fiduciary.

So what's happened? The SEC, in the '90s, did put together that executive summary at the front of the fund's prospectus. It's called the Risk Return Summary, and it was the result of considerable work, including empirical surveys of investors about how they use the documents, what the most important information is, and it includes things like our fee table, the standardized performance index comparisons, descriptions of investment policies and objectives, the risk characteristics of the fund, and the like.

We have been urging the SEC, and the SEC now has an ongoing rulemaking, as you know, to go beyond that, and to develop a standalone summary with the balance of the information available to an investor 24/7 on the internet, or upon request in hard copy form through the mail. And we have high hopes that the summary prospectus proposal will be acted on favorably at the SEC.

But it seems to me that then addresses itself to the question, how can a fiduciary cut through the massive information to the key information they might need about a fund? You can do so now looking at the Risk Return Summary, perhaps you will be able to do so in future looking at the summary prospectus, but with the confidence that, if there's more information you want, it will be there on line for you, or it will be there in paper form if you need it.

The net of all this is that

there's no loss of information about a fund through the simplification process, but there is a way of addressing the need for more high quality, concise and targeted information that sponsors of small plans may very well need, quite critically, to do their duties.

CHAIR CAMPBELL: Okay. I don't want to take up all the time here, and we actually are expired, and out of fairness to the other witnesses, we are going to need move on. But if you all can see if you have some key questions you want to ask quickly, because I would like to give the rest of the panel a chance, as well.

PANEL MEMBER DWYER: You talk about SEC disclosures.

MR. STEVENS: Yes.

PANEL MEMBER DWYER: Okay. Isn't it true, though, that in those disclosures, that is only going to show the plan fiduciary the costs of investing in the mutual fund? It's not going to show who is sharing the revenue that's produced by the mutual fund that the plan may be interested in. I mean, are there -- talk about that.

MR. STEVENS: Well, it certainly identifies the major recipients of the revenue. I mean, you will have the mutual fund's manager or investment advisor that will be identified. It's major service providers, the transfer agent, for example, principle underwriter will be identified. So the large, if you will, constituents that make a mutual fund go will be identified in a prospectus, and the fees that are being paid to them will be reflected there, but it's the huge category of subsidiary service providers, if you will, that will not be. And frankly, it would be impractical to try to have to disclose them in a fund prospectus. It would be of no value, in my judgment, anyway, to an investor.

PANEL MEMBER DWYER: Well let me ask you, some of the commenters talked about situations where, for instance, a broker is given a bonus of some sort for putting money into a particular fund, or investment product, or keeping it there at the end of the year. Does that happen with mutual funds, and if so, would that be disclosed anywhere?

MR. STEVENS: I'm not sure I understand what the example is that you're citing. Funds don't pay bonuses to investors for those purposes. In fact, the great thing about the mutual fund is it's highly democratic. The returns to all of the investors will be the same, at least investors in a given class of shares of the fund. And the SEC rules pretty much guarantee that.

Now, there may be arrangements, revenue sharing arrangements which funds are required to disclose with brokers that could come out of compensation that is received by an investment advisor to the fund, but it will not be paid out of the fund to an investor as a bonus in the way that you put it.

PANEL MEMBER DWYER: And that is

c21020a4-0b71-40d1-bade-e3b09f4800dc

disclosed? Where would that be disclosed?

MR. STEVENS: To the extent that revenue sharing is permitted, the SEC has required that it be disclosed in funds' prospectus.

MR. HADLEY: I just want to add that, to the extent you're talking about, payment to a service provider to the plan, a record keeper or somebody who's actually providing services, as we said in our testimony, your rule covers that gap which doesn't exist now. The prospectus does not provide individualized disclosure about every person who is going to receive a 12b-1 fee. It's certainly there, and covered by the expense ratio, but it doesn't say, X person received it.

The great thing about your rule is that it makes sure that the recipient who is actually servicing the plan discloses that compensation.

PANEL MEMBER DWYER: And where

would you ask us to draw the line in the rule? To the direct contractor, the party directly contracting with the plan?

MR. HADLEY: The rule is intended to deal with people that have to worry about 406. That's your universe, and that's the right place to draw the line is somebody who's a party in interest.

PANEL MEMBER DWYER: All right. Thank you.

PANEL MEMBER ZARENKO: A couple of quick questions.

You're talking about the concern that the rule seems to imply that some providers to funds might be moving into the providers to the plan, and making that distinction. But yet you were talking about how compensation received by an investment manager would be relevant to a plan fiduciary. So I'm just wondering, is the investment manager, do you view that differently as all the other providers to a fund, and you think

c21020a4-0b71-40d1-bade-e3b09f4800dc

that information is relevant to a plan?

MR. STEVENS: No. My point was rather that, to the extent that part of the fiduciary obligation is to understand the cost structure of investments that are being offered to plan participants, that all that information is available with respect to the cost structure of a fund. And again, it's in gross terms in the fee table, but the investment advisory fee, administrative costs in accordance with the way the SEC has structured the fee table, will all be there.

So the net economics of the fund investment will be apparent, and I think that's the key thing from the point of view of the fiduciary looking at the fund as an investment option. The subsidiary economics, all the categories of service providers that the fund's management or its board have decided are appropriate to make the fund work effectively for shareholders, that, it seems to me, is not relevant.

PANEL MEMBER ZARENKO: Okay.

MR. STEVENS: So my answer to you is that, no, we don't look at one provider of services as perhaps a service provider to a plan as opposed to others.

PANEL MEMBER ZARENKO: Okay. And my second question has to do with the conflict of interest provisions, which leaving aside that they're too broad, you talk about limiting those disclosures to service providers that make recommendations. Are you really saying, limit it to fiduciaries? I mean, when I hear "making recommendations," is that a provider with discretion, it's an ERISA fiduciary, are you trying to use that as the line, or no?

MR. STEVENS: Well I guess, and I'll let Mike talk about it in legal terms, but in common sense terms, where money is changing hands here, your regulations go a long way to making -- and in fact, all the way towards making those things apparent. All

c21020a4-0b71-40d1-bade-e3b09f4800dc

right. Where there may a conflict of interest that arises is where someone is making a recommendation to a plan, and is also in receipt of that compensation. And that, it seems to us, is the area where "conflict of interest disclosures" perhaps are appropriate.

The way the provision is written now, at least as I appreciate it, is it's almost six degrees of separation. And I just don't see that that's very useful. It's really where an economic interest bumps up against some recommendation or similar activity on behalf of the plan.

PANEL MEMBER ZARENKO: And when you talk about recommendations, are we talking principally about recommendations of investments?

MR. HADLEY: Or services.

MR. STEVENS: Or services.

MR. HADLEY: Or services.

PANEL MEMBER ZARENKO: Or other services?

MR. HADLEY: Yes.

PANEL MEMBER ZARENKO: Mike, do you have any comments on the issue of whether we're talking about ERISA fiduciaries, or is that not --

MR. HADLEY: No. I think, if it's a fiduciary, ERISA's rules already cover that situation. If you're making a recommendation, and you're receiving compensation because of that recommendation, I think ERISA already prohibits that.

PANEL MEMBER ZARENKO: Okay.

MR. HADLEY: So we understood part of what you're trying to do here is to deal with situations where somebody does not identify themselves as an ERISA fiduciary. Maybe they are, maybe they aren't, but they claim they're not. But they still might have some position of influence over the decisions made by the plan fiduciaries. And that's -- we thought that was a good place to nail the focus of the rule.

PANEL MEMBER ZARENKO: Okay. Thank you.

PANEL MEMBER WIELOBOB: I just have one question, and this is going to -- I want to clarify, and try to understand something both of you have discussed in your testimony, and it sort of follows up on what Fil was asking you about.

I think, if I understood what you said, one of your suggestions for the proposal would be to require fiduciaries to obtain fee and expense information, and I think you said, under the rubric of 404, you know, service providers should help fiduciaries understand what they need to understand in order to make decisions.

One of the things we heard yesterday during the day of testimony from several witnesses was that people on the other side of the equation encounter reluctance and sometimes refusal to provide information from some service providers, that it's not that

c21020a4-0b71-40d1-bade-e3b09f4800dc

easy, and I just would be interested in your reactions to that, what we heard.

MR. STEVENS: Well, it seems to me that's the justification, perhaps, for this regulatory project that you have, and with the teeth that you will have in it, making it subject to the prohibited transaction standards of ERISA.

You know, I'm not aware of specific circumstances, and could not comment.

PANEL MEMBER WIELOBOB: Well, I guess, were you suggesting, it sounded like in your -- and this is what I wanted to clarify, in your testimony, were you suggesting that the onus be placed on the fiduciary to obtain the information, or --

MR. STEVENS: Well, I think in my comments I said there are two ways that you could, and correct me if I'm wrong about this, Mike, but there are two ways that you could approach it. With respect to our information, it's available in our disclosure documents, or if the issue is facilitating the collection of that information with respect to a number of different plan investment options, the record keeper could be put in a role where that information is gathered together, and provided to the fiduciary.

Did I get that right, Mike?

MR. HADLEY: Yes, that's right.

I think ERISA already requires a fiduciary to know what the basic fees before they put an investment on a menu, or make an investment for a DB plan, they need to get that. If they cannot get it, for example, by looking at the prospectus, or some kind of compilation of that, then it's hard to imagine that it would be appropriate to investment in it.

PANEL MEMBER WIELOBOB: Thank you.

CHAIR CAMPBELL: Okay. Well, thank you very much.

MR. STEVENS: Thank you. Appreciate the opportunity.

Would any of you like a copy of our 2008 Service Directory?

CHAIR CAMPBELL: We'll be happy to take whatever you'd like to submit.

MR. STEVENS: I'll submit it for the record.

Next up would be Mr. Kant, with Fidelity Investments.

Whenever you're ready, sir.

MR. KANT: Thank you.

Good morning. I'm Doug Kant. I'm an ERISA lawyer with a group of companies known as Fidelity Investments. We provide investment management, and a range of administrative services to thousands of retirement and welfare plans governing millions of participants.

Since this is for the record, I'm going to mention that today is the completion of my 19th year at Fidelity. In an odd way, it seems like an appropriate way for an ERISA lawyer to celebrate such an event.

We have already filed detailed written comments on the proposal, and like everybody else, we appreciate the opportunity to testify today.

We certainly support the Department's desire to promote a more consistent disclosure framework for the plan service provider hiring process. However, the proposal won't accomplish that goal unless certain disclosure responsibilities are clarified, and service providers have sufficient flexibility for discharging those responsibilities.

I'm going to basically talk about six points. The first, you've probably heard more than you want to, which is I'm going to join the ICI in encouraging the Department to confirm that those persons who provide services to a mutual fund do not become, solely by virtue of those services, a service provider to a plan that invests in such fund. It's just that sort of position would be contrary to existing law, and would cause lots of legal problems unrelated to the topic at hand.

The second issue of the bundled provider language in the proposal. The proposal acknowledges a bundled service provider as one who offers an array of services that are priced as a package, rather than as a separate fee for each service.

Bundled pricing and servicing is common and appropriate for 401(k) plans.

The same firm provides plan administrative services, and at least some of the investment products. Because the mutual fund expense ratio, that is, the fees charged to operate the fund, defray the costs of some of the same services that are required for plan administration, mutual fund companies can sometimes provide plan record keeping services without charging an additional record keeping fee. However, any attempt to assign a percentage of the mutual fund revenue as revenue received for plan administration is arbitrary. The mutual fund structure does not allow the investment management to be purchased separately from the shareholder services that facilitate plan administration.

The proposal would require a 401(k) record keeper to disclose revenues received by affiliated manager's mutual funds, as discussed earlier, and the compensation paid to other servicing affiliates included in the plan's investment lineup. This is necessary, and we agree with this, so the fiduciaries can evaluate the total cost of the plan, and the compensation paid to that firm.

We believe, however, that the current wording of the proposal may improperly disclose or impose disclosure obligations on a bundled provider for investment products offered by unaffiliated parties. Where Fidelity is the bundled provider for a 401(k) plan, for example, we commit to provide record keeping services with respect to both Fidelity

c21020a4-0b71-40d1-bade-e3b09f4800dc

and non-Fidelity mutual funds. However, we only provide investment management and related services for Fidelity funds, not non-Fidelity funds.

It seems to us inappropriate to impose this add-on disclosure responsibility as a condition for a statutory exemption for the service provider's contract with a plan, that is, for our service provider's contract with a plan.

Moreover, this would be inconsistent with the definition of a bundled service arrangement in the proposal, and that your recently finalized 5500 regulations. We encourage the Department to clarify the proposal by restricting a bundled provider's disclosure duty to aggregate compensation for services provided directly or through its affiliates or through its subcontractors.

If you are determined to pursue this course of action, and we understand this is a tough one for you, the Department must clearly address the service provider's limited responsibility to provide the prospectus or other fee information that we receive from the unrelated third party and our lack of legal exposure for the problems arising from such third party's disclosure. That is if they make a mistake, it's their mistake not ours.

Turning to the conflicts disclosure provision in the proposal. And, again, you've heard this several times.

We do understand the concerns -- we think we understand the concerns expressed by the Department trying to make sure that a fiduciary can assess the objectivity of a service provider's decisions or recommendations. And this was talked earlier. The fiduciary conflicts are generally prohibited or else accommodated pursuant to a statutory or administrative exemption under ERISA.

A good example is the Pension Protection Act of 2006 exemption for

investment advice. The statutory exemption imposed certain conditions including disclosure on an investment provider subject to potential conflicts and provided advice. So we assume, really, that the focus has to be on non-fiduciary services.

Now the proposal would require that service providers disclose both direct and indirect compensation in the service or services provided in return, which should acquaint the hiring fiduciary with the financial interests and the role of each party that it hires.

It is the potential mandate to characterize each relationship as a potential conflict that causes the concern.

In terms of methods of disclosure, the proposal preamble states that the required disclosures may be provided in electronic format. We agree that greater flexibility will help to lower the cost of plan administration to the benefit of plan sponsors and participants alike. We encourage the Department to consider the approach followed in Field Assistance Bulletin 2006-03 which provides transitional guidance for participant statement recorded under PPA. In the bulletin the Department concluded that effective access to a secure website would constitute statement delivery, subject we understand to the condition that participants be provided with notice of such availability and of their right to request paper documentation instead.

We currently provide plan sponsors with online access to prospectuses for Fidelity mutual fund, and with fee disclosure regarding payments received from unrelated fund companies for servicing those funds on our platform.

In both cases this manner of disclosure is documented in the trust and service agreement that we enter into with the plan sponsor.

Finally, we note that the proposal

would permit service providers some flexibility in disclosing fees, for example, by using a formula or a percentage of assets and by using separate documents such as a fund prospectus or brokerage fee schedule. We urge the Department to promote flexibility in the use of existing disclosures whenever possible.

Our experience demonstrates that the timing of disclosures will vary greatly from contract to contract. Therefore, we agree with the Department and we ask that you retain the approach in the proposal and not include a specific time frame or try to dictate a specific time frame for when the disclosures need to be made before a contract is entered into. In contrast, however, we believe that the effective date contained in the proposal is completely unrealistic.

We are confident, and that's in a negative but respectful manner, that the proposed 90 day rule does not provide enough amount of time needed for us to analyze and

c21020a4-0b71-40d1-bade-e3b09f4800dc

prepare for the final regulation in advance of contract negotiations for which such disclosure will be required.

We do appreciate the desire to bring this project online as expeditiously as possible. Nevertheless, we strongly believe that the final regulation effective date must be extended to a full year at least to allow service providers sufficient time to get ready for negotiations.

The Department should also confirm that the new disclosure mandate would only apply to contracts entered into or renegotiated after the effective date of the final regulation.

We as a firm maintain thousands of service contracts with retirement and welfare plan sponsors. And we would literally be unable to amend all those contracts, other than in the normal course of contract changes.

As an alternative approach you could impose the new fee disclosure requirement on service providers without the need for full scale contract provisions. Again, we would strongly suggest that we'd need a full year to get ready for implementation under this approach.

And finally, service provider recourse. The prohibited transaction class exemption that you propose in conjunction with the guidance would give a plan fiduciary relief if they unknowingly enter into a contract with a service provider that has not satisfied the disclosure requirements of the regulation. In order to retain the exemption relief, the fiduciary would be require to request the misinformation from the service provider who would then have 90 days within which to respond.

Until now our primary concern is whether a mistake or omission in disclosure may cause a loss or expense to plan participants or fiduciaries. The new rule could result in the imposition of an excise

tax on the service provider in the event of a disclosure failure, regardless of its impact on plan administration. We ask the Department confirm that the 90 day notice rule in a proposal would provide the service provider with the opportunity to correct the error or omission in timely fashion and appropriate fashion without financial penalty.

In the alternative, we ask that the Department republish the proposed class exemption and expand it to provide service provider relief in appropriate cases.

In conclusion, I would be pleased to respond to any of your questions.

CHAIR CAMPBELL: All right. Why don't we start on this side.

PANEL MEMBER WIELOBOB: No questions.

PANEL MEMBER ZARENKO: A couple of questions.

MR. KANT: Sure.

PANEL MEMBER ZARENKO: The first

c21020a4-0b71-40d1-bade-e3b09f4800dc

one has to do with the burden and the time frame for compliance. I understand under this rule there's a lot of contract issues --

MR. KANT: Yes.

PANEL MEMBER ZARENKO: -- renegotiating, revising, redrafting. But a lot of commenters also suggest that there's changes in their systems and their record keeping that would need to take place. And I'm wondering if some of those changes are already underway because of the final Schedule C reporting requirements, and whether that might help offset what would be necessary to comply with this rule?

MR. KANT: I'm going to confess we're in the industry probably having trouble deciding which guidance to focus on more. But we're going back and forth.

I think part of it depends on what the final regulation looks like. And that may be part of what you're hearing.

From our end, for example, when

you're focused on disclosure of our free structure, that is within Fidelity, I think it's more of a startup cost we're talking about, you know rather than a huge cost going forward. If you're talking about how we deal with third parties, unrelated third party's fees, you know we get into that. We often are with plan sponsors looking at sort of proposed option-by-option expense ratio, for example. Even for non-mutual funds. Was an attempt to put the fees in there. But it's really on more of a well this is just the two of us talking this out rather than formal process of getting that information and then putting it in front of the plan sponsor before you could really do the contract negotiation.

So if you're talking about third party responsibility, that's an area where we could be talking about a lot more expense. And it's hard to be useful to you without kind of knowing the magnitude of that third party responsibility.

Another example is the fact that we now do some of the disclosure, for example dealing with payments we may get from other fund companies to help defray our costs for record keeping those funds on our platform. We currently disclose that with a secure website. And we did that, in part, because in the mid late '90s when more and more plan sponsors were asking us to take designated options managed by other parties, it got to be a very big universe. So this is one place we can have people come to to get all that disclosure.

If the final regulation doesn't allow that, you know, if we don't have that flexibility, that's going to require a lot more expense, frankly. A lot more lead time and a lot more expense to do because it's going to require us the kind of cut and paste it plan-by-plan, and that would be painful. So really a lot of this is really going to depend on what it looks like.

PANEL MEMBER ZARENKO: Talking

about what goes on right now in terms of disclosure to plan fiduciary, you spent a lot of time talking about the prospectus and passing that through --

MR. KANT: Yes.

PANEL MEMBER ZARENKO: -- and that's effectively communicating information about investment costs to plan fiduciaries. I'm just wondering from your perspective do plan clients ever say "I don't want a pile of 20 prospectuses. Can you boil this down for me? Can you reformat it somehow?" Do you get those kind of requests? Do you accommodate them?

MR. KANT: Well I know we get those requests. And I think part of it is to some degree it's sometimes if you want to know the fee, if someone wants to know I want to know what this fund costs because I want this compare this fund to that fund, really it's a matter of okay, on page 1 is the index. And you see the topic fees. You go to page 14 there's an expense ratio right there. And so it really isn't that complicated once you tell, yes I know the prospectus is long. Because a prospectus is designed and it was originally designed for the retail world where you're selling individual-to-individual. So it tells you everything and, yes, sometimes more than you'd like to know. But it will tell you everything that you could want to know about the fund, it's operation, the board, everything. But in terms of, okay, that's what you need; that's easy to find, easy to point to.

Yes, we do. We will pull that out for Fidelity funds and we do it often in the contract process or even in a review process in terms of let's look at where you are in terms of your lineup. But we've never had to do it, and if you will, we've never had sort of a legal framework which kind of ups the risk.

PANEL MEMBER ZARENKO: Right.

MR. KANT: And particularly knowing that, okay, if you transfer that and you missed one. And, you know, you missed ten basis points transferring with the prospectus is still clear, so what does that mean to us. And that's sort of what you hear. And I think some of what you're hearing is discomfort with whether now in helping, we take on more legal exposure at the same time.

PANEL MEMBER ZARENKO: Do you think a lot of plan fiduciaries end up focusing on the expense ratio?

MR. KANT: They certainly do more now than they did a couple of years ago. Because it's in the news, and we've had several plan sponsors who have asked now to agree to contract language generated by the 408(b)(2) guidance. And, unfortunately, we've had to then remind that it's not final yet and so we don't really know what it should look like yet.

But I mean, they know fees are in

the news. Once you remind that, okay, it's just the expense ratio, I think often the rhetoric dies down pretty fast. And part of the reason is just there's a lot of talking, there's a lot of noise in the industry in general, and I mean the 401(k) and DC plan industry in general, a lot of noise about fees. So I think it's understandable, a lot of questions. I do think that once you've sort of laid it out, I think a lot of that concern is allayed.

PANEL MEMBER ZARENKO: Okay. And your comment whether -- you talk about how we incorrectly assumed that it's the record keeper in a bundled construct that is the bundled provider. But then the example that you give is in the health and welfare plan context. So I'm wondering is that only true in the health and welfare context or in the --

MR. KANT: I think the concern was that the bundled provider concept seems to work the best in the 401(k) world, and it's the easiest to see. And I think that our people on both the DB servicing and health servicing side were sort of concerned well if we're providing, for example, participant disbursement service to defined benefit plan or if we're doing communication service for a health plan, are we bundled? We're just not sure what that means.

The term, it's harder to define. It's hard to articulate in the other practice areas. And I think that's part of what you heard yesterday. I think.

PANEL MEMBER ZARENKO: But the DC side, would you say it typically is the record keeper that's a bundled provider?

MR. KANT: We certainly know that we're viewed as kind of the focus. And our concern is we understand that. The problem is that our lack of control over other people's managed funds. And some of the mutual fund. And there you sort of know it all kind of works the same way. But, you know, you get into bigger plans, individually managed options, bank group trust products, employer stocks; you know various types of things, there's sometimes it means -- you know, bundled to us means what you have control over. We don't control over that.

We have plan sponsors who are still talking to other firms about one or more of the options as we're trying to get our service contract in place. And so that we're concerned about that being viewed as part of the bundle. We're going to record keep it. And we're going to have to tell you if that's going to cost extra for us to record keep it. And if the other provider, the unrelated party is going to make payments to us to help defray the costs, you need to know that and we disclose that now. And we will certainly keep doing it whether you enacted this guidance or not. But, we'll take care of that.

Our concern is we don't -- as I once have said, I don't view these other people as part of my bundle.

PANEL MEMBER ZARENKO: My final question is whether you have any comments on any similar need for transparency in the IRA market?

MR. KANT: I don't. I mean I think the IRA market I think has been worked well in terms of it's different in part because it really is you're dealing with the person who is going to open up the IRA account. And there is a disclosure regime in place there already. And I think it works. I'm not aware of problems, but I'm also not sure how you do it.

I mean sort of the contract process really doesn't happen in an IRA account. I mean, IRA documentation is pretty much here it is. If you want ours, here's the stuff, here's the disclosure. And if you want somebody else's, that's where you go.

You know, it is certainly true that you see a wide range of investments in IRAs, and that's kind of a problem in itself.

Because more and more IRAs are represented on brokerage platforms. So you've got kind of array of stuff that can be bought.

But I'm not sure, frankly, it's an arena that would benefit from adding this into it. And I'm not sure how it would work.

PANEL MEMBER ZARENKO: Some people have suggested that the IRA market would be more akin to any requirements for disclosure to plan participants and beneficiaries rather than to disclosures to plan fiduciaries. Do you have any thoughts on whether you think that's the way to go?

MR. KANT: I'm not sure, because I'm not sure what's the perceived lack. I mean, I know in the 401(k) you know you're going to publish more guidance and we're going to have to respond to that. We already have pretty extensive participant disclosure in place that we use with our clients. But we understand that we're going to see more and deal with that.

In the IRA world I just don't have a good sense of what the perceived need is. I could ask.

PANEL MEMBER ZARENKO: Thank you.

PANEL MEMBER DWYER: Let's say you're the record keeper and often on your top form. Affiliated funds and unaffiliated funds. Okay. What is the universe of your source of revenue on those two respective type of funds? And I'll tell you my follow up question in advance.

MR. KANT: Sure.

PANEL MEMBER DWYER: Which of those sources of revenue are not disclosed under the current SEC requirements?

MR. KANT: I think this is the follow up question. I think it's sort of pursuant to a question you asked the earlier speaker.

I mean the prospectus, in terms of what we get, what Fidelity gets from our funds, that's totally disclosed in the prospectus and we'll also lay it out for you if you ask us to make it simple.

PANEL MEMBER DWYER: So any kind of revenue sharing would be disclosed?

MR. KANT: You mean revenue share within the --

PANEL MEMBER DWYER: Well, you tell me. What happens in there, what's going on?

MR. KANT: I mean from our perspective when you buy mutual fund, you're buying all in. When you're buying our mutual fund, you're buying all in. And so the prospectus will tell you the expense ratio; that's it. If the expense ratio is 67 basis points, that means pretty much we get 67 basis points.

PANEL MEMBER DWYER: Yes.

MR. KANT: If you look at prospectus you'll seem, a little far back, it will lay out -- at least in our prospectus, for example, it will tell you not only what

c21020a4-0b71-40d1-bade-e3b09f4800dc

that is but okay, let's show you in a hypothetical, say, $10,000 investment. And let's say, I think the earning assumption was 5 percent a year. We'll show you the dollars what you would end up paying the first year, second year, third year. Kind of give you a sense of what this means. And so they have all that detail in our mutual funds.

With respect to somebody else's mutual fund, I don't think their prospectus will tell you what they might pay us. So we would do that.

PANEL MEMBER DWYER: What will they pay you? Record keeping plus what?

MR. KANT: It's just an agreed fee for servicing, if you will.

PANEL MEMBER DWYER: So it's just record keeping? There's nothing -- I mean, what other fees might there that would --

MR. KANT: That's it. I mean, you know, there's just a basis point charge, which is the agreement. Because we need to work out

c21020a4-0b71-40d1-bade-e3b09f4800dc

-- usually with a fund group we're going to have to work out an agreement. I mean, we're passing information and money back and forth in a daily record keeping environment. And so we have to work out the methods by which we do that. Okay. And in return for our servicing their funds as part of the 401(k) world, they may agree to pay us, it could be 25, 35 basis points. If that helps to --

PANEL MEMBER DWYER: What would you call that fee? Is there a name for that type of fee?

MR. KANT: Payment for administrative services.

PANEL MEMBER DWYER: Yes.

MR. KANT: I think you're going to get different firms to be different names.

PANEL MEMBER DWYER: And is that disclosed currently in the SEC disclosures?

MR. KANT: I don't think their prospectus will tell you that. That's frankly why when we started doing this back in mid late '90s we did bill a separate disclosure regime. So that piece of it we're sort of looking forward to your guidance because then everyone will have to do it. But we make sure that a plan sponsors know what we get from anybody else. So they understand that for Fidelity, because for Fidelity you get record keeping, all the options, and we manage say a finite set of the options in your plan. And for all of that we want you to know everything we get.

PANEL MEMBER DWYER: Right. See, we understand that you're saying you voluntarily disclose it. But where from a regulatory perspective, we're interested about what's not being disclosed right now that exists in this --

MR. KANT: Yes, and I understand.

PANEL MEMBER DWYER: Right.

MR. KANT: I don't think that detail --

PANEL MEMBER DWYER: Yes,

generally. Yes.

MR. KANT: I mean and part of the problem would be to get that into the prospectus the fund company would kind of have to know year-to-year everyone they could enter into arrangements with, third parties. And I think that's probably why you don't see it. And so we felt particularly in the 401(k) world you need to tell your plan sponsor so they know what's going on so they can decide, frankly, whether our earnings are appropriate.

PANEL MEMBER DWYER: And another question. You may just have to give me examples. But you know there's been all of the comments on bundled versus unbundled. Let's say we break up the bundle. You're the record keeper. What's in there? Tell us what's going to be in the bundle. What are the components?

MR. KANT: Yes. I always struggle with this one. Because to me the bundle simply means you get it all. You get your record keeping investment management. And one of our problems has been, because we've talked about if we unbundle, how would we do that. We spend more time arguing about how we'd have to describe what the breaking out is not.

For example, we can come up with a number, but this will not reflect your record keeping fee but the Government told us we have to give you a record keeping fee number. I mean, we don't do it that way. We don't charge it that way in the mutual fund. The mutual fund was designed, it is priced, the compensation is earned to allow us to do it all in. You know, it's not broken out.

In terms of I've heard people argue that well it's hard to compare a bundled service arrangement to an unbundled. And I really struggle to understand why it's difficult.

Bundled means you look at each option, investment option and there's the expense ratio and you're done. If you look at unbundled well each fund still has an expense ratio, so that doesn't go away. And there's an additional record keeping fee. Well, you add that on in a participant basis and again you're done. It just takes a little more work.

Since in the end from the participant's perspective if you're going to pay 67 basis points, whether you decide well we're going to tell you that 17 is record keeping but if you don't like that, we'll tell you that 20 is record keeping. You know, it's just not made to be broken out. And so we are--

PANEL MEMBER DWYER: But would it be impossible to break it out?

MR. KANT: We could make up a number, but we'd want you to tell us --

PANEL MEMBER DWYER: But would that number be real or --

MR. KANT: No, it wouldn't. And we'd want you to assure us is it okay that it's a made up number.

Part of our problem is how do we describe to people what it is without trying to tell them what it's not. And what it's not is a number that is useful to them. Because what it's not is -- and I've heard -- I even heard one consultant refer to it as hidden fees. I'm really struggling to understand what's hidden about 67 basis points. I just don't understand. For 67 you get investment management record keeping and you're done.

PANEL MEMBER ZARENKO: Just internally --

MR. KANT: Yes.

PANEL MEMBER ZARENKO: -- you don't try to attribute your costs between record keeping and investment --

MR. KANT: I'm sure we try to keep track of costs. But --

PANEL MEMBER ZARENKO But that in no way though you're saying would translate into the compensation made by a plan?

MR. KANT: You may give people

credit, you may give an organization credit for bringing business in. You know, I mean that's how you pay people if you think they're doing a good job. But it doesn't really tell -- but telling a plan what you're paying-- what you were paid in compensation for record keeping. We really don't run our business that way on that side.

You know, to a plan we could sell record keeping only. And then it would be record keeping only, and so we give you a price, a separate price. And if you're a third party record keeper, that's what we're going to disclose. Obviously if they're a third party record keeper and they get payments from fund companies and that reduces that, they'll tell the plan sponsor as well to make sure the plan sponsor knows exactly who gets what.

But, you know, Fidelity is a firm. It's a firm, it's a common economic interest. All the pieces of Fidelity, and we do have a lot of pieces. In the end it's one economic entity. Just as, you know, on the fiduciary side if one part of Fidelity tried to exert any fiduciary authority regarding the plan that might benefit another part of Fidelity, you would quite properly say that's a fiduciary breach. You can't do that. Because it's one economic -- you know we have a common economic industry.

PANEL MEMBER WIELOBOB: So it's hard to say how the component parts affect the whole?

MR. KANT: It is in the context of the way mutual fund work, yes. You know, you can run a business model and some firms run a different business model in which there's a separate investment management arm and a separate record keeping arm and they are priced separately and you can buy either one. You know, I can take, I can take that; I don't need to take them together. With mutual funds it's all put together.

PANEL MEMBER DWYER: Thank you.

CHAIR CAMPBELL: Okay. I just had one question. We had received some comments from folks who were concerned about the requirement that they disclose in their arrangement or contract whether they're a '40 Act fiduciary or an ERISA fiduciary. I was curious if you had any comments on that.

MR. KANT: I think it was, at least from our end, our concern was that the '40 Act reference to us seemed to imply that we're sort of getting back to the investment advisor to a mutual fund, whether that might be construed as a party interest relationship. I think that was more our concern. And the other thing, maybe it was just within the industry some questioning why you care about '40 Act fiduciaries because we always thought you only cared about ERISA fiduciaries. But that may have been our oversight.

CHAIR CAMPBELL: Okay.

PANEL MEMBER CAMPAGNA: Back to

your conflict of interest testimony.

MR. KANT: Yes.

PANEL MEMBER CAMPAGNA: You had problems with the way we characterized it. I think it was that we characterized it as conflicts of interest disclosure.

The ICI suggests, for instance, that we focus perhaps just on service providers who make recommendations. Could you just give me your thoughts on what you would see as appropriate and react to that?

MR. KANT: And this probably may be more of a concern in the consulting industry, just in terms of if you're a fiduciary, you just can't have conflicts. If you're providing help to people in whether it's selecting a vendor or selecting funds, whatever it is, you may get into the sort of recommend mode but not step over the fiduciary line.

I think the plan fiduciary absolutely has to know, oh by the way I'm going have you pick the lineup, and by the way some of the manager share income with me. And you, the fiduciary, should know that.

I think it may be just the characterization as a potential conflict, does that add anything and is there a characterization there that causes concern. I think for us it's more a matter of just being clear what's meant by potential conflict.

PANEL MEMBER CAMPAGNA: But you see it as valuable information?

MR. KANT: I think the critical is the plan sponsor understands all your financial interests.

PANEL MEMBER CAMPAGNA: Okay.

MR. KANT: You know, what are you getting. When you're talking about, for example, a fund lineup if you will, what's in it for you.

PANEL MEMBER CAMPAGNA: Okay. Just one last question for interest of time. You say that for some of your clients you actually take the prospectus and refer to various places in the prospectus where the relevant information is. Would you have any problem with that being part of the regulation?

MR. KANT: In terms of disclosing the plan sponsor is this where you find it?

PANEL MEMBER CAMPAGNA: Yes.

MR. KANT: Well, I don't think I would except the page -- the fee information will be different from prospectus-to-prospectus.

PANEL MEMBER CAMPAGNA: Right.

MR. KANT: So as long as we don't have to cite page numbers, I guess I'm good with that.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

PANEL MEMBER PIACENTINI: Two questions. I'm trying to get a clearer sense of the dynamics of some of this market. I'm understanding more and more about the

c21020a4-0b71-40d1-bade-e3b09f4800dc

arrangements, but you talked about Fidelity's role as a record keeper. I know that it's also, of course, a fund vendor. You talked about how you might receive revenue sharing as a record keeper from unaffiliated funds that you offer. I wonder if you might also provide revenue sharing to other record keepers who offer your funds.

But in thinking about maybe both of those types of flows, my question is we heard I think yesterday and today how in some sense investment options are bought. That is, plan sponsors might ask a record keeper please make it possible on your platform for me to investment in this fund. I wonder to what degree funds are also sold where a fund vendor might go to a record keeper and say please add my fund to your platform and make an offer of what the revenue sharing arrangement might be that might that attractive? Can you just talk about that dynamic a little bit and how that plays out?

MR. KANT: Yes. And by the way, some plan sponsors ask quite strongly that we would record keep other people's options.

I think it's inevitable in some cases to get in conversation in terms of payments to be made to a service provider, if you will. But you know it comes down to the plan sponsor needs to know what's going on. And if they need to know what's going on in terms of, okay, you're going to get X basis points. If I pick those three funds, I now know that you're getting 40 basis points instead of 30 basis points. The critical to me is the plan sponsor knows that's happening.

The dynamics, I think disclosure cures a lot of the concern. The problem is when it's not disclosed, then you don't know.

PANEL MEMBER PIACENTINI: So you said that as a record keeper, Fidelity does disclose revenue sharing that comes back --

MR. KANT: Yes.

PANEL MEMBER PIACENTINI: -- to

c21020a4-0b71-40d1-bade-e3b09f4800dc

defray the record keeping costs. Do you know whether the record keepers, on whose platforms Fidelity funds are sold, whether they also disclose revenue sharing from Fidelity? Is that something that you're concerned about.

MR. KANT: Well, when we contract with third party record keepers, we would normally require in our contract that they do that disclosure. And I don't work on -- Fidelity has several different business models that operate. So I tend to operate more on the direct side. But my understanding is that when we contract with a third party's meter, then when we're going to require as a matter of contract that they take on the disclosure. Because, again, we want to make sure the ultimate users, if you will, the ultimate payor knows what's going on.

PANEL MEMBER PIACENTINI: Okay. I have one question about the idea of a single cost in the expense ratio that might include defraying the cost of record keeping in the direct offering arrangement.

MR. KANT: Yes.

PANEL MEMBER PIACENTINI: I understand what you said in response to an earlier question about how dividing those costs up is kind of artificial. But I guess the question that poses for me, if I understand correctly for investors in a given share class, they'll all have the same expense ratio. But some of those might be record kept by your company and some might not. So is that correct?

MR. KANT: I'm sorry. For the same plan -- not for the same plan? I mean, again--

PANEL MEMBER PIACENTINI: No, for two different plan clients.

MR. KANT: Okay.

PANEL MEMBER PIACENTINI: One is record kept by your company and invests in fund A.

MR. KANT: Yes.

PANEL MEMBER PIACENTINI: Has a particular expense ratio associated with that. And then another has a different record keeper, but also invests in fund A. Would they have the same share class and pay the same expense ratio even though they're not getting record keeping from you?

MR. KANT: Yes. Historically on the direct side we have not had much in the way of different share classes. So I'm probably not the world's expert on this.

My guess is the answer is yes, at times depending on -- for example, it could be the given share class imposes a minimum dollar amount as an investment before a plan can get that share class. And so it could be that a smaller plan is ineligible for a given share class. And the way you define eligibility may differ a lot from fund group-to-fund group and, frankly, from fund-to-fund. But I'm sure the answer has to be yes. Yes, there are situations in which either we're record keeping plans in different share classes, somebody else's different share class or somebody else record keeping in different share classes.

PANEL MEMBER PIACENTINI: So in a case like that the client who is using a different record keeping might actually be able to separate out from your expense ratio how much is going for record keeping if the record keeper disclosed to them a revenue share that was coming back to defray a record keeping expenses.

MR. KANT: I don't think that would tell them at all. It would tell them if there is a difference in share classes. What they make with that information, I don't know.

PANEL MEMBER PIACENTINI: Okay. Thanks.

MR. KANT: I don't think that was very helpful, but it's the best I could do.

PANEL MEMBER PIACENTINI: It was a strange question.

c21020a4-0b71-40d1-bade-e3b09f4800dc

MR. KANT: Thank you.

CHAIR CAMPBELL: All right. Well, with that, having already consumed our 15 minute break with questioning, we will take a five minute break and then come back after that.

Thank you very much.

MR. KANT: Thank you.

(Whereupon, the above-entitled matter went off the record at 10:33 a.m. and resumed at 10:47 a.m.)

CHAIRMAN CAMPBELL: All right. Our next witness is Ms. Fallon-Walsh with The Vanguard Group.

MS. FALLON-WALSH: Thank you.

Good morning. My name is Barbara Fallon-Walsh. I'm the principal at The Vanguard Group in Valley Forge, Pennsylvania, who is responsible for our Institutional Retirement Plan Services Group.

My remarks will be relatively brief to leave time for discussion and the questions I know you'll want to ask.

Vanguard is the world's second largest mutual fund company, managing approximately 1.3 trillion in assets invested in some 150 U.S. mutual funds. We are also one of the nation's largest full service providers of investments and record keeping services for 401(k) and other retirement savings plans. Vanguard administers some 240 billion of retirement savings plan assets on behalf of some 2,000 plan sponsor clients and more than 1.3 million plan participants.

We have long advocated and provided full and candid disclosure of plan and investment fees and we support the Department's proposal to provide full disclosure of direct and indirect fees paid by retirement plans and their participants to service providers.

For a number of years Vanguard has regularly provided all-in fee reports to our bundled defined contribution plan clients so that these plan sponsors can easily understand the fees the plan and participants pay. Clients consistently tell us that this report is clear and quite effective at helping them satisfy their fiduciary duties under ERISA because the report provides a concise breakdown of all indirect or asset-based fees that the plan is paying and a breakdown of all other direct fees paid by the plan.

In our comment letter to the Department we provided a sample of an all-in fee report, and I did bring copies of that report today for submission into the record.

We believe the Department's proposed disclosure will fulfill its objectives of helping plan sponsors understand the services provided to the plan, all fees paid directly and indirectly by the plan and its participants for those services so that sponsors can determine whether those fees are reasonable, and any compensation that third parties receive in connection with the services provided to the plan so that plan fiduciaries know that the service provider has no hidden or conflicted interest in the services it's providing.

These disclosures will help plan sponsors fulfill their ERISA responsibilities which, in turn, should help participants achieve their retirement savings goals.

Although the 401(k) market is extremely price competitive, it's not always easy for sponsors to compare fees. It can take considerable effort by sponsors to compare fees among providers because of varying reporting formats, differing service models and unique fee structures associated with different investment vehicles. We endorse the Department's goal of moving toward a more uniform fee disclosure regime where the onus is on the service provider receiving fees to affirmatively provide regular disclosures to the plan sponsor.

This initiative will reduce the

c21020a4-0b71-40d1-bade-e3b09f4800dc

effort and time sponsors spend on gathering and comparing price information, and importantly facilitate apples-to-apples comparisons of different service models and investment products.

The proposed disclosures will be most effective if they are clear, consistent across all investment types and free of redundant information. To ensure that plan fiduciaries understand their precise legal obligations with respect to the disclosed information, we believe the proposed regulation could be clarified in several respects. The comment letter we submitted to the Department on February 11 covers these recommendations in detail. Today I'll just highlight a few of our suggestions.

First, we recommend that the Department require service providers for all types of plan investments, whether separate accounts, insurance products or collective trusts to provide fee disclosures in a form similar to the expense ratio disclosures required of mutual funds. The expense ratio is a widely understood method of expressing asset-based fees and sponsors could easily use such ratios to compare varied types of investments and fee structures.

What's more, such a simple and uniform disclosure format would provide a level playing field for all types of plan investments. Tens of millions of investors regularly use expense ratio type disclosures mandated by the SEC in comparing mutual funds. And we believe the Department could develop standards similar to those required by the SEC to ensure that disclosures for all retirement plan investments are similarly comparable.

In practice, Vanguard provides expense ratio type disclosures for our non-mutual fund products such as separate accounts and collective trusts and these disclosures are well received by our plan sponsor clients.

At the same time, we think that it

is important for the Department to confirm that plan sponsors are not required to receive mutual fund expense information that goes beyond what the SEC requires today. Today the SEC requires the disclosure of all shareholder fees, fees charged directly to an investor such as the sales load or redemption fee and the disclosure of all annual fund operating expenses; the ongoing expenses that are deducted from fund assets and thus are born indirectly by investors.

In our experience this disclosure regime works well for all fund investors, individual investors and retirement plan sponsors alike and it would be very helpful for plan sponsors in the industry if the DOL would confirm that compliance with the SEC disclosure requirements is sufficient for the purposes of ERISA section 408(b)(2).

Similarly, we believe that it is important for the Department to confirm that service providers to mutual funds are not service providers directly to the plans that invest in the mutual funds. In other words, the providers of services to mutual funds such as fund investment advisors, custodian banks, auditors who have no direct connection to the plans that invest in the mutual fund should not be required to provide disclosures that are contemplated under the Department's proposal.

If the Department were to take a different approach and require a look through to the underlying service providers of mutual funds, plan sponsors would be overwhelmed with disclosures that would be of limited value and completely duplicative. These service costs are already reflected in the fund's expense ratio. What's more, these service activities are already governed by existing federal securities laws designed to protect all investors in the mutual fund.

Also, in many cases it would be impossible for a mutual fund service provider to know the identity of any specific plan invested in the mutual fund since the mutual fund service provider does not enter into contracts or arrangements directly with the plan sponsor.

When a plan invests in a Vanguard fund but does not use Vanguard plan record keeping services, we will provide fund fee and expense information through the fund's prospectus to the plan's record keeper. The record keeper will then provide the expense information directly to the plan sponsor. That is what happens when Vanguard is the record keeper for a plan that invests in a non-Vanguard fund on our bundled platform. We collect fee and expense information for each of the non-Vanguard funds offered in our clients' plans and report this information to our plan sponsors.

You can see an example of how this disclosure works in the non-Vanguard asset-based fee section of our all-in fee report. We have found that this consolidated disclosure form is reviewed by fiduciary committees which regularly monitor the reasonableness of fees charged on their plan's investments.

With regard to revenue sharing payments, we strongly support the Department's approach that requires a service provider receiving a revenue sharing payment from a mutual fund or other investment to disclose to the plan sponsor the amount of the payment that is being received. In that way the plan sponsor can monitor who is receiving such payments and whether or not such payments are appropriate given the services being provided.

In addition, we would encourage the Department to remind plan sponsors that to the extent the revenue sharing payment is coming from a fund, under the plan that charges an additional fee such as a 12b-1 fee, the plan sponsor has a fiduciary responsibility to consider the appropriateness of that fee because it is ultimately being born by all investors in that fund, including the plan sponsor's participants.

With respect to bundled versus unbundled service delivery and fee disclosure, we strongly support the Department's conclusion that bundled service providers need not artificially unbundle services and fees if the services are not delivered in an unbundled package and fees are not charged separately for each service.

Bundled service offerings are popular in the marketplace today because they offer an effective one-stop approach to delivering the ever expanding breadth of services it takes to provide a top-notch retirement savings package. This approach enables the plan sponsor to partner with a single central service provider whose core investments, service quality and fees can be monitored without hiring teams of consultants or other experts to oversee multiple providers. This can be especially important to smaller employers with more limited resources.

Examples of the types of service Vanguard is capable of offering in our bundled service offerings include:

The ability for participants to have 24 by 7 account and transaction access through the web and toll free telephone lines;

Regular participant account statements and comprehensive investing education and advice programs;

Extensive compliance testing services such as nondiscrimination testing and excess contribution monitoring;

Plan loan and hardship withdrawal tracking and payment processing;

After tax and Roth contribution tracking and tax reporting.

To the extent a bundled price is charged, we feel a requirement to separate out components of the bundled fee would result in an artificial and irrelevant allocation of fees. If, however, some of the services are delivered separately with a separate charge associated in an unbundled or quasi-unbundled approach our view is that it is appropriate to require disclosure of that component price since it represents a reliable number that is separately negotiated and charged to the plan sponsor.

You'll notice in our sample all-in fee report that we do provide specific disclosure for service fees that are billed separately.

We agree that plan sponsors need to have a comprehensive list of the services that are included in the bundled offer in order to compare that package's all-in fee with other bundled offers or the aggregate fees associated with a group of unbundled services offered in a more a la carte fashion. To make the comparison manageable, we recommend that the Department's final rule mandate broad descriptions of services

c21020a4-0b71-40d1-bade-e3b09f4800dc

provided to the plan, such as investment management, record keeping, participant education, web and phone services, brokerage, et cetera rather than a long list of each individual service component provided to the plan. The latter approach could overwhelm fiduciaries and would not be meaningful since plan sponsors do not purchase services on such a granular basis.

Ultimately, this guidance should be an incremental approach to plan sponsor disclosure. The issuance of comprehensive benchmarking data in the future derived from the additional plan expense disclosure on the Form 5500 Schedule C holds the potential to provide plan sponsors with a meaningful comparison of the fees associated with their plan as compared to plans of similar size, type and complexity. If these final regulations provide uniform, consistent summary information regardless of the service provider or type of investment, then plan sponsors will have the data they need to benchmark their plans against a national standard. To this end simplicity and uniformity will serve the purpose of fiduciary prudence.

I appreciate the opportunity to present Vanguard's views today. And I'm pleased to take any questions you might have.

CHAIR CAMPBELL: Thank you. We'll start down here.

PANEL MEMBER PIACENTINI: I guess I'd like to start with the same question that I finished with with the last witness. And it goes to this question of how record keeping expenses are defrayed relative to other expenses in the presence or absence of revenue sharing.

MS. FALLON-WALSH: Yes.

PANEL MEMBER PIACENTINI: If I understand correctly, Vanguard itself as a business practice generally does not pay revenue sharing to record keepers.

MS. FALLON-WALSH: We don't.

PANEL MEMBER PIACENTINI: Okay. But when you act as a record keeper, you might receive revenue sharing?

MS. FALLON-WALSH: Yes.

PANEL MEMBER PIACENTINI: So I guess my question then is in a case where your fund is offered on a different platform versus on Vanguard's own platform, do the plans that come in through those two channels invest in the same fund class share classes? And if so, does that then imply that because they'd be paying a similar expense ratio that they'd be paying record keeping separately at Vanguard? How does that work? How does the economics of that break out?

MS. FALLON-WALSH: All right. Some funds offer additional share classes and some funds do not. So when a fund is offered on our record keeping platform, it might most often be in investor shares. And we might use the Index 500 as an example.

So there are institutional share classes of that fund, and that might be what is offered on a competitor's or another third party administrator's platform. So that would be a separate.

When you think of the investor share class, that's a share class that is shared between our retail shareholders, you know often, as well as our plan participants. And that's part of what points to the challenges in trying to differentiate what is record keeping versus what isn't because there are different costs associated with those two service models.

PANEL MEMBER PIACENTINI: Thank you.

And then I guess I'd also like to ask the other question I asked the previous witness. In terms of the dynamics of the market, of how different investment options end up on different platforms and ultimately on different plan menus.

MS. FALLON-WALSH: Yes.

PANEL MEMBER PIACENTINI: You know, I think I understand that some fund vendors use revenue sharing as one tool to try to get their fund offered on more platforms. And you don't do that. Can you talk to me a little bit about that dynamic and what's behind your strategy versus competitors and how you view that?

MS. FALLON-WALSH: Yes. Well, Vanguard is different. I mean, I'm not sure, you might be somewhat familiar with the company. But we are a mutual fund firm that operates at cost. And so there's no profit of Vanguard. What otherwise would be profit is returned to the shareholders in the form of lower expense ratios.

We don't pay for distribution. So where our funds appear on other people's platform it's because the plan sponsor wants them there. And that they would have to cover their costs of record keeping through other means.

Other fund companies might be on our platform. We're not soliciting them to be on our platform. In fact, we're most closely philosophically aligned with plan sponsors that put a high premium on low cost, if you'll let me mix those two phrases. So they would start off with a depreciation for low cost funds on behalf of their participants, but they might want to complement the Vanguard lineup with other particularly active fund mandates.

Some of those funds would offer revenue sharing. We would use that revenue share to defray some of the costs of record keeping. Those are clearly disclosed and have been, I think for a decade, to plan sponsors in the all-in fee report. And when you look at that, you'll see it gives the total expense ratio of the fund and then what portion of that is returned to Vanguard to defray record keeping expenses.

I mean, if outside funds are half of the assets or 30 percent of the assets in a plan, there are times when what they're paying for investment management on a tiny percentage or 30 percent of the assets in the plan is greater than what Vanguard is receiving for both investment management and record keeping on all of the assets in the plan.

PANEL MEMBER PIACENTINI: One last question.

MS. FALLON-WALSH: Yes.

PANEL MEMBER PIACENTINI: And I will look with interest at the sample all-in fee report that you talk about.

MS. FALLON-WALSH: Yes.

PANEL MEMBER PIACENTINI: My question immediately is does that treat as part of the all-in fees the transaction costs incurred by the fund brokerage and so forth? And if, why not? What's the philosophy for not calling that part of all-in fees?

MS. FALLON-WALSH: Well, I point

back to the comments that Mr. Stevens made earlier about the expense ratio of the fund capturing the all-in fees. And then I would say the transaction costs of the fund go to reduce the return. So I think if you were to report those, it would be double counting in a way, because you would have reduced return that would include things like brokerage funds and that sort of thing. You've already taken the return down. It's not the expense ratio, right? So I'm looking at that thinking I'm not sure what I would do with that and how I would consider it because you've already captured it in the reduce return in the fund.

PANEL MEMBER PIACENTINI: Thank you.

MS. FALLON-WALSH: You're welcome.

PANEL MEMBER CAMPAGNA: You spoke about a possible broad description of all the services that could be provided vis-à-vis record keeping and what the fund would offer. There are those who say you should unbundle and come up with a definition for every single service and disclose that and the fees associated with that. What are the broad definitions that you're talking about and could they accommodate all the particular services that really are being provided in a bundle?

MS. FALLON-WALSH: I think the broad descriptions could accommodate all the services that are included in the bundle. Things like record keeping services, education, participant services, compliance testing if that's part of the bundle. I think it's not difficult to come up with a broad description.

We don't have the granular cost accounting that would be associated with trying to ascribe a price to each of those and to what end.

So I think, though, as far as the broad descriptions of the services included, that's very straightforward. And we do that on a regular basis.

PANEL MEMBER CAMPAGNA: You're a proponent of the use of the prospectus, but there are those who have said prospectus really doesn't disclose who is receiving revenue sharing. So I take it your position is that the record keeper or the point of contact with the plan would be responsible for their own disclosures regarding that; their receipt of revenue sharing?

MS. FALLON-WALSH: If I understand you correctly, if what you're asking me is how would a plan sponsor know that the service provider Vanguard is receiving record keeping, we disclose that as part of our all-in fee report. And so we say here's the gross expense ratio on a fund, here is what Vanguard is receiving to defray the cost of record keeping. So we do disclose that.

PANEL MEMBER CAMPAGNA: Now if you're record keeping it for a non-affiliated fund, how would you describe your obligations with respect to the information that the non-affiliated fund has with respect to fees of that fund?

MS. FALLON-WALSH: I think it's our obligation to take the information that they provide to us. You know, we're using the term "fund," so the expense ratio is readily available.

What share class that fund might represent to provide that to the plan sponsor.

And then to also disclose out of that broad expense ratio what component of that expense ratio, if any, is being paid to Vanguard to defray the cost of record keeping. In addition, we also disclose to the participants the expense ratio of the funds that are included in the plan. It's available both by prospectus as well as fund fact sheets that we supply to them on paper when they join the plan as well as on the web.

PANEL MEMBER CAMPAGNA: All right. Those are my questions. Thank you.

MS. FALLON-WALSH: You're welcome.

PANEL MEMBER CANARY: Thank you.

I'd like to follow up a little on Mr. Piacentini's questions focused on expense ratios.

MS. FALLON-WALSH: Yes.

PANEL MEMBER CANARY: I was intrigued by your statement that Vanguard currently has an expense ratio base disclosure for separate accounts and common/collective trusts.

MS. FALLON-WALSH: These are for Vanguard separate accounts and collective trusts, for those that we administer. Excuse me. For those that we investment manage.

PANEL MEMBER CANARY: I understand.

So can you talk a little bit about how you end up developing that expense ratio for those different sorts of products? And part of that is, if I understand it correctly, in the mutual fund area there are certain expenses that are included in the expense ratio and others that are not. For example, brokerage?

MS. FALLON-WALSH: Yes.

PANEL MEMBER CANARY: So how did you go about defining what was going to be included in the expense ratio when you were talking about an insurance product or a bank investment fund?

MS. FALLON-WALSH: Bank investment fund, I'm not familiar with those.

PANEL MEMBER CANARY: Okay.

MS. FALLON-WALSH: And in our own, I'm not the expert in terms of how we go about collecting that information. But we do provide an expense ratio type disclosure. And we would be happy to provide to the Department detail on how we do that, if that would be helpful to you.

PANEL MEMBER CANARY: Yes. I think that would be helpful.

MS. FALLON-WALSH: Okay.

PANEL MEMBER CANARY: Then just back to the mutual fund area. So can you talk a little bit about what the expenses are that are included in the expense ratio versus not? And my focus is, is there in your view something that ties the expense that's included in the expense ratio to a reason why the investor should be told about that, i.e., that they are getting an indirect service as part of that expense and that's why it's included as opposed to, for example, the brokerage expense which isn't is somehow a different type of expense?

MS. FALLON-WALSH: Obviously in developing the expense ratio we're following the rules of the SEC, which I think are pretty clearly laid out.

I can't think of any expenses that are not included in the expense ratio that would be relevant to a plan sponsor or a participant that wouldn't be captured in a reduced return of the fund, right? I think that the plan sponsor has an obligation to look at the expenses of the fund and then how a fund is performing. If you have a very high expense ratio fund with low returns, it's not tracking to its benchmark, it's not competitive, that's where if those expenses were outsized compared to their peers.

The other thing that comes up that's unique to the mutual fund world is that we do have mutual fund boards and they do provide oversight of the funds as well. And it's their job to look through and make sure that the things that are being charged to the funds are in the best interest of the funds and the funds' shareholders. So it's an additional level and layer of oversight that other investment vehicles wouldn't provide.

PANEL MEMBER CANARY: Okay. Then one last question. I know this may be not really the greatest question for Vanguard because you don't do much revenue sharing payment.

MS. FALLON-WALSH: We don't do any.

PANEL MEMBER CANARY: Okay. Don't do any. So based on that understanding, I think you said that you supported the Department's proposal in the component where the recipient of revenue sharing payment would be required to disclose that to the plan fiduciary.

MS. FALLON-WALSH: Yes.

PANEL MEMBER CANARY: In distinguishing between revenue sharing payments and then, I guess, expense sharing among affiliated groups, do you see a difference there? And let me try to clarify that a little bit.

So if I'm an independent party and I'm getting a revenue sharing payment from an investment provider, you say well that should be disclosed to the fiduciary. Let's assume that I'm an affiliate of the investment provider and it's part of the bundled expense?

How would you separate those two disclosures?
MS. FALLON-WALSH: Oh gosh. We don't have affiliates particularly either, so I'm not --
PANEL MEMBER CANARY: I know it's hard because it's not an area where you have a lot of experience or any.
MS. FALLON-WALSH: Right.
I guess my question would be where it's so clear where it's coming from an outside party and if you're looking for payments within affiliates, I guess I would question the validity of the number. It would be very hard I would think to track and determine what number's real when it's within the family.
PANEL MEMBER CANARY: All right. Thank you.
MS. FALLON-WALSH: You're welcome.
CHAIR CAMPBELL: We had a witness yesterday testifying about sort of the process that goes on when a plan is negotiating with a

service provider and all the discussion of what the services are and kind of more specifically how they'll be provided and how they'll be judged for performance and so forth.

So going to your testimony about the broad service description, is your concern trying to attach a price to each part of a more granulated service? Because I'm assuming in at least some of your contracts that you enter into with plans that you probably do specify in great detail exactly how services will be provided. Could you discuss that a little bit?

MS. FALLON-WALSH: When we are negotiating with plan sponsors, when we are bringing in new business, for example, there is usually a pretty detailed RFP process that goes on. But you know, I look at that and you think that can get quite granular. I wouldn't want to have that be part of official reporting. Because the plan sponsor's needs change and ways of doing business that -- you know, think about negotiating with someone ten years ago and the web wouldn't have even been conceived in terms of how business would be provided. So I think those documents would become stale pretty quickly.

So the broad service description but the underlying components of it as efficiencies are realized.

You know, think back and it would have said we'll send payments by check, and then it went to wire, then it went to ACH, and all that sort of thing, leveraging the web for increased efficiencies, how reports get transmitted back and forth, whether Social Security numbers are going to get used, whether or not -- you know, things like one step automatic enrollment programs, automatic escalation programs. If you get extremely granular that isn't a living document, whereas the service model continues to evolve and grow in partnership with the plan sponsor. And

c21020a4-0b71-40d1-bade-e3b09f4800dc

that is better served under a broader umbrella.

CHAIR CAMPBELL: So in other words, the practice in the industry in your view is that the plan -- not the plan documents per se, but sort of all the documents that relate to the relationship you have with the plan aren't always reflective of what actual practice is occurring and that there is a disconnect at times in terms of keeping those current and fresh as you go through that would make it burdensome to be more specific?

MS. FALLON-WALSH: I think it would be burdensome to be more specific. So when we talk about we provide keeping services or we provide participant education, what the education program looks like in 2007 could be different from the education program in 2008 because the plan sponsor may have a different focus and a different need.

In 2007 we're focusing on new

funds that are being added to the lineup and we want to support that program in this way. In 2008 we may be focusing on trying to increase savings.

So we would say participant education is there without saying it is that granular, that it's X number of meetings and that it's this many pieces of mail and that sort of thing.

CHAIR CAMPBELL: Okay.

PANEL MEMBER DWYER: You stated that when Vanguard record keeps for an unaffiliated fund it may receive revenue sharing and that it voluntarily discloses that revenue sharing. Are you required to disclose that by the SEC or by anybody else?

MS. FALLON-WALSH: It would be the Department of Labor, I believe. I mean, we have always done it. I have never lived in a world where we didn't.

PANEL MEMBER DWYER: Would that be available in any SEC disclosure and would it appear in the expense ratio?

MS. FALLON-WALSH: Of the other party's fund.

PANEL MEMBER DWYER: Yes.

MS. FALLON-WALSH: It wouldn't be something that we would be reporting because we don't do it, right? So since we're not the revenue sharer, we wouldn't be disclosing anything like that.

Now the other fund companies, there are 12b-1 rules and all that sort of thing, and those payments have to be disclosed in their prospectus. Not that X company receives it, but that they do pay it.

PANEL MEMBER DWYER: And to whom?

MS. FALLON-WALSH: Not the to whom. The to whom would be a broad category, right? For distribution we pay X, but it wouldn't list all the recipients.

PANEL MEMBER DWYER: It wouldn't list the parties.

MS. FALLON-WALSH: Yes.

c21020a4-0b71-40d1-bade-e3b09f4800dc

PANEL MEMBER DWYER: Okay. The second question I have it deals with breaking up the components of the bundle, which you say would be very difficult to do because it's not how the business model works.

MS. FALLON-WALSH: Yes.

PANEL MEMBER DWYER: But what about at least segregating the administrative costs from investment management? What would be involved in that? Why would that be so hard to do?

MS. FALLON-WALSH: First of all, you know the speaker just prior to me talked about a shared economic model. And ours is a shared economic model across the retail part of Vanguard and the institutional part of Vanguard. And we accumulate the cost of the complex and we set an expense ratio that nets to zero. We could not break out in a way that I feel would be either accurate or actionable the record keeping component of that separate from all of the other costs.

PANEL MEMBER DWYER: All right. Thank you.

MS. FALLON-WALSH: You're welcome.

PANEL MEMBER ZARENKO: I'm just wondering, the all-in fee report, what else do you typically disclose along with this to your plan clients, or does it just depend on what else they ask for?

MS. FALLON-WALSH: Yes.

PANEL MEMBER ZARENKO: I mean you can pass through a prospectus?

MS. FALLON-WALSH: Right.

PANEL MEMBER ZARENKO: Please just explain to me how that typically works.

MS. FALLON-WALSH: We annually provide the all-in fee report. It's often part of an Investment Committee meeting reviewed with the fiduciaries of the plan. We would talk about the services and activities that happen with the plan over the course of the past year, any special events that might have come up.

We would try to provide context for the fees, you know, in terms of the Vanguard funds. And in regards to the Vanguard funds, you know through broad communications often as well as meetings we're talking about what trends have occurred in, for example the expense ratio of the Vanguard funds.

I was pulling some statistics in anticipation of this meeting and looking at something, just the expense ratio for example on a couple of our funds. The Index 500 and the Total Stock Market Index Fund.

In 1995 the Index 500 fund had an expense ratio of 20 basis points and Total Stock Market 25 basis points. In 2008 today they're both at 15 basis points. So one has dropped by 25 percent and one by 40 percent. So we look at those trends over time with our plan sponsors as well.

We would talk about any explicit fees that get charged. If there's a per

c21020a4-0b71-40d1-bade-e3b09f4800dc

participant fee within the plan. We talk about fees that are charged on an as-used basis, things like loan fees, QDRO calculations, something like that.

PANEL MEMBER ZARENKO: Some commenters are asking that the Department provide more specific formatting or consolidation requirements, I think trying to get at something more like this --

MS. FALLON-WALSH: Yes.

PANEL MEMBER ZARENKO: -- with the argument being that's much more useful to a plan fiduciary. But on the other side people saying, you know, it would be impossible for us to come up with a one-size-fits-all consolidated disclosure format.

MS. FALLON-WALSH: Yes.

PANEL MEMBER ZARENKO: Because there's so many different services and so many different ways that these are charged.

MS. FALLON-WALSH: Right.

PANEL MEMBER ZARENKO: Any views

c21020a4-0b71-40d1-bade-e3b09f4800dc

on these?

MS. FALLON-WALSH: I think it is hard to come up with a one-size-fits-all. So I would -- my remarks are well received, I hear cheering in the halls.

But I would say that I think a one-size-fits-all perhaps could be difficult. We find this works particularly well for us, and I would suggest would work well for others that are using mutual funds as the basis for the expenses that are charged.

PANEL MEMBER ZARENKO: So this is more just an example of how you disclose than --

MS. FALLON-WALSH: Yes. Right.

PANEL MEMBER ZARENKO: -- any recommendation of formatting requirements on our part?

MS. FALLON-WALSH: I think our plan sponsors find it clear. It's easy to use. It's useful information and it's not overwhelming. And I think that's particularly important for smaller plan sponsors.

PANEL MEMBER ZARENKO: And on smaller plan sponsors, are there any generalizations or differences that you think would be helpful for us to know about in dealing with large plan clients and small plan clients? There's been a lot of distinctions drawn yesterday about the difference between the two. I'd just enjoy hearing your comments.

MS. FALLON-WALSH: I would say that the larger plan sponsors generally have more breadth and depth in terms of the expertise and support that they can bring to the table. Smaller plans probably rely more on us to provide our expertise. So that would be one difference that I would offer.

PANEL MEMBER ZARENKO: Any reasons you can think of why the small plan market should be excluded from our requirements?

MS. FALLON-WALSH: No.

PANEL MEMBER ZARENKO: Thank you.

c21020a4-0b71-40d1-bade-e3b09f4800dc

PANEL MEMBER WILLIAMS: Okay. In the interest of time, just to reiterate you say that Vanguard receives revenue sharing and that it discloses this and it supports disclosure. Does it ever have any problems receiving the information that it would need to provide that disclosure?

MS. FALLON-WALSH: Since most of the -- since the revenue sharing that we receive comes through mutual funds, it's readily available. Now, if it were collective trusts or separately managed trusts and things like that that were administered by outside parties, I think it could be quite difficult to get to the underlying expense ratio equivalent type of number. I think that is where it could become more challenging.

PANEL MEMBER WILLIAMS: Okay. Thank you.

MS. FALLON-WALSH: You're welcome.

CHAIR CAMPBELL: All right. Thank you very much.

MS. FALLON-WALSH: You're very welcome.

And next we'll have Mr. Mollahan with the American Bankers Association, or I should say representing the American Bankers Association with JP Morgan Chase.

MR. MOLLAHAN: How are we on time.

CHAIR CAMPBELL: Well we will certainly make sure everyone has the time they need.

MR. MOLLAHAN: Okay. Good.

In the interest of that time, let me get right to some comments. I've submitted testimony on behalf of the ABA that provides additional insights and perspective.

Unlike many of the people who have spoken prior to myself, both yesterday and today, I represent a broader based view, I believe, that incorporates all employee benefit plans that include defined benefit, defined contribution and all forms of health and welfare plans. So hopefully, that perspective will be valuable to the group today.

Okay. First of all, my name is Ed Mollahan. I'm a Managing Director at JP Morgan Chase. I'm also the Chairman of the American Bankers Association Committee on Retirement and Employee Benefits.

The ABA brings together banks of all sizes and charter into one association. Many of these institutions provide trust or custody services for institutional clients including employee benefit plans as well as services to individuals holding retirement assets and individual retirement accounts. As of 2006, banks and savings associations held more than 22 trillion in fiduciary assets for both personal, institutional customers in 20 million accounts. As a result, the Department's proposed regulation is of great important to the banking industry.

The ABA appreciates the opportunity to testify before the Department of Labor today on the issue of disclosure of compensation of plan sponsors for plan services and commends the efforts of the Department to try to strike the right balance between disclosure that a plan sponsor needs to make an informed decision and disclosure that includes extraneous information.

Okay. So my testimony today is highlighted by three key points. Collective funds, like mutual funds, are not plan service providers as we see it. The conflict of interest disclosure provision is overly broad and unworkable on many fronts. And I'll provide some specific comments to that.

And finally, more time would be required for banks to come into compliance with regulation once that regulation is finalized and adopted.

Okay. First relative to collective funds. Like mutual funds, they're important investment vehicles made available to plan sponsors and participants alike.

c21020a4-0b71-40d1-bade-e3b09f4800dc

There's no secret that collective funds provide plans and plan participants with extraordinarily cost effective vehicles in which to invest retirement assets.

The Federal Government's own Thrift Savings Plan is heavily invested in collective funds. According to recent FDIC data there are 1.6 trillion assets held in collective funds today. JP Morgan Chase offers a number of collective funds holding tens of billions of dollars in assets alone. These funds are made available to the many plans that we service. That number is in excess of 1,000 retirement plans.

The proposed regulation would appear to require the plan service provider to disclose information about compensation earned by persons that are not handling the plan's assets or providing services directly to the plan. This would appear to include some advisors and other persons who provide services to the fund. It is our understanding

c21020a4-0b71-40d1-bade-e3b09f4800dc

that service providers to mutual funds would be exempt under ERISA from providing that disclosure. We support this treatment of mutual funds but believe that the regulations should make clear that service providers to collective funds are to be treated in the same fashion.

As with mutual fund, service providers to plan asset pool investment vehicles would contract only with the collective investment fund and will not know the identity of the investors in the fund. And it would also be impossible for service providers to a collective fund to determine if they or one of their affiliates had any relationship with any particular sponsor invested in that fund, much less maintain such information on an ongoing basis.

Just as with mutual funds, collective funds utilize services provided by many providers that may or may not be affiliated with the collective fund trustees,

c21020a4-0b71-40d1-bade-e3b09f4800dc

including but not limited to custodians, asset managers, securities lending agents, evaluation service providers, fund accountants, auditors, legal counsel, et cetera.

Moreover, and finally, we question the need for this level of disclosure. The disclosure to plan sponsors of compensation paid by the collective fund to third parties that are not affiliated with the investment manager, such as securities or real estate brokers, appraisers, pricing services, accountants, auditors and printers, lawyers, et cetera should not be required.

Regarding conflicts of interest. The conflicts of interest provision is extraordinarily broad and requires too much unnecessary disclosure. The proposal would require the service provider to disclose whether the service provider or any affiliate has material, financial, referral or other relationship with money managers, brokers, another client of the service provider, another service provider of the plan or any entity that could create a conflict of interest for the service provider in providing those services.

In effect, the proposal nearly shifts some of the burden placed on plan sponsors from a fiduciary standpoint onto the service provider to identify on a plan-by-plan basis all of the service providers for each plan client and then determine whether they "could" pose a conflict of interest. On its face it seems unreasonable and extremely burdensome to require service providers to perform a detailed inventory and analysis of all of the relationships that could potentially give rise to conflict of interest and then create a customized disclosure for each plan client listing all of these potential conflicts. And I would highlight the word "potential."

JP Morgan and its affiliates

provide trust custody investment management and securities lending services to plans in addition to a number of other services. We also provide underwriting services to issuers of securities and other investment banking services, transition management, securities brokerage and trading, foreign exchange and the like.

We also provide a great deal of services to unaffiliated mutual funds including custody fund accounting related services that also include shareholder record keeping and transfer responsibilities.

Under the proposal it would appear that JP Morgan -- if JP Morgan Chase was to serve as a directed trustee of a plan that was directed by a named fiduciary or investment manager to buy a security underwritten by the JP Morgan Chase Securities, Inc., that transaction under the proposal could be deemed a disclosable event, regardless of whether the security is purchased directly from JP Morgan

Chase Securities, Inc. or from another unaffiliated member of the underwriting syndicate.

In addition, the Department is aware the banking industry for many years has been in a period of consolidation. Mergers between institutions increase the potential for newly affiliated companies, and that they will have existing relationships with plans.

For example, my own firm is compiled of JP Morgan Chase, Bank One, Chemical, First Chicago, MBD, Manufacturers Hanover, and this all in my career by the way. So of these institutions there are a number of affiliates and subsidiaries that exist, and that's just with JP Morgan Chase. There are plenty of other institutions with equally or possibly even greater number of conflicts -- not conflicts, but interconnecting relationships which are nearly impossible and definitely a costly standard to achieve in today's complex financial world.

Finally, the proposal fails to recognize that even if there is an actual conflict of interest between the plan and party of interest, the party in interest may have been granted a prohibited transaction class exemption with its own required disclosures. Many conflict situations could be covered, perhaps, by various prohibited transaction exemptions that service providers have sought and have been granted over the years.

The effective date -- this is my favorite. Ninety days is, in our opinion, insufficient time for creating the disclosures regime mandated under the proposal in its current form. The extensive information that would be required to be captured under the final regulation will require time for bankers to review and understand the final regulation and develop new or update current systems to track that particular information and report it in a format that's useable.

Specifically, the extensive conflict of interest disclosures mandated under this proposal will require the development of an entire system to capture the many relationships between numerous service providers.

There are a number of other points that I would like to touch on, but I would like to open it to questions given the significant difference, perhaps, in terms of my position here of testifying today and some of those who have testified before me.

CHAIR CAMPBELL: All right. Thank you very much. Let's start down here.

PANEL MEMBER WILLIAMS: Thank you.

Now the collective funds that you're talking about, hold plan assets, correct? So when you say that a servicer to a collective fund is not a party interest to an investing plan --

MR. MOLLAHAN: Right.

PANEL MEMBER WILLIAMS: -- are you

thinking of a situation where the collective fund is holding plan assets of that plan?

MR. MOLLAHAN: The collective fund is holding plan assets. What we're saying is that the contractor and auditor, by way of example, to that fund is not being contracted by the plans. It's contracting with the fund itself.

PANEL MEMBER WILLIAMS: So the fact that this is a service provider for plan assets of a plan avoids the need for 408(b)(2), is that --

MR. MOLLAHAN: Well, what we're saying is that the collective investment fund in our estimation is not different than a mutual fund.

PANEL MEMBER WILLIAMS: Even though it holds plan assets?

MR. MOLLAHAN: Yes.

PANEL MEMBER WILLIAMS: So --

MR. MOLLAHAN: It should be treated similarly for that reason.

c21020a4-0b71-40d1-bade-e3b09f4800dc

PANEL MEMBER WILLIAMS: Okay. So in your view you don't have a prohibited transaction when the collective fund engages anyone for a service or for a transaction? What am I missing?

MR. MOLLAHAN: What we're saying is that the collective fund, right, will obtain the services for accounting, legal, regulatory review, preparation of documents to the OCC by way of example, and the like. And that those service providers may be providers of other services to participants in the collective fund.

PANEL MEMBER WILLIAMS: Then I think you said that you can't identify all of the people that are providing services to a collective fund or to the people that are acting as subadvisors or subservicers?

MR. MOLLAHAN: No. We will not be able to identify all of the inter-relationships that they may have, right, with plans who have chosen collective funds.

PANEL MEMBER WILLIAMS: Okay. But you are required to meet conditions that are in the existing class exemptions where that would be required?

MR. MOLLAHAN: Perhaps. I mean I am not the collective fund expert nor the class exemption expert on that topic. But I'd be happy to come back, Fil, and answer that question more succinctly.

PANEL MEMBER WILLIAMS: Okay.

PANEL MEMBER ZARENKO: Our definition of compensation, most commenters are saying it's too broad, especially when we're talking about indirect compensation and that there has to be some limit in our rule about how far down the line the concept of indirect compensation goes.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: But of course any time that we try to draw a line, it always gets very fuzzy as to what falls on one side or the other.

MR. MOLLAHAN: Right.

PANEL MEMBER ZARENKO: And we also want to try to avoid drawing any line that would cause people to just change their compensation practices or structures to ensure that they're on one side of that line or the other.

MR. MOLLAHAN: Right.

PANEL MEMBER ZARENKO: And you talk about limiting it to compensation that's related to the plan.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: And that seems to me to be exactly one of those kinds of the hard lines to draw. Can you just expand a bit on how as a regulatory matter we would define what it means to be related to the plan to avoid those problems?

MR. MOLLAHAN: I'm not sure that I have a unique or specific definition that I can share. I can certainly take a look at that. However, we are for full disclosure of the expense aspects, whether it's in our defined contribution practice, or defined benefit practice or health and welfare, right. They're operating independently but often unite across the board relative to common customers.

While it would be preferred, I think, to have a bright line sort of test, I'm not sure it's that simplistically drawn, when you look across types of plans, size of plans and the underlying nature whether it's DB ranked as those services are somewhat different, as you might imagine, than DC versus health and welfare. So perhaps I can take that away as well and come back to you with some thoughts more specifically that we can come up with.

PANEL MEMBER ZARENKO: Okay. The other thing I want to touch on is the requirement in the rule that you or a service provider identify itself as an ERISA fiduciary. And I know you recommend that we eliminate that requirement in your comment letter.

The delegation of fiduciary responsibility under ERISA is a big deal.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: And so I understand that that's a functional test and it's not always crystal clear. But yet it seems to me like very important information for a plan fiduciary to know up front, at least whether they think they're delegating fiduciary responsibility or not.

MR. MOLLAHAN: Right.

PANEL MEMBER ZARENKO: So it's one thing to say we need to have a rule that would accommodate mistakes in identifying oneself as a fiduciary or otherwise.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: It's another thing to say we don't think we should even have to go there. Could you just expand on why you recommend eliminating that requirement?

MR. MOLLAHAN: I'm sorry. Let me perhaps ask you to repeat the question. Because I want to make sure I answer that correctly.

PANEL MEMBER ZARENKO: And I guess the bottom line in your comment you request that we remove the requirement that a service provider identify whether or not it's an ERISA fiduciary.

MR. MOLLAHAN: Right.

PANEL MEMBER ZARENKO: Other commenters don't necessarily say you should remove that requirement. They say you just need to find a way to accommodate the fact that people might slip up despite their best intentions because it is a difficult standard that depends on what happens in practice.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: And it's hard to always say with certainty at the beginning I will or won't. But to the extent the delegation of fiduciary function to a service provider is very important --

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: -- understanding that there be mistakes, I'm just wondering why you recommend eliminating the requirement entirely rather than trying to accommodate the fact that it's a difficult line to draw?

MR. MOLLAHAN: Well, I think there's two reasons or two components, right. One of them is we're not providing services uniquely and solely to the 401(k) or defined contribution arena. Okay.

Secondly, I think that the requirement can be -- certain requirements can be delegated and certainly are passed contractually but we think others, you know steadfastly remain the responsibility of the respective parties, the named fiduciary versus a trustee versus an asset manager, et cetera. And we think that's a little clearer than it

c21020a4-0b71-40d1-bade-e3b09f4800dc

would appear to be from the requirement.

PANEL MEMBER ZARENKO: Just could you comment on something, from a service provider perspective, although again I know it's hard to say with certainty up front whether fiduciary functions are going to be performed.

MR. MOLLAHAN: Yes.

PANEL MEMBER ZARENKO: But again, apart from a plan sponsor wanting to know that information, wouldn't a service -- given that a bunch of other requirements and restrictions flow from being an ERISA fiduciary --

MR. MOLLAHAN: Right.

PANEL MEMBER ZARENKO: -- wouldn't a service provider want to do its best to know if it is or isn't providing fiduciary services?

MR. MOLLAHAN: Well I think from our standpoint, we're frequently the trustee. We're always acting in a fiduciary capacity.

PANEL MEMBER ZARENKO: Yes.

MR. MOLLAHAN: And that would be the case with most of the constituents within the ABA.

And to the extent that we were performing fiduciary responsibilities, we are I think disclosed and open specifically by contract and otherwise to the services and responsibilities that we take, whether they're fiduciary or purely administrative in their nature. And so to that extent, we think that's quite clear and has been for some time.

PANEL MEMBER ZARENKO: Okay. Thank you.

PANEL MEMBER DWYER: I have no questions.

CHAIR CAMPBELL: Well, actually I wanted to follow up on that. Because I was also somewhat perplexed by that comment about wanting to not state whether you're a fiduciary or not, given as you just said it seems to me well the standard is based on what actually occurs. When you're entering into a service contract you're sort of deciding what types of services to provide, which ought to give you an indication as to whether you intend for those to be, as you say, trustee services where there's a fiduciary relationship.

MR. MOLLAHAN: Yes.

CHAIR CAMPBELL: So it's not clear to me why it's so difficult to state at the outset of the contract this is the type of services we think we're providing and we think that makes us a fiduciary for ERISA purposes or otherwise.

MR. MOLLAHAN: I suppose maybe to try to get back to Kristen's question and to maybe answer that, there are a plethora of other services that we provide that are not fiduciary and purely administrative in their nature.

For example, we may be a record keeper, right, in one instance but not the trustee. We could be a custodian and a record keeper and providing asset management services. And/or there are just plain administrative services that we may supply in support of a plan's operation where the administrative nature of those services would not be defined by any stretch of the imagination as fiduciary in their nature. And I get that straight from counsel. And each of those contracts clearly stipulates whether or not we're performing in a fiduciary fashion, but not all contracts.

CHAIR CAMPBELL: I'm sorry. I guess I didn't quite understand what you meant. Each of those contracts states it but not all contracts?

MR. MOLLAHAN: To the extent we're only providing an administrative service, right?

CHAIR CAMPBELL: Then those contracts are silent as to whether you're a fiduciary or not, or they say you're not?

MR. MOLLAHAN: They typically say

c21020a4-0b71-40d1-bade-e3b09f4800dc

we're not if it's a purely administrative undertaking and support of the sponsor or elements of services that they require to carry out their responsibilities and their obligations.

CHAIR CAMPBELL: And I don't mean to belabor this but I guess I'm still confused then. Aren't you already complying with the proposal then?

MR. MOLLAHAN: From a contractual standpoint, whether or not we're a fiduciary?

CHAIR CAMPBELL: I mean, your contracts state whether you are or not already?

MR. MOLLAHAN: Right.

CHAIR CAMPBELL: Okay. So again, I just am confused as to why then it's a problem to state that affirmatively under the proposed regulations?

MR. MOLLAHAN: I'll confirm with counsel. I mean it was their opinion that we were clear enough already. That we did not need to take any additional clarifying acts, if you will. But contractually where we're a trustee, we're a trustee and we clearly state that.

CHAIR CAMPBELL: Okay.

MR. MOLLAHAN: It's a contracted service.

CHAIR CAMPBELL: Thank you.

PANEL MEMBER CANARY: Okay. Let me just follow up. Because I may have heard an element to your answer which at least I understood to suggest the following is: That if you're dealing with a multiple service arrangement that the issue for you is trying to confirm where you're a fiduciary and where you're not and making that sort of disclosure may be complicated if you end up with a range of services. So currently under your contracts, where you get into whether you're a fiduciary or not, are you suggesting that's the problem, is that now when you are a fiduciary you say you're a fiduciary, but if you're providing multiple services the concern is going through and trying to identify in your contract as to each service whether you're a fiduciary?

MR. MOLLAHAN: That is certainly an element of it.

PANEL MEMBER CANARY: Okay. I guess we've had some testimony suggesting that one thing that might be good, and I think you're a good person to ask this question, is having other providers mirror their disclosures to what are now in the mutual fund industry disclosure requirements. Do you have any thoughts about that coming from the bank collective fund perspective?

MR. MOLLAHAN: I do. I think that expense ratios, any expense can be stated fundamentally in a ratio. Performance of funds, returns of investments whether they're mutual funds, collective funds or separate accounts that are established for defined benefit, defined contribution or health and welfare plans can be stated and stipulated in a similar fashion, right. So by way of example, it's been very common practice in the performance and investment analytics arena, which is a service that we provide to our clients, to state returns both in gross and net of fee terms and calculate expense ratios where a client's preference is to see it reflected in that fashion.

PANEL MEMBER CANARY: Okay. So when you do that, how do you define what's in the expense ratio and what's out? I guess I'm focused again on this expense ratio question, as I understand it not all expenses, at least from one perspective, are included in calculation of the expense ratio.

MR. MOLLAHAN: Right.

PANEL MEMBER CANARY: Can you talk about that and why that is?

MR. MOLLAHAN: Depending on the level of requirement, for example in a defined -- I'll try to use a defined benefit plan by

c21020a4-0b71-40d1-bade-e3b09f4800dc

way of example. In the defined benefit plan the investment manager, right, is employing his services making asset selection, et cetera. They also select the brokers that they choose to execute trading with.

We do track for 5500 purposes the reportable transaction events, right. So we do have the brokerage expense and we are able to incorporate those expenses as part of the expense ratio.

There may be other situations where certain expenses are not known or not clear by way of example, but they would be picked up in the performance aspect. Foreign exchange trading, right, which is a spread product just like a lot of fixed income trading, right, is often spread based. And so it gets incorporated in the investment return of the fund.

PANEL MEMBER CANARY: As opposed to being in the expense ratio?

MR. MOLLAHAN: Right, as an

identified expense. Right.

PANEL MEMBER CANARY: Right.

MR. MOLLAHAN: Two point two basis points for a particular purchase of currency to settle a trade.

PANEL MEMBER CANARY: Okay. And I want to follow up on Fil Williams' question a little bit. Because I think in the collective investment fund area they're plan assets, there are parties that are clearly fiduciaries managing those plan assets for ERISA purposes.

MR. MOLLAHAN: Yes.

PANEL MEMBER CANARY: And I think that the conclusion would be well if they're fiduciaries under ERISA, then does not reflect that they're providing some sort of a service to the plan in connection with that fiduciary status, even though it may be similar to the investment manager or investment advisor to the mutual fund. And if I'm understanding you correctly, it isn't so much the legal status that you're getting at as opposed to the operational equivalence or treatment that you're looking for?

MR. MOLLAHAN: That's correct. It's purely from an operational standpoint.

PANEL MEMBER CANARY: Okay. Thank you.

PANEL MEMBER CAMPAGNA: You spoke in terms of our conflicts of interest provisions being too broad because of all the relationships that a bank trustee may have through mergers, acquisitions, et cetera. But do you believe that there could be a problem in the conflicts area regarding certain service providers, brokers, pension consultants, those kinds of things that could lead to the need for such a provision? And how could we narrow it to fit that?

MR. MOLLAHAN: I'll try to answer that not from a personal opinion standpoint.

I certainly think a monitoring process makes sense. How far and how wide that monitoring process goes I think is the

c21020a4-0b71-40d1-bade-e3b09f4800dc

subject of our comments, right?

There are certain studies that have been done, there's research that's been done related to conflicts and where they tend to range. I think there's been a number of changes since a lot of the '05 studies have been done, for example, in the consultant arena, right, where oftentimes consultants are contracted on behalf of employee benefit plans now as fiduciaries where prior to that, that was not always the case. I don't want to say that that's the unique example, nor am I picking on the consultant industry, but I'm simply pointing out that at some point the level of look through for conflicts becomes unmanageable from a knowledge standpoint and requires an interpretive component that's not measurable nor easily reportable.

PANEL MEMBER CAMPAGNA: So you're talking about, perhaps, limiting it at the point of contact with the plan?

MR. MOLLAHAN: Yes. Much the same

c21020a4-0b71-40d1-bade-e3b09f4800dc

as I believe one of the prior speakers did, yes.

PANEL MEMBER CAMPAGNA: Okay. Now I know that you're not the class exemption expert. You said as much. I hope this doesn't catch you off guard.

MR. MOLLAHAN: I would say not.

PANEL MEMBER CAMPAGNA: But just describe a couple of the class exemptions, and it refers to your comment later, too.

MR. MOLLAHAN: Yes.

PANEL MEMBER CAMPAGNA: Because you did mention these in your comment letter.

MR. MOLLAHAN: Yes, that there are problems, yes.

PANEL MEMBER CAMPAGNA: That basically class exemptions should be left as is apart from the regulations. But there are two in mind that I have; one in 1975 for brokerage --

MR. MOLLAHAN: Yes.

PANEL MEMBER CAMPAGNA: -- where

there's not a lot of disclosure regarding this indirect compensation that a broker may receive in connection with the provision of brokerage service.

In '84 we did a class exemption for -- you know affecting the sale of an insurance contract. And again, it's only about the commissions. It's not about indirect compensation that the agent may be receiving which could, perhaps, reflect some kind of interest that the agent might have in steering the plan to that particular contract.

Do you see a need in any of those cases for new information to come forward?

MR. MOLLAHAN: Well, and I believe it was Vanguard had a rather well documented process around disclosure of its expenses and related impacts to their client base. We fully applaud and support disclosure and disclosure to the extent those interests are known and understood and could be quantified in a way that makes an important and

c21020a4-0b71-40d1-bade-e3b09f4800dc

meaningful decision process effective for the plan fiduciary.

PANEL MEMBER CAMPAGNA: Okay.

MR. MOLLAHAN: And the only other comment I would add to that is that it's not clear to me whether or not knowing that information would be beneficial to a participant who tends to look for some sort of expense ratio or the net result impact from its performance return.

PANEL MEMBER CAMPAGNA: I'm just talking about the plan fiduciary in context, say, with a broker.

MR. MOLLAHAN: Right.

PANEL MEMBER CAMPAGNA: An insurance broker, selling him a contract.

MR. MOLLAHAN: Yes.

PANEL MEMBER CAMPAGNA: Is there a need for more information than just commissions --

MR. MOLLAHAN: Right.

PANEL MEMBER CAMPAGNA: --

associated with that sale? Do they need to know that there may be some additional payments coming from the insurance company in association with that?

MR. MOLLAHAN: It would seem that the plan fiduciary has a responsibility to know that.

PANEL MEMBER CAMPAGNA: Okay. Thanks.

PANEL MEMBER PIACENTINI: Just one narrow follow up on a question that Joe Canary asked.

MR. MOLLAHAN: Yes.

PANEL MEMBER PIACENTINI: And this has to do with whether something like an expense ratio could be reported for a bank collective fund.

MR. MOLLAHAN: Yes.

PANEL MEMBER PIACENTINI: I think I heard you say that probably that could be done in the context of performance analysis. And as I heard that, and I thought does that mean that this could be done retrospectively only or could it also be done prospectively; that you could generate an expense ratio that would let people know in advance what they would pay to the same degree that it does now in the case of a mutual fund?

MR. MOLLAHAN: It could be done either way. I mean, the calculation is not extraordinarily burdensome, you know, from the mathematical perspective or how you would present or state how you summarize your fees.

Many times we break down our fees individually at the dollar level and they can be rolled into an expense ratio. There are many clients who ask for it to be stated in that way even if you disclose the individual numbers to them.

PANEL MEMBER PIACENTINI: Now just one narrow follow up. As I understand in the case of a mutual fund that number is consistent? The expense ratio is the same for all holders of a particular share class.

Would that be the same in a bank collective fund or does it vary by client for any reason, is it negotiated separately or how would that work?

MR. MOLLAHAN: To my knowledge it is not a different level of fee structure based on the client or type of client, et cetera. I can verify that for the counsel or Committee as well.

PANEL MEMBER PIACENTINI: Thank you.

MR. MOLLAHAN: Okay.

CHAIR CAMPBELL: All right. Thank you very much. We appreciate it.

MR. MOLLAHAN: Thank you.

CHAIR CAMPBELL: And our last witness before lunch, no pressure, is Mr. Ryan with the Securities Industry and Financial Markets Association. And I do mean that, no pressure. Take all the time that we've allotted for each witness, please.

MR. RYAN: Okay. Well, good

c21020a4-0b71-40d1-bade-e3b09f4800dc

morning on this happy April Fool's Day.

My name is Bill Ryan. And on behalf of SIFMA, I appreciate the opportunity to testify for you today.

We have obviously submitted written comments. And we'll try in the interest of time and not having people throw things at me while I'm speaking, we'll try to condense our comments to some discrete points and then leave it open to questions for the Department.

We're basically concerned about four aspects of the regulations. Number one, we respectfully submit and agree with the ICI, Vanguard and other parties that enhanced disclosure requirements for fees should be issued and addressed by the issuance of new guidance. We, however, believe that the appropriate vehicle for this guidance is actually 404, not 408(b)(2). We don't believe that the prohibited transaction rules for service provider contracts necessarily gets at what we think you and others have focused on, which is the fiduciary's obligation of the plan to actually obtain the information. And we understand the issues they may have with respect to trying to get that from nonresponsive service providers, and we'll be happy to deal with that in questions.

But as we understand it, the Department's primary focus here is the receipt of payments from third parties, such as mutual funds, advisors, transfer agents and the like by pension consultants, brokers, advisors and record keepers and that the plan fiduciary should be better aware of. And we're definitely prepared to work with the Department to ensure that these payments are disclosed. But we think that these disclosure obligations, generally speaking, should be addressed first in the 401(k) context, in the mutual fund areas where people have seen this problem and then more gradually expanded to the defined benefit and health universe. As it reads right now, the same standards and the same disclosure requirements apply to all different types of plans and all different types of service providers.

Our view is that trying to treat all of these arrangements the same and forcing the disclosure requirement through the excise tax provisions, which basically to the point that was raised earlier by Vanguard, puts a premium on granularity, puts a premium on excessive disclosure because no one wants to miss a particular type of service that one might be providing if they think they have a 15 percent excise tax to pay for it. And what we're worried about, and we think our clients are worried about, is that forcing it into this framework will result in expensive, voluminous and candidly excessive disclosure.

Our second point is that in achieving the objective of enhanced disclosure the Department in our view should not mandate specific types of disclosure required of every type of service provider to any type of plan regardless of the types of service providers or candidly, the types of plans.

SIFMA urges the Department to recognize that, as others have said, one size does not fit all.

Third, in its efforts to expand disclosure to plan fiduciaries, SIFMA is concerned that the Department, and this has been the talk of other conversations this morning and yesterday, has inadvertently overextended its reach through the use of 408(b)(2) as the vehicle for the changes.

For example, it's been discussed in the mutual fund context brokerage commissions and advisory fees paid from assets of a nonplan asset vehicle are not subject to the prohibited transaction requirements. They are not subject to an excise tax regime.

At a minimum we think that any final regulation should distinguish between compensation paid by funds and their affiliates for distribution, record keeping and similar services in connection with the particular plan, on the one hand, and separate that from commissions paid for the purchase of the underlying portfolio securities that are held by the mutual funds themselves.

Finally, and again I think I'm preaching to the choir here, SIFMA believes that the effective date of the final rule needs to be at a minimum coordinated with the effective date of the Form 5500 disclosure. So we would propose currently that that would be July 2010, roughly an 18 month phase-in from whenever the Department finalizes these rules.

We think that trying to look at these as a package, as we believe the Department has, and looking at the disclosure obligations for 5500, the disclosure obligations for service providers and the like should be looked at in a coherent form.

Now, to touch on some of the

points in a little more detail, SIFMA again strongly supports the goal of ensuring that plan fiduciaries have the information they need. But we continue to believe that the fiduciary requirements of 404 are more amenable to a flexible approach to disclosure than is advanced in the one in the proposed regulation.

We think it's appropriate to follow the regimen of the current framework which allows a fiduciary, a plan fiduciary to decide how much disclosure is appropriate under the circumstances for their type of plan, for their type of service provider relationship and how to obtain that efficiently, shouldn't be discarded in the absolutely legitimate effort to raise consciousness of plan fiduciaries regarding the information that may be relevant to their decisions.

Now in dealing with the contracting part of the regulation, we have a couple of points that we've made in greater detail, but I want to summarize them briefly.

First, we urge the Department to continue its view not to require signed agreements for every service provider. We think the cost and the delay of doing this both from the plan's perspective and candidly and more selfishly from our perspective is prohibitive. And we're not entirely clear with our experience on obtaining signed contracts that that process will either be expeditious or necessarily in the best interest of plans or participants.

We urge also that the Department continue its view to think that in terms of looking at the documentation itself that we incorporate other documents that are simply published and other rules that are applicable to many of our firms. Especially in the securities brokerage area many of the rules on disclosure are mandated already by FINRA, by the SEC, by state security requirements as well as the Department of Labor. And what we're concerned about and what our members are concerned about is actually imposing a new set of these requirements onto an existing brokerage framework where disclosure with respect to compensation is often times on a transactional basis after the fact. Our entire structure has been dealed with giving very detailed disclosure on a transaction-by-transaction basis through the Confirm system rather than trying to come up front with an estimate of what some of these brokerage commissions or expenses could be.

We've urged the Department to consider a safe harbor for disclosure under the regulations such that any disclosure that meets the requirements of the securities laws, for example, will be deemed to meet the disclosure requirements of 408(b)(2). And we urge the Department to also consider a rule similar to that of the Insurance Company General Account Rule in 2550.401c-1 which

c21020a4-0b71-40d1-bade-e3b09f4800dc

allows noncompliance of these requirements to be cured in a reasonable period of time without imposing an excise tax regime.

We think the regulations should provide that if a service is provided has not been fully disclosed, it's full disclosure in a reasonable period after discovery should cure the harm.

We also think, and I touched on this point earlier, that a written comprehensive disclosure document in advance of all plan service provider relationships is not going to be required or honestly workable for a number of different reasons.

First the services, as others have noted, may evolve over time. It is very possible that you may have brokerage services, you may have custodial services, you may use mutual funds, ETFs, managed accounts and the like all within the same context of a plan relationship and all within the context of a brokerage relationship in the retail side. On the institutional side where a lot of our members also transact business on behalf of pooled funds and large plans, plans like the General Motors plan and the like, we have different requirements and different services that they may require with respect to securities lending, principle trading, transition management and the like, all of which evolve over time, all of which are usually in the institutional context at least, directed by an independent plan fiduciary, in many cases a QPAM, or someone of equivalent stature, and all of which we think are adequately protecting the interests of plan participants and beneficiaries who may be invested in those vehicles.

We also believe that all of the relationships themselves with respect to the service providers aren't candidly going to be known at the time that any particular contract is entered into. The representative from the American Banking Association noted his own corporate structure which, candidly, I would have to say on behalf of Morgan Stanley's, our corporate structure is equally convoluted and equally historic. But more to the point, most of the service providers that you would be dealing with, especially on an institutional basis evolve. They hire affiliates. They hire different types of transactional activities. And I will say that conflicts disclosure when you do it in an advisory vehicle through the Investment Advisors Act recognizes that in many cases the disclosure has to be fairly general with respect to these relationships, especially with respect to conflicts.

So the level of granularity and the particularity may not be achievable, in part because times change, the service providers themselves change and the services that the plans require may change as well.

And one point I think that we would like to make in particular with respect to the conflicts of disclosure, we think for our members, and we're trying to deal with this from an institutional as well as a retail basis, we think the provision for explicit, detailed, candidly onerous, conflicts disclosure is misplaced outside of the fiduciary context.

Where someone is an investment advisor under the Advisors Act, where they have taken on an ERISA fiduciary role or the like, there are documentations and procedures that you should be concerned about with respect to conflicts disclosure, and there are issues that we all have to deal with as financial institutions in making sure that occurs. But if you're dealing with a service provider to, let's say, a bank collective trust or a pooled vehicle that is a plan asset vehicle and you have a contract with that fund to provide mailing services or printing statements and the like, candidly and no disparagement to FedEx or the like, I doubt that any plan investor in a bank collective trust is going to be worried about FedEx being used as the service provider of choice in mailing.

So our point is that the level of specificity really should depend on the types of services that are actually being engaged in.

We also think that if the industry, and again we're speaking primarily of the brokerage industry here, is required to document in advance every possible service or fee that a broker may be asked to perform for all potential conflicts, from our own experience the disclosure will be so voluminous, especially given the fact that we are concerned about missing a specific conflict, a specific service that we may provide or the like, that we think any value in this disclosure will be lost in the overwhelming nature of it.

So believe me, I think it's safe

c21020a4-0b71-40d1-bade-e3b09f4800dc

to say that every ERISA lawyer who is worrying about this and concerned about this focuses their attention on the excise tax aspect of this. And I can tell you from my own experience, more will be recommended rather than less.

We also, and this was a point that was raised earlier, strongly urge the Department to leave other exemptive relief unaffected by any new changes to 408(b)(2). We think it's entirely appropriate for any of the original and applicable prohibited transactions to apply in their current form. And we think the Department carefully considered many of these issues in the issuance of these types of exemptions, both on the retail side and actually addressing retail transactional issues as well as the institutional asset management and verbal transactions such as QPAM and the like.

And finally, and again, once again we just do believe that when the Department settles on a final proposal on the type of disclosure that's warranted, we believe an extended period of time to actually implement this is appropriate.

And I thank you for your attention. I hope no one's throwing too many things at me at this point. And I'm open to any questions you may have.

CHAIR CAMPBELL: All right. Thank you.

Well let's start down on this end.

PANEL MEMBER PIACENTINI: I don't have anything.

PANEL MEMBER CAMPAGNA: You mentioned that a 404 approach --

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: A prudence approach by the plan fiduciary.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: Others have been before us and they have said that there are problems with nonresponsive service providers.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: And that small plans have a hard time negotiating in this marketplace.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: Given the issues that we've heard, how would the 404 approach work given --

MR. RYAN: Well, let me focus primarily on the retail side of this because I think this does not tend to occur on the institutional side as much.

If I'm talking about the small plan universe where you have less than 100 participants, I think part of the issue that you're going to have here is that regardless of what goes on, the plan sponsor, the plan fiduciary has a responsibility to know this information.

I can tell you that our various members in their retail programs may provide fairly voluminous discussions and disclosures already with respect to the types of conflicts or the types of fees. But what we think is most important here is that the Department through the 404 process tries to remind plan sponsors and plan fiduciaries that sponsoring a plan honestly is serious work. That they have responsibilities to do this. That they really need to use their best judgment on the types of providers. And that candidly, advice from the Department would be required on this, perhaps. But candidly if they're not provided the information that they think they need with respect to the engagement or the services, they shouldn't engage the service provider. Rather than trying to penalize them after the fact, simply don't engage with them or terminate the relationship. It's always been part of 408(b)(2) that plans should be able to get out without penalty. So we would suggest the Department in part of this process simply remind plan fiduciaries that that would be appropriate..

PANEL MEMBER CAMPAGNA: Okay. You also mentioned the conflicts provision. And I think what I heard you say is it should be limited to fiduciaries.

MR. RYAN: Fiduciaries.

PANEL MEMBER CAMPAGNA: Okay. And my question is do you think that there are possible service providers who may not be fiduciaries but are still in a position of influence over plan or plan fiduciaries.

MR. RYAN: Well, I think as the Department has said in various advisory opinions, and I know this goes to the point of recommendations versus investment advice, it's entirely possible that people have influence without necessarily having fiduciary ERISA defined investment advice with respect to the purchase of securities and other property.

Do I think it's appropriate that there may be some disclosure? Absolutely.

Do I think that most service

providers represented by SIFMA do provide baseline disclosures, certainly if they're dual registrants with respect to the types of conflicts that may arise? Absolutely. But the types of conflict disclosure that may be provided here is fairly general. It is not going to be plan-by-plan specific. It can't be by its very nature of it. And it will be difficult on the small plan context for many of the members to try to drill them with each particular, for example on the retail side, broker to figure out does he or she have sufficient influence to warrant a specific disclosure or not.

We think that there may be ways to approach this in terms of the general conflicts area, to remind plan sponsors for example that most service providers are there, in fact, to make a profit. And that they do have financial relationships with other parties that may be unaffiliated or unrelated to the plans.

PANEL MEMBER CAMPAGNA: Is the problem you see that the conflicts provision could be interpreted to go beyond the point of contact, the service provider point of contact with the plan, or you do not see it even in that context?

MR. RYAN: Well, I'm not exactly sure I'm following you. But I do believe the relationships can evolve over time, especially on the retail side.

PANEL MEMBER CAMPAGNA: Yes.

MR. RYAN: The conflicts can evolve as well as the parties involved in there. This is not to say that we think that the Department has not already addressed fee disclosure issues with respect to Form 5500. We do believe that that is, in fact, already addressed. We're just not sure that the specific nature of a conflict disclosure adds that much value in this case.

PANEL MEMBER CAMPAGNA: Okay. You also mentioned you're in favor of the incorporation by reference of other documents.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: We actually have that in our reg. And I'm just trying to understand the differences that you see or what we could add?

MR. RYAN: Well, I mean I think part of the issue that we have, and I think others have addressed here, part of this does depend on the type of plan that we're offering. And let's leave aside the health and welfare types of plans for the time being.

To the degree that we actually have information for mutual funds and similarly type of registered products, I think most of that disclosure can be incorporated by reference. It does require, candidly, people to be as dedicated as the counsel from Fidelity to point to pages where perhaps they can find it. But they can find it.

So we can list various types of disclosure. We know that our members and we know that the mutual fund industry generally has issued various types of bills of rights describing fee arrangements, revenue sharing whether or not it's coming out of the fund or not. It's clearly being disclosed in the fund documents, if it is in fact being paid by the fund. If it's being paid by the advisor, there's usually point of sale contact with respect to the service provider or broker that actually would disclose that nature.

PANEL MEMBER CAMPAGNA: Last question, same question I asked Mr. Mollahan, previously.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: About the class exemptions, and I pointed out two involving execution of brokerage and sales of insurance contracts --

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: -- where the only things being disclosed now are as basic commissions. And what we're talking about in our regulations, perhaps, is a little bit more regarding indirect compensation or conflicts associated with this.

MR. RYAN: Yes.

PANEL MEMBER CAMPAGNA: Do you see --

MR. RYAN: I actually do believe that in many cases 75-1 and 84-24 would take into account some of these issues.

If I recall correctly the Department's enforcement positions on insurance contracts over the late 1990s articulated that posture. So I'm not entirely sure that candidly you need this.

PANEL MEMBER CAMPAGNA: All right. Thank you.

PANEL MEMBER CANARY: A couple of people have talked about the difference between the broker and the broker's activity when you are sort of buying and selling shares in a portfolio that's managed by either the mutual fund investment advisor or another institutional fund versus the role of the broker more as a point of contact --

MR. RYAN: Yes.

PANEL MEMBER CANARY: -- where the plan may be going through the broker and using the broker as a provider as a platform, more or less. Can you talk a little bit about those different roles?

MR. RYAN: Sure.

PANEL MEMBER CANARY: And how you think our regulations should deal with those different roles?

MR. RYAN: Well, I think the former, which is the institutional -- what I would classify as the institutional trading platform. The broker dealer serves as the institutional broker for the underlying assets of a mutual fund, a bank collective trust and the like. In many cases those transactions are directed by the fund advisor, a fund manager, an independent fiduciary, not necessarily an ERISA fiduciary, but a fiduciary either under the Advisors Act, the Company Act or perhaps ERISA.

What usually happens in those cases we are talking about large scale trading. We are talking about a selection of brokers that these funds and accounts use. And in many cases on the institutional side there are no contracts because there are relationships that the particular funds may have that could use any one of a number of institutional brokers based on their responsibilities for best execution. So in terms of the disclosure requirements, Number 1, in that space you may not have written contracts.

Number 2, you clearly have independent experienced investment professionals as well as the broker dealer who has to satisfy the requirement of best execution.

So I would look at that as not an areas candidly, that needs to be the

Department's focus with respect to -- nor would I recommend or I believe SIFMA would recommend sweeping into brokerage that one size fit all.

Now on what I call the retail side, which is an individual broker who's affiliated with a broker dealer or that broker dealer itself may have relationships with a plan, these are usually personal relationships. There may be assets that are custodied on the balance sheet of the broker dealer, they may be held away at various vendors like Vanguard, Fidelity and the like. In those kind of relationships I can guarantee there are contracts. I mean, there are contracts clearly with respect to the accounts that are opened on our members' platforms. There are also contracts that are opened at the various provider networks.

Now I think it's safe to say that in those cases you may want to focus in, and those tend to be the retail focus that you were trying to address in terms of disclosure. Those contracts are there. We have the issues that we will have with respect to amending them and trying to supplement disclosures to the degree that the Department thinks it's appropriate. But it's a different framework. And actually that's a framework that's closer in spirit to what I believe the Department is addressing in the regulation.

PANEL MEMBER CANARY: Okay. So in that environment --

MR. RYAN: Yes.

PANEL MEMBER CANARY: -- in terms of the broker in that circumstance then receiving payments from parties other than the plan --

MR. RYAN: Yes.

PANEL MEMBER CANARY: -- can you talk a little bit about things like nonmonetary forms of compensation that may be received in that environment and your thoughts about the regulation's treatment of the nonmonetary disclosure of the receipt of nonmonetary compensation?

MR. RYAN: Well, I think it's safe to say that I can't give you an exhaustive list. But when I think of nonmonetary compensation, I tend to think about, among other things, training seminars rather than I'm worried about gift and entertainment expense that the broker may be receiving.

Most broker dealers in that context, candidly, are worried and the Department's helped that worry by focusing in on the LM-10 Project in keeping track of the expenses that they in fact incur in entertaining and that could be gifts, entertainment. That's also a question of training facilities or training seminars.

So the degree that you could be receiving those, most broker dealers, financial providers are given access to training seminars to let the platform providers teach you about what types of offerings they have. Those things do occur in the ordinary course. They can be generally described. They can't be described necessarily specifically up front as how many of those go, or I believe as the Vanguard representative indicated, the contents of each one of those programs may change.

I think you can have generalized disclosure about the existence of those arrangements, which I think the Department wants to encourage rather than discourage because they're primarily vehicles for people to learn more about how to properly invest. So that would be my take on it.

PANEL MEMBER CANARY: All right. Thank you.

MR. RYAN: Thank you.

CHAIR CAMPBELL: Mr. Ryan, I guess we had heard from a number of folks testifying that small plan in particular can have difficulty getting the information that they feel they need from their service providers.

c21020a4-0b71-40d1-bade-e3b09f4800dc

And I'm wondering if that's consistent with what you've observed in your professional experience?

MR. RYAN: Well, again, on a retail focus my own world is that I support Morgan Stanley's institutional retail and money management business.

I can tell you with all candor that no small plan at Morgan Stanley seems to have any trouble finding my phone number. So in terms of the access issues, I think there are very real issues that clients have probably grappled with, which the Department has grappled with on how I would, for example, calculate float, how I would calculate indirect compensation of the type that, candidly, none of our systems really capture, at least currently.

It is not my experience, I don't believe it's the experience of the majority of the members where they have not provided information upon request. I will tell you the requests don't always come in a timely basis. They are usually required to be provided yesterday. But I do think that the small plan community in particular has been, as one speaker said earlier, very sensitized to the whole nature of fees, disclosure, commissions, expenses and the like. So I don't think they are not getting -- they're not getting heard. They are clearly getting heard. There may be some things that we can't give them any specific details on, but they tend to be the issues like float where we can only tell them about the specifics, where we've disclosed it, at least the existence of it up front but can't give them a specific dollar amount.

CHAIR CAMPBELL: Okay. But we'd, as I said, received testimony to that effect that in particular small plans, and this has been a recurring issue that we've heard over a number of years. Indeed, it's one of the factors that I think led us to this proposed regulation.

MR. RYAN: And I think realistically that the Department's efforts and the SEC's efforts with respect to various sweeps with pension consultants and the like, candidly, have had some benefit in terms of sensitizing everyone with respect to the importance of responding to those kinds of requests.

CHAIR CAMPBELL: Well, I appreciate that. And I notice in your comments that you suggest though that we carve out from this regulation small plans to ensure that they aren't subject to these disclosure requirements -- service providers, rather, to those plans and the plans themselves aren't subject to it. And I'm curious why that is.

MR. RYAN: Well, I think part of it is honestly logistical. To the degree that we have to go down the road, you can have a lot of small things. But if you are requiring a recontracting of these types of arrangements, I can tell you from personal experience those do not tend to be negotiations that are done quickly. They are protracted. Part of it is an explanation again of the services and the model and the cost and the like. But I think our view tended to be that in that market what we were most -- we are obviously concerned about providing the right level of disclosure to the plans. What we're most concerned about, though, is inundating them. I will tell you a recurring theme that we keep getting on all of our marking material at Morgan Stanley is we're sending you too much. We're sending you too much disclosure. Why are you sending the prospectuses? I will tell them it's because the Department of Labor says so. But why are you providing all this paperwork? Why am I looking at multiple versions of the contract? Why am I basically going down the road of actually seeing these documents?

I think part of this is just based on the retail side of the practical experience of how we deal with some of our small plan clients. It takes a lot of them, candidly, to actually negotiate much of this stuff.

And honestly, some of it is a question of force feeding to some degree the disclosures we provide.

CHAIR CAMPBELL: Well then do you think that lends itself to suggest, as some other commenters have, that there should be a summary document where either one document or executive summary that points to other documents so that there's one place where all this information is?

MR. RYAN: I think it's a noble goal. I'm not entirely sure how one would do it given the types of services.

I will also tell you I think -- you know, I would like to paint myself as sponsoring a noble industry. And I think it is. But I would say that also a practical issue that we have with small plans is that we don't necessarily want to be responsible for compliance issues with 408(b)(2) in failing to get contracts signed and finally negotiated. I mean, the excise tax does concern us from that perspective.

CHAIR CAMPBELL: Okay.

PANEL MEMBER ZARENKO: Can I jump in with a follow up question.

CHAIR CAMPBELL: Of course, do.

PANEL MEMBER ZARENKO: So you had started out by recommending that we should have done this as a 404 matter, not a 408(b)(2)?

MR. RYAN: Yes.

PANEL MEMBER ZARENKO: So if we went that route, would you no longer have this concern or even requirements under 404 should have some kind of a carve out for small plans?

MR. RYAN: Well, I think it's less pressing. I think telling -- if the Department, for example, and I'm not recommending this, believe me, but if the Department was trying to come up with a one stop shop to give small plan clients a sample contract that's one thing, and that's something that they could do as illustrative guidance under 404 not mandating, as you said in the past, that it's the only way to proceed. But to look at different aspects of the service provider relationship and then see does that make sense under your context? Do you understand these basic issues?

That's really our focus on this from a 404 perspective. We think a lot of this is, candidly, employer education and plan education.

PANEL MEMBER ZARENKO: Thank you.

PANEL MEMBER DWYER: Let me just follow up on a question asked by Mr. Canary about the brokers.

MR. RYAN: Sure. Yes.

PANEL MEMBER DWYER: You said there were brokers in these two regimes, the institutional broker and the retail broker. In your written comment you state that it would

c21020a4-0b71-40d1-bade-e3b09f4800dc

be extremely cumbersome to have contracts -- for investment managers to enter into contracts with the brokers. Is that comment limited to the institutional regime?

MR. RYAN: Institutional. Institutional.

PANEL MEMBER DWYER: Institutional. Why is that so difficult?

MR. RYAN: Well, it's not a question of difficulty, it's simply interfering with market practice, number one. And number two we are not the exclusive broker with respect to any mutual fund or any pooled vehicle. They choose among a dozen different broker dealers on any given day with respect to trading activities. These are phone calls that are engaged in, and the truth is you can open under the securities laws a securities brokerage account, again not an advisory account, a brokerage account simply without a written contract.

We're just saying that in the

context of the reduced costs that have been passed on, which others have talked about in terms of the institutional market and the institutional funds, adding a requirement that you suddenly have to have a contract where you've never had to have one on the institutional side, doesn't seem to me to help anyone.

In terms of the institutional trading activity we think the plans are already well protected by the parties that are engaging in the brokerage transactions. They're receiving the confirms, they understand the nature of the brokerage relationship as principal versus agency, they understand the full range of compensation that's being disclosed. The manager may have an obligation to report that as part of the expense ratio, et cetera in a mutual fund. But we're not sure that this necessarily adds anything to the context of those types of trading activities.

PANEL MEMBER DWYER: But as a practical matter could it be done?

MR. RYAN: As --

PANEL MEMBER DWYER: What would be involved in that?

MR. RYAN: Recontracting every institutional trading relationship in the middle of, let's just say, a relatively unsettled financial trading situation? It would take months. You are talking to the one person who would be reviewing most of them. I can honestly tell you I am not looking forward to spending the next year and a half trying to do that.

PANEL MEMBER DWYER: Okay. A second question. You talk about the regulations should distinguish the fund's payments of distribution and record keeping --

MR. RYAN: Yes.

PANEL MEMBER DWYER: -- in connection with the plan's purchase of mutual fund shares and commissions for the underlying

c21020a4-0b71-40d1-bade-e3b09f4800dc

portfolio securities of the fund.

MR. RYAN: Right.

PANEL MEMBER DWYER: Can you explain more about that and --

MR. RYAN: Sure.

PANEL MEMBER DWYER: -- and why that distinction would be important to a plan--

MR. RYAN: Sure

PANEL MEMBER DWYER: -- in determining reasonableness of the fees?

MR. RYAN: Well, I actually think others have already articulated these points rather elegantly.

What we're referring to, again, is the breakdown between the institutional and the retail distribution arms. What I was referring to in the portfolio trading activity was in fact the trading of the underlying securities held by the mutual fund themselves.

Now I know we've had different discussions about expense ratios and the like.

But when we compute an expense ratio in a mutual fund context, that tends to be something that's know in advance. It's usually the investment management fee, record keeping fee. Think of it as the administrative start up costs and maintenance costs with respect to a mutual fund, generally.

When you're talking about the portfolio trading activity, you're talking about transaction-by-transaction cost that basically incurs when you invest in securities, when you use Morgan Stanley, Goldman Sachs or any other institutional broker dealer. Those costs are not known up front. Those are trading costs that are known at the time of the transaction. So you simply can't disclose them up front. At the best you can do with respect to those is, as others have noted, include those in the performance evaluation with respect to the fund on a quarterly or annual basis.

So that's really the distinction.

When we're talking portfolio theory, we're really talking about the trades the mutual fund managers are doing through the institutional trading arms and those types of costs, which are really found generally, I believe, in the portfolio return.

PANEL MEMBER DWYER: Thank you.

CHAIR CAMPBELL: Any other questions?

PANEL MEMBER WILLIAMS: Just one minor point. You know, banks are often affiliated with broker dealers. And we had done some advisory opinions a while back about discount brokerage and those advisory opinions analyzed it in terms of 408(b)(2) and the avoidance of fiduciary self-dealing.

MR. RYAN: Yes.

PANEL MEMBER WILLIAMS: Say where you have a directed trustee and you have an affiliate that would be used as a broker pursuant to the direction of the an independent fiduciary.

MR. RYAN: Yes.

PANEL MEMBER WILLIAMS: In those instances are you saying there's no written contracts with the affiliated broker?

MR. RYAN: No, I think there is what I would think of as the retail side. It's a discount brokerage. These tend to be retail operations where you actually would have a contractual relationship.

PANEL MEMBER WILLIAMS: Okay. So in the institutional side where the investment manager will be affiliated with the broker dealer would there be contracts with the affiliate?

MR. RYAN: The affiliate would have a contract if for no other reason to make sure that the account is coded as an agency only trading account. Because the one thing you want to avoid if you have an affiliated investment manager is trading through an affiliated broker dealer on anything other than an 86-128 basis.

PANEL MEMBER WILLIAMS: Okay. So that's really 86-128?

MR. RYAN: Right.

PANEL MEMBER WILLIAMS: And that's why you're saying don't mess with that? That's separate?

MR. RYAN: Yes. That's exactly right.

PANEL MEMBER WILLIAMS: Thank you.

CHAIR CAMPBELL: All right. And with that we have concluded.

I think we're right now about half an hour behind. So I think what we'll do is halve that. Let's come back at 1:15, that will give you all a few moments to become acquainted with our cafeteria, unless you can quickly find other options. And we'll see you at 1:15.

Thank you.

(Whereupon, the above-entitled matter went off the record at 12:30 p.m. and resumed at 1:20 p.m.)

PANEL MEMBER CAMPAGNA: I think we'll begin. Okay. Mr. Campbell is probably tied up; I wouldn't be surprised. So let us begin with the Council of Insurance Agents and Brokers.

MR. FINDLAY: Ready for me? Okay.

Thanks very much. My name is Cam Findlay. I'm currently the Executive Vice President and General Counsel of Aon, which is the world's largest insurance broker and one of the world's largest employee benefits consulting firms.

I served as the Deputy Secretary of this Department from 2001 to 2003, so I know a little bit, not much, about the work of EBSA. And I just would say that it is great to be back for the first time in an official capacity back in the building, because I have great affection for the place and the people here.

I'm appearing today on behalf of the Council of Insurance Agents and Brokers.

And I wanted to expand and clarify the substance of the Council's written comments on proposed regs.

I want to emphasize, also, that my testimony is submitted on behalf of the entire Council and not just on behalf of Aon, because as I'll discuss at various points, Aon has introduced some business reforms which go beyond what some other members of the industry have done.

The CIAB is the association that represents the nation's largest insurance brokerage firms and insurance agencies. And we specialize in a wide range of insurance products and risk management services for business, industry, government and the public.

Council members conduct business in 3,000 locations, employ 120,000 people and place 80 percent of all U.S. insurance products and services protecting business, industry, government and public at large.

We also place the majority of U.S.

employee benefit insurance products.

We want to start by saying that we strongly support the efforts of the Department to increase transparency and disclosure. Indeed, our group has been supporting such efforts since 1998, when we adopted a formal policy position in favor of greater transparency. And in 2004 we again publicly took steps to enhance transparency and disclosure in the insurance industry, working with the NAIC NCOIL, which is the National Conference of Insurance Legislators to develop model state laws on transparency.

As I'll discuss ins greater detail, Council members are absolutely committed to disclosure of their compensation and routinely do disclose information on how they're compensated, either voluntarily or certainly when requested of them by their clients.

We do differ with the proposed rule somewhat, but we do so not because we want to keep our compensation secret, but rather because we do not believe that the Department's rules need to overlay on existing requirements and practices, creating a new and burdensome federal regime that seems to us to have been designed for different industry providers of 401(k) plan services, and seemingly devised for fiduciaries, which insurance brokers and agents are not.

As I'll discuss in greater detail in a moment, the considerations that might lead the Department to impose strict disclosure requirements on 401(k) providers simply don't apply very well to insurance brokers given our role. For instance, 401(k) providers manage and service large pools of assets for beneficiaries. We insurance brokers do not.

Moreover, insurance brokers are not typically thought to be fiduciaries to plan beneficiaries or even to plan purchasers, but the Department's proposed rules would seem

c21020a4-0b71-40d1-bade-e3b09f4800dc

to treat brokers as equivalent to fiduciaries. For these reasons, while we certainly support efforts toward greater transparency and disclosure in our industry, we don't believe that the proposed rules would be a positive step in such a case.

Let me first tell you a little bit about our industry and how we operate. Our primary business is the placement of insurance products with welfare benefit plans and others. The products include, amongst others, life, health, disability and long-term care insurance. And in connection with the insurance products that Council members place, they may also provide a variety of administrative services to the purchaser, including assisting plan sponsors with plan design, applications for coverage, claim forms and claim resolution.

The relationship among a purchaser of insurance products, which we sometimes call the client, the broker placing the insurance, and the carrier issuing the policy is governed principally by the contractual relationship entered into between the purchaser and the broker or agent, and then of course by the terms of the insurance policy itself.

There's a well developed body of state law and in some states, statutory law, providing that the legal relationships between the plans that purchase insurance products, the broker that places the coverage and the carriers that provide the coverage are contractual matters.

Council members receive compensation in these arrangements in a variety of forms, and it's very difficult to generalize how Council members receive compensation.

Some receive commissions from carriers; some receive fees from the plans themselves; some receive a combination of those two; some, though not Aon and other large brokers, accept contingent payments from

c21020a4-0b71-40d1-bade-e3b09f4800dc

the carrier when business originated by the broker passes certain thresholds; and then some brokers, though again not Aon, accept discretionary travel or gifts from the carrier.

And the variety in the forms of compensation is exacerbated by the fact that, as I alluded to, really a very large segment of the industry, including the four largest brokers, Aon, Marsh, Willis and Gallagher, do not accept contingent commissions at all or similar forms of compensation.

As noted above, state insurance laws govern whether and to what extent brokers or agents must disclose the types and amounts of compensation they receive. Under the laws of most states, brokers and agents are required to at most disclose the type of compensation they receive in advance. However, brokers are generally not required to disclose in advance the amounts of compensation they're going to receive, in part because the actual amounts of compensation cannot be known until after placement of the insurance, because commission rates and the forms of compensation vary by carrier and program and because it's never clear what the uptake will be for particular aspects of a program.

Welfare plan benefits programs vary in terms of carriers, products, price and usage. A single welfare plan could offer its participants multiple products for multiple insurers in several categories of coverage: medical, dental, life and so on. The commission earned by the broker will vary with the carrier and the premium paid on the particular policy. The premium, in turn, will vary with the take-up rates by plan participants because brokers can't determine in advance how all these factors will play out, they really can't provide upon placement more than general disclosure about the commissions they receive.

Let me just say a word about contingent compensation. As I discussed a second ago, some brokers and agents, though not Aon, Marsh, Willis or Gallagher, accept contingent compensation such as contingent commissions, overrides, bonuses or gifts. The level of such compensation is explicitly contingent upon factors such as volume, client retention and premium income levels. The extent to which these factors affect the actual level of compensation is not knowable at the outset of an engagement.

Additionally, some contingent commission is based on a broker's overall relationship with a carrier and not the premiums with respect to any particular plan. So it's not practicable for the broker to determine with any precision the extent to which contingent compensation arises from insurance placed for any particular plan.

The existing disclosure regime is, as I said, essentially a matter of state law and contract. Insurance agents and brokers, as you know, I'm sure, are already subject to extensive state regulation including disclosure requirements. And that sets them apart from some of the other service providers that you're addressing in the rule.

State law regulates the placement activities of insurance agents and brokers and most states require compensation disclosures when a broker is providing both placement and non-placement services.

In addition the largest four brokers, as I've mentioned, have adopted business reforms under which they disclose to their clients prior to binding an insurance policy the types and levels of commissions and fees which they and affiliates will be paid under various scenarios.

Next, supplementing the state law regulation, most carriers contractually require brokers to make significant disclosures to policy holders and potential policy holders, and we give you some examples of that in our written testimony.

Further, obviously under Form 5500 and related opinion letters, the Department requires comprehensive disclosure regarding commissions and fees earned by insurance agents and brokers in particular, in contrast to other service providers.

And finally, where agents or brokers or their affiliates act as fiduciaries under prohibited transaction class exemption 84-24, they of course must comply with the exemption's comprehensive fee and conflict of interest disclosure requirements.

Let me now just talk a little bit about why we think that the proposed regulations really don't apply particularly well to our industry.

The Department's primary concern under the proposed regulations appears to be with participant-directed defined contribution plans, in particular, with undisclosed, indirect compensation paid in connection with those plans.

The Council certainly understands the Department's concerns and certainly supports the desire to enhance transparency in connection with those plans. However, in our view the Department appears to have cast its net too broadly by promulgating one-size-fits-all rules that also sweep in the placement of insurance products and other welfare plans with such 401(k)-type defined contribution plans.

We're not aware, and at this point of any public record that indicates that the Department's concerns relating to such 401(k) plans are equally applicable to insurance placements. In fact, I think it's fair to say we think that the two types of products are completely different, both in their essential nature and in the existence of state regulation.

As we see it, 401(k) plans and

insurance programs have different purchasers, different beneficiary concerns, different duties of the service provider and different regulatory schemes.

Service providers for defined contribution plans often manage assets for plan beneficiaries, whereas insurance agents and brokers do not.

Moreover as previously explained, under state law and the contractual requirements of insurance carriers, disclosure concerning fees and relationships to the extent feasible is already the standard in our industry.

Further, in the 401(k) context services are performed on literally a daily basis that affect the purchasers and plan beneficiaries. In contrast, brokers are typically just selling a product on an annual basis with little day-to-day involvement beyond that. Therefore, we're uncertain that the sorts of rules that you proposed would apply very well beyond the 401(k) scenario to insurance brokers.

We submit that the Department's efforts to bring transparency to service provider compensation and potential conflicts of interest in the context of section 408(b)(2) should not affect the conditions for relief under other existing class exemptions. In crafting those exemptions the Department carefully considered the industries and transactions at issue and the attendant risks. In many cases, but not all, the Department addressed those risks by predicating a relief on comprehensive disclosures regarding fees and other issues. We would respectfully submit that in the absence of any evidence that prior exemptions have not adequately protected plans, the Department need not revisit them. However, to the extent the Department believes that it should, we submit that the Department should do so on an exemption-by-exemption basis.

And, of the existing class exemptions, is the one that's most relevant here is 84-24. As you know, this permits brokers and agents to place insurance products with plans when they're fiduciaries or affiliated with fiduciaries, notwithstanding the self-dealing prohibitions. The exemption has unique, carefully crafted conditions intended to protect the plans involved, including comprehensive disclosure and consent conditions.

And we've set out in our testimony the various types of information which is required to be disclosed and the sorts of consents that are required.

And we think that that exemption actually highlights one of our major points, which is that, when an entity is a fiduciary there should be strict responsibilities placed on that entity. So for instance, the purchaser of our services is often going to be a fiduciary, and we would understand why the purchaser should have certain requirements.

As I mentioned before, insurance brokers are typically not fiduciaries. They're a provider of service to fiduciaries, and we think that different requirements ought to be imposed on service providers.

I see that my red light is going off, so I'm happy to address any questions that you have.

CHAIR CAMPBELL: Great. And I apologize. I had missed the very first part of your remarks there. But hopefully -- I think I caught the gist of what you were saying and certainly want to welcome you back to the Department as our former Deputy Secretary just a few years ago.

Going to your question about some of the differences that might be there in welfare plans, one of the reasons that I think came out a lot in the testimony yesterday is the question of, from the fiduciary's perspective, who, after all, is contracting for services across a variety of different regulated products, some regulated by the SEC, some by the OCC, some by state insurance commissioners, from the perspective of the fiduciary is there a distinction in the different decision making process and the type of information they need? Because the focus of the regulation was looking at what is it that a fiduciary needs to carry out his or her duty, what information do they have to have? And obviously we have to adjust that to suit the law and the regulatory structure. But are there distinctions you think in welfare plans that would make a fiduciary approach that decision process in a different way in the welfare context versus, say, a defined contribution plan context?

MR. FINDLAY: I think there are a couple important differences. One, as I mentioned, an insurance broker is typically assisting the client with purchasing a product, and it's not actively involved in

c21020a4-0b71-40d1-bade-e3b09f4800dc

managing these vast amounts of assets that would be involved in a 401(k) plan. So I think that's one difference.

I think a second difference is the difference in the sort of fall-back regulatory and disclosure regime that exists absent DOL putting itself into this situation. And in our world, as I mentioned, there are all sorts of reasons why there's good disclosure out there.

And then I think the other reason I'd say is that it's the nature of the sorts of compensation issues which are lurking in the background. When you're talking about 401(k) plans, and I'm far from an expert on those, as I understand it, it's hard to get behind the kinds of information that might be provided, like the cost and basis points or something like that.

In our situation if you know the commission rate which is, in our case, provided to the client, then that's really all you need to know. You know what your gross premium is going to be. That's the most important thing to a purchaser. If what you're concerned about is how is the broker making money, we do disclosures first of all in our letters of engagement. I believe that's industry standard practice. As I say, many carriers require us to disclose the commission that we receive and any compensation. And then, for the vast majority of the industry, we are already providing very extensive disclosure in the pre-bidding process where we will say in each way that we get compensated.

So I think that the biggest difference is that they're just fundamentally different kinds of products that are being purchased. Essentially the asset management versus insurance purchase. And the second thing I would say is that you ought to take account of what is in existence if you don't engage the DOL in this process.

And in our view there are a lot of strong protections in place already in our industry.

CHAIR CAMPBELL: Okay. Why don't we start over here with Allison.

PANEL MEMBER WIELOBOB: You said that something that we've heard earlier, yesterday primarily, from health and welfare service providers, that they don't think the regulations should apply to them. However, Congress decided that welfare plans should be covered by the same fiduciary protections -- at ERISA's most basic level, the same protections that retirement plans get.

I mean, if not this type of regime, you're telling us that it's sort of apples and oranges with your industry. What types of disclosures -- what would work better?

In your written comments you've asked us to reserve with respect to welfare benefit plans, so --

MR. FINDLAY: Well, I think that you're absolutely right that the statute doesn't distinguish between the fiduciary responsibilities as the two types of plans, but as I mentioned before we're not a fiduciary. So what we're really saying is: is the information available to the purchaser of these plans, who is the fiduciary, from folks like us? And so I think it is appropriate to take into account the existing regulations under state law, the existing practices in the industry and decide, do we need to do anything different as the Department of Labor in our rules to make sure that that information is available to the purchaser?

Ultimately it is the purchaser's responsibility to exercise its fiduciary duties, to protect its plan beneficiaries. It ought to ask the questions anyway, whether or not you require us to provide information, it ought to be asking us for that. And our members routinely have provided information in response to questions, and in many contexts, as I've mentioned, we actually are required to provide it already.

So I think that, while the underlying responsibility of the fiduciary is the same, the background information as to what the availability of the information to that fiduciary is, is different.

PANEL MEMBER WIELOBOB: Okay. Another question. Well, you're subject to state regulation, I get that with the insurance industry. And we actually, you know, in other areas of this reg, we incorporate by reference information provided to other agencies.

With that in mind, I'd like to hear a little bit from you about exactly what kind of information are we talking about. What would that get to plan fiduciary in a meaningful way? How does it reach them?

MR. FINDLAY: Absent the Department?

PANEL MEMBER WIELOBOB: Absent, yes, aside from the federal regime. What do state insurance commissions -- in effect, is it easy for them to access, it is understandable for the plan fiduciaries?

MR. FINDLAY: I think it's a lot less complicated than for 401(k) plans. Although there are various ways in which the tens of thousands of brokers and agents in the country get compensated. It's kind of easy to summarize.

You know, typically we get paid on either a commission basis or a fee basis. For large clients, they don't want the brokers to be getting commissions so they'll often negotiate a fee with us. For smaller brokers and smaller clients, it's quite common that they get paid in commissions.

Now there's this third category that I mentioned, which is contingent commissions. As a result of state actions the big four brokers have all decided we no longer take them. So you're really just talking about smaller brokers in that area. And smaller brokers are the ones that typically would really be affected in terms of burden if these rules were to go into effect.

We're not a small broker. We're actually the largest one in the world, so I can't really talk in a sort of practical, down-to-earth way as to what the burdens would be for them. But I can say that we've had to build IT systems and very extensive processes in order to get that kind information to our clients. And I would imagine for a small broker -- and the smallest ones in my association are about $5 million in revenue -- that would be a huge burden for them if they were to have to put this in place.

Of course if a client asks, it's the practice of every broker I know of to basically say: Here's what the commission is going to be. Yes, we get paid contingents and so forth. Even absent the sort of new requirements that we had, we always did that.

PANEL MEMBER WIELOBOB: Speaking

c21020a4-0b71-40d1-bade-e3b09f4800dc

of contingent commissions, how is that regarded by brokers, if you can imagine? I mean, what portion of compensation is that, if it's a part of a broker's/agent's compensation, is it something that this is the contingent, which is that's based on the totality of the relationship with the carrier?

MR. FINDLAY: Yes, and it tends to be very, very small.

PANEL MEMBER WIELOBOB: Okay.

MR. FINDLAY: In fact I think differences amongst contingent commission arrangements with carriers would be dwarfed by differences in commission rates between various carriers. There's not a kind of standard commission in, really, even any line of insurance in the industry. It tends to be a negotiation between the carrier and the broker.

PANEL MEMBER WIELOBOB: Okay. I just have one more question. It's about your position on 84-24 and juxtaposed or in

c21020a4-0b71-40d1-bade-e3b09f4800dc

combination with the 5500 and these disclosures to other entities you feel is adequate for a plan fiduciary.

I guess, you know, the information provided in the 5500 is really retrospective. Perhaps the arrangements don't change very much in compensation formulas, what have you, it remains relatively static. But information provided to state insurance commissions, is that prospective, retrospective? What's the nature?

MR. FINDLAY: Well, you know, we're not a carrier, so I'm not an expert on what carriers have to file. The carriers generally have to file with state insurance commissions how they compensate brokers. I don't think, honestly though, it's to the sort of level detail that you would be requiring if I'm reading the rule correctly.

And I guess, as I alluded to before, we think 84-24 appropriately strikes the balance. Because it recognizes that, when a broker or if a broker ever acts as a fiduciary, you ought to impose on the fiduciary the same sort of responsibilities you do on the purchasers of the plan who are fiduciaries. But when we don't act as a fiduciary, I think a different disclosure regime is appropriate. And that's why we think 84-24 really appropriately struck the balance.

The fiduciary can still ask us anything they want, and if they don't like the answer, of course, they can hire a different broker. So there are market pressures here also that cause us to be transparent.

PANEL MEMBER WIELOBOB: Well, that's actually -- my last point is, you know, one of the things in your written testimony is that you say amongst this whole sort of disclosure or background for you all, is carriers require disclosure from the brokers. What type of information of that? Because while that might be an important component part of getting information out, it's a little different from a federal agency entrusting --

MR. FINDLAY: Sure.

PANEL MEMBER WIELOBOB: -- the private entities to provide that information.

MR. FINDLAY: It's a point we wanted to make to kind of -- you know, what exactly is broke here that needs to be fixed? That there seems to be a lot of information out there out for the fiduciaries who are the ones required to get it, digest it and act on it. And so when you have a background of a fair amount of information out there, you know we would say that we don't need to have the DOL take on this new role and impose burdens on smaller brokers in particular, who would really be hurt very significantly by this in terms of the cost burden, the day-to-day hassle of putting together all the systems and forms and so forth.

PANEL MEMBER WIELOBOB: Thank you.

MR. FINDLAY: Thank you.

PANEL MEMBER WILLIAMS: Okay. I have a quick clarification. The selling agent, I think you said, was just doing this sort of on an episodic basis and there wasn't really an ongoing service relationship that would create a service provider status?

MR. FINDLAY: It's not to the same extent as a 401(k) plan. There is sort of episodic involvement. For instance, sometimes a broker will assist with pursuing a claim. But quite often insurance products are bought and then no claim comes in for a long time, certainly in the property or casualty areas.

In this area we don't get as involved in pursuing claims on behalf of beneficiaries, although I think some benefits providers will provide that service. But it's not the kind of constant, minute-to-minute, day-to-day relationship that you have in the 401(k) context.

PANEL MEMBER WILLIAMS: Okay. When that does happen, you're taking on the

c21020a4-0b71-40d1-bade-e3b09f4800dc

role as a consultant; is that how you trigger the 84-24 status with being a fiduciary?

MR. FINDLAY: I think we largely think that we're not fiduciaries. And we typically make that quite clear to our clients that we're not fiduciaries. Under state law, we're typically not considered fiduciaries.

I was going to say, except in rare circumstances, but I can't even think of a circumstance where state law imposes a fiduciary duty on us. And even during the midst of the Spitzer investigations, it was never asserted that we had a fiduciary obligation to our client. It was that we owed a duty to our duty, but it didn't rise to the high level of fiduciary duty.

PANEL MEMBER WILLIAMS: Okay. So what exactly goes on when they are acting as fiduciary and they're using the 84-24?

MR. FINDLAY: I think it would only happen if we affirmatively agreed with a client insurant to do that, that we were going

to be a fiduciary in some particular instance.
But the general backdrop of law is that insurance brokers are not fiduciaries.

PANEL MEMBER WILLIAMS: Okay. Thank you.

PANEL MEMBER DWYER: I do understand that your company doesn't take contingent commissions, but I did want to ask about it. You say that they're not known at the time contracting, but what level of specificity is known about them? And you might not know the exact amount, but what would the broker know about the contingent commission at the time of contracting?

MR. FINDLAY: Again, we don't take them so I might not be the best person to talk about this. And I was greeted upon by arrival at Aon with a subpoena from Mr. Spitzer and we haven't taken them since I've been there. So I'm not the expert on contingents.

But I think that in most cases the broker would know the sort of general arrangement, but these contingents tended to be on an entire book of business between a broker and a carrier. They often even wouldn't be known to the people except at top management to avoid a sort of conflict of interest situation in a broker.

And so in a sense, one could say that the sort of disclosure required would actually get information to the people in a position to act on a conflict when it typically isn't there now.

But to answer your question directly, Ms. Dwyer, you would usually know at the time of placement that you had a contingent commission -- the company would know it had a contingent commission arrangement in place and kind of what its broad outlines were -- that for a certain amount of business you get a certain --

PANEL MEMBER DWYER: Okay. So every $100,000 worth of business you get $10,000?

MR. FINDLAY: Yes, or --

PANEL MEMBER DWYER: They would know that?

MR. FINDLAY: Or if you had a particular level of volume that they get an extra half percentage of premium across the entire book of business.

PANEL MEMBER DWYER: I see. Okay.

And the second question is; the brokers have four categories of fees, as I understand. There are fees, commissions, gifts and contingencies. Those are the four classifications. Are all four of those required to be disclosed under state law?

MR. FINDLAY: Well, we are dealing with 51 or 54 state laws or state and territorial laws. So it is very difficult to generalize.

In most states, maybe all states, but certainly the predominance of states, if you take both fee and commission, then you have to disclose the commission.

c21020a4-0b71-40d1-bade-e3b09f4800dc

I think your commission-only state law usually does not impose a requirement of disclosing the commission, just because in that circumstance I think it goes back to the days when brokers were considered really to be kind of agents of the carrier so it wasn't information to be disclosed to the client. State law is very unclear as to who brokers and agents work for, quite often. And, indeed, some states have been moving towards just a producer license because it's too complicated to decide whether you're a broker or an agent. Agents typically are thought to work for the carriers; brokers work for the clients, is kind of the line we would draw.

PANEL MEMBER DWYER: And what about contingent commissions and gifts?

MR. FINDLAY: I think contingent commissions would be considered commissions, so they would fall under the same rules that commissions would.

PANEL MEMBER DWYER: Yes.

MR. FINDLAY: But if you're not a fee client, there is typically not a state requirement. Though I think that certainly the practice even pre-2003 that carriers would disclose the fact that they received contingent commissions. They typically would not, and those that take them now, still do not disclose kind of the variety of all the types of arrangements they have in place with different carriers. They would basically make a general disclosure that we also take in contingent from carriers and here's basically what they look like.

PANEL MEMBER DWYER: And as a matter of industry practice, in the contract between the broker and, for instance, the purchasing plan the fees would be included, obviously.

MR. FINDLAY: Fees they know, obviously.

PANEL MEMBER DWYER: And commission rates would be in that contract as

c21020a4-0b71-40d1-bade-e3b09f4800dc

well?

MR. FINDLAY: It's usually in the initial contract it would say that we're paid, but we also will receive commissions from carriers and we won't say because they wouldn't know what the commission rate is going to be. Because until you go out to the markets, the markets are all very different in terms of the commissions they pay, you couldn't really say. At most you could say that we would get a commission of up to 20 percent or something.

PANEL MEMBER DWYER: Yes.

MR. FINDLAY: And it really is contractual in the sense that the client is free to say, I want you only on fee; I don't want you to accept commissions. And that's not an uncommon feature in a contract. Or they can say, your fee is going to be X hundred thousand dollars, but if you receive any commissions we want them to be credited against the fee.

PANEL MEMBER DWYER: And that would all be in the contract?

MR. FINDLAY: And that would be in the contract.

PANEL MEMBER DWYER: All right. Thank you.

MR. FINDLAY: Thanks.

PANEL MEMBER CANARY: Just let me follow up a little bit on Adrienne's line here. In talking about the contingent commissions and the non-monetary comp, especially when we're working under Schedule A that you referenced, issues came up about having that information in advance for the plan fiduciaries so the plan fiduciary would say, when I'm getting recommendations from a broker as to which product to pick, if there are such contingent compensation or potential incentives in there, that that would be information that might be relevant for the fiduciary to know up front. And I guess one of your comments suggested that maybe that information isn't down at the sales force line. Can you talk a little bit more about that? And two, assuming that it does get down to the sales force line, what is in the current structure that you think gets that kind of information to the fiduciary?

MR. FINDLAY: Well, again, I always have to preface it by saying we're out of the business of contingents.

PANEL MEMBER CANARY: I appreciate that.

MR. FINDLAY: But I think that I would come back to the point that the fiduciary is in a position and actually may be under a fiduciary obligation to talk to its broker and say - Okay, I'd like to know, when you have brought back this list of four carriers, do you have an arrangement in place with this carrier or that carrier, and that's an appropriate time to ask that question. Because then the broker will know what markets it's gone out to, what the compensation scheme is in relation to that market.

I think the difficulty with the proposed rules, I think it seems to suggest that it ought to be a duty of the non-fiduciary and it ought to be at a stage where we really don't know the information.

And then, Mr. Canary, on your question about who knows within a broker; at least in our case when we took them, it was that the contingent arrangements were negotiated at a high level and, while there wasn't a strict Chinese wall, it was not something that it was thought to be relevant to the placement decisions of a line broker. So our line brokers typically didn't know the arrangements themselves.

Now if a particular client said, I want you to find out, they would be able to find out and relay it.

And that was, ironically, put in place to avoid the sorts of conflicts of interest that I think your rule is addressing.

And for the brokers who are still accepting contingents, I believe that they -- at least in the case of the big brokers that still do, have put in place protections to avoid the conflict of interest. In a very small broker, it's very difficult, frankly, because there might be four people in an office or something. And therefore, it would be hard to set up a Chinese wall of that sort.

PANEL MEMBER CANARY: Two questions. One sort of to follow up on that. I think that the people -- from SIFMA, had maybe a similar strain, suggesting that really the obligation should be on the plan fiduciary to ask the right question. And in a small employer marketplace, I mean, if you're dealing with a large employer there may be a sophistication and support group there that they can figure out what the right question is, and have the ability to ask it without some help. But in a small employer marketplace, do you think it's realistic to assume that the small employer who is making this insurance purchase is going to be able to ask that question and then pursue it to get useful information to make a decision without some structure that would help empower them to do that?

MR. FINDLAY: Yes, I actually do. I think that this is not that complicated an area. As Ms. Dwyer said, there's not that many different forms of compensation. So I think that a small employer ought to be able to ask the same questions.

And indeed, as was pointed out earlier, the fiduciary obligation is the same for a small purchaser as a large purchaser. So we would argue that they really are the ones in the best position to protect their beneficiary's interest.

PANEL MEMBER CANARY: And then switching to Ms. Dwyer's last question.

MR. FINDLAY: Sure.

PANEL MEMBER CANARY: I think in

c21020a4-0b71-40d1-bade-e3b09f4800dc

some of the comments, the fact that the employer may be paying for the insurance policy, especially in this marketplace and there may not be plan assets involved or if there are plan assets, they're going to be employee contributions that are withheld and commingled with the general assets you use to pay for the contract. Do you think that complicates the application of this reg to that marketplace? And that may be an overly, sort of, hypothetically legal question, so I apologize.

MR. FINDLAY: Yes. I haven't really had time to think about that one. So maybe we'll come to you in writing on that question.

PANEL MEMBER CANARY: Okay.

MR. FINDLAY: But it's just difficult to respond.

PANEL MEMBER CANARY: I appreciate it. Thank you.

PANEL MEMBER CAMPAGNA: Not to

belabor 84-24, but our regulation is aimed at the receipt of indirect compensation and conflicts. Just, you know, maybe one more time, I guess, why do you think 84-24 addresses indirect compensation and conflicts of interest?

MR. FINDLAY: Well, what I would say is that it appropriately doesn't address compensation of brokers and agents when they don't act as fiduciaries. And I think that's the general scheme under ERISA, which is that it governs the actions of fiduciaries and it doesn't impose -- it principally governs the activities of fiduciaries and doesn't impose the strict duties of disclosure and conflict of interest and so forth on non-fiduciaries. And we're typically, almost always non-fiduciaries. And so we think that the duty ought to be on the fiduciary and not on the various types of providers, certainly not in the insurance industry that interact with fiduciaries.

We can see that there might be a special exception made for the sort of 401(k) plans that were identified in the rule, but we don't think that concept overlays very well onto our industry.

PANEL MEMBER CAMPAGNA: Well, what is the relationship and how does it work when insurance contracts are sold to plans? Do they ask you questions, do plan sponsors ask questions about appropriate plans, appropriate contracts --

MR. FINDLAY: Yes.

PANEL MEMBER CAMPAGNA: -- the parameters are given you of what they're interested in?

MR. FINDLAY: Yes, typically.

PANEL MEMBER CAMPAGNA: And you kind of lay out things?

MR. FINDLAY: Absolutely. And it obviously varies quite a bit with the thousands of people who are brokers and the hundreds of thousands of clients, but typically we would be competing with some other brokers for the brokerage business of a client. The client would ask us all sorts of questions from who else do you work for to how are you compensated. And then we would end up signing a contract that governs in a fairly detailed way the kind of compensation we do and can receive.

We would then sit down with a client, understand their needs, help shape their needs. Tell them, you know you don't really have very good coverage for this type of risk or this type of employee class or so forth. We would then go out to several markets. Usually we would agree with the client what markets we would approach or talk about what markets we would approach. We would go out to the markets and then we'd come back and say, I've got four quotes for you. There's Aetna, CIGNA, et cetera, et cetera. We think that the coverage is good here, but the cost is higher. We think that the coverage is not as good here but the cost is lower, and they're good at claims and that sort of thing. And we essentially help the client pick its carrier.

If the client asks us, even prior to our business reforms, if the client were to ask us, wait a second. You seem to be pushing CIGNA awfully hard, do you have some special arrangement with CIGNA? We would say, here are our arrangements with CIGNA. Here's what our commission rate is, and so forth.

So it really is a very iterative process, even with the smallest clients. We would go out and get several quotes and present them to the client.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

PANEL MEMBER BUTIKOFER: You've mentioned that there's already the state regulation in place, but how uniform are the regulations across the different states? I could imagine a situation where there could be a large variation and the disclosures could be quite high in some states and not in others. But how uniform is it?

MR. FINDLAY: I think it's relatively uniform. As I said, it's almost always, perhaps always the case that if we take fee and commission, we have to disclose the commission. It's almost always the case that you typically don't have to disclose the commission under state law when you're just acting on commission. But it certainly is the practice between the contractual arrangements we have with our clients, the contractual arrangements with carriers, the market pressures and us wanting to be good custodians of our clients' decisions to do disclosure of that sort.

So I don't think that you would be entering an area where there's no disclosure going on. But you would be entering an area where, for the first time, you'd be putting a new federal disclosure regime in place where the states and market practices have been pretty good.

PANEL MEMBER BUTIKOFER: The other question I have is, if the regulation were to go in place as is, you've already mentioned that the largest carriers or brokers don't have a problem with contingency fees, the smaller brokers would, and that you've already built up an IT system which the smaller brokers would have to implement and could be quite burdensome. Is there anything else that would be unique to the brokerage industry that could impact the cost of implementation?

MR. FINDLAY: Well, I think you touched upon it, which is that there are four brokers that are larger than maybe half a million dollars a year in revenues. Don't check me on that, but I think that's right. And the vast number of brokers and -- most of whom are not represented by our Council -- are small mom-and-pop types that might be a handful of employees and a million of dollars in revenue or something.

In our organization, to be a member of the Council you've got to have $5 million in revenue, but that's not really a particularly large outfit, typically.

So I think that what would distinguish us from 401(k) providers or other service providers is that the vast majority of our providers are fairly small outfits that would find it very burdensome to have a new one-size-fits-all kind of very strict disclosure regime placed upon them.

PANEL MEMBER BUTIKOFER: But would that burden be just an initial -- complying with the regulations, finding out what it is, or would it be a continuing compliance cost?

MR. FINDLAY: I think it would be continuing compliance. Obviously you've got to build the system and the processes and put them in place, but then, every discussion with every client regardless of whether they need a particular type of information, you would be having to gather that information for them, and it's not easy.

And one of the things that we found is that when we go back with a lot of this information to customers, they look at it and they say, you know, I'm being asked to sign something. When I'm being asked to sign something, it's probably not good for me. It's somehow giving up my legal rights. And so there's quite often a lot of back and forth with the client where they say, I ain't signing nothing. I'm going to take this to my lawyer, and I want to have my lawyer look at it.

And so it introduces a lot of friction into the relationship. So it is a very much an ongoing, day-to-day burden of taking away from time that they could be out advocating for their clients, instead they're kind of doing paperwork.

PANEL MEMBER BUTIKOFER: All right. Thank you.

CHAIR CAMPBELL: Thank you very much. We appreciate the time.

MR. FINDLAY: Thank you.

CHAIR CAMPBELL: And our next witnesses will be Mr. Saxon and Ms. Eller.

MR. SAXON: Good afternoon. My name is Steve Saxon. I'm a principal at Groom Law Group in Washington. With me is Jennifer Eller, who is also a principal at Groom. We're testifying today on behalf of a number of financial institutions and administrative service providers. The companies we represent today offer a variety of services to plans subject to ERISA, including administrative services, record keeping, consulting and advisory services. A number of them also offer investment and insurance products.

We appreciate the opportunity to comment on the proposed amendments to the 408(b)(2) regulations. Our comment letter identified a number of significant issues and concerns with the proposal. Many of the

c21020a4-0b71-40d1-bade-e3b09f4800dc

witnesses at the hearing have raised similar concerns, and instead of restating the problems with the proposal, today we want to share with you some thoughts we have on how to craft a more workable solution.

What we're doing is suggesting to the Department that you consider six revisions to the current proposal. If made, these changes would offer a dramatic improvement over the proposal. Without these changes, the proposal is virtually unworkable and could be vulnerable to challenge in federal court. So I'm going to run down those six suggested revisions.

First, limit the scope of the regulation to providers of services to plans. In order for any regulation interpreting ERISA section 408(b)(2) to work, the application of the regulation must be limited to the service transactions between a plan and a party of interest. Otherwise, there's simply no transaction for which section 408(b)(2)'s exemptive relief is required.

Under the Department's proposed plan asset regulation, an entity managing an investment vehicle that does not hold plan assets is not indirectly providing services to a plan invested in the vehicle, thus it is inappropriate for the Department to characterize a plan's investment in such a vehicle as involving any services to the plan that require a relief under section 408(b)(2). For this reason we asked the Department to recognize some limits of 408(b)(2) and not require disclosures from entities to providing services to a plan.

We also asked that prior DOL guidance to service providers be respected. Such entities should not be deemed parties in interest for purposes of the final regulation.

Second, hold plan service providers to a reasonable-efforts standard. The final regulations should provide that a services arrangement will not be unreasonable if a plan service provider makes reasonable efforts to comply with the disclosure requirements, and when it becomes aware of a deficiency in its disclosure, uses reasonable efforts to correct the deficiency.

The proposal requires a service provider to certify that it has disclosed the required information to the best of the service provider's knowledge. This is a trap for not only the unweary, but the diligent. The required disclosures are complex. Service providers will endeavor to provide all the required information, but there will inevitably be oversights and errors. In addition, different providers will interpret the rules in different ways.

A service provider who has used reasonable efforts in complying with these requirements should not be subject to potential excise tax liability or being reported to the Department merely because of a mistake or interpretive error.

Third, recognize the limits of a service provider's ability to collect information regarding payments made in connection with plan investment options.

If a bundled service arrangement simply allows the plan to access a universe of investment alternatives or investment platforms, the management of the investments should not be considered a service provided as part of the bundle. Plan service providers frequently offer access electronically to investment options, but do not have anything to do with the management of those investment options or payments made from the options. Quite simply, this is not information that the access provider should be expected to know.

If the Department intends to require service providers, such as 401(k) record keepers, who offer access to plan investment options to make disclosures with respect to perhaps hundreds or thousands of investment alternatives, it must be sensitive to the limitations inherent in these relationships.

For instance, one option would be for the final regulation to require that plan service providers offering access to investment alternatives to disclose any information about the fees and compensation paid from the investment alternative that is contained in the investments disclosure documents and available to the access provider. Alternatively, the Department could identify the types of information it expects the access providers will request from the investment providers or platform providers and will require that the access provider disclose the responses to these information requests to plan fiduciaries. As noted above, to the extent a service provider makes reasonable efforts to obtain information and cannot, the service provider's contract with the plan should not fail to be deemed a reasonable arrangement.

The Department should allow for flexibility in determining when allocation of compensation within a bundle is necessary, especially where requiring disclosure of the allocation of compensation could result in a competitive disadvantage or release of proprietary information.

For instance, where an investment manager in accordance with the terms of its investment management agreement hires a subadvisor, the manager should be required to disclose only the aggregate compensation for which the management services are made. If the Department does not agree with this comment, it is imperative that the Department provide clear and specific examples of the disclosure requirements and the scope of their application. Otherwise, there is a very significant risk that differences in interpretation will result in a competitive disadvantage for compliance-oriented companies.

c21020a4-0b71-40d1-bade-e3b09f4800dc

That last sentence that I read was highlighted by all of our clients.

Fourth, require yearly updates of information from plan service providers. The proposed regulation requires providers to update their disclosures within 30 days of the service providers learning of any material change in the information. Plan fiduciaries and service providers may have different views as to what constitutes a material change. Furthermore, to the extent disclosures regarding a bundled arrangement must be made by a single service provider, a 30-day rule is simply not enough time for the elements of the bundle to give notice of the change to the provider and for the bundle provider to be give notice to the plan.

In any case, plan fiduciaries may be inundated with notices of piecemeal changes to their service contracts. Instead the Department should require updates on a yearly basis, or upon reasonable requests of a plan fiduciary.

Fifth, mandate specific disclosures but not contract terms. The final regulation should not mandate the inclusion of specific disclosures, statements or representations in the services contract itself. A significant issue with this requirement is that it could be read to mean that every plan services agreement is immediately ineligible for the final section 408(b)(2) exemption, even if every disclosure has been given merely because the contract terms themselves do not require the disclosure to be provided.

If the services contract has to include specific terms, a separate writing should be acceptable. It is not always possible or practical to amend a services contract. Under state law, an insurance company's contracts must be approved by the state insurance commissioner before they can be issued to the public. If the contracts are materially modified, they must be resubmitted for approval. It's not clear whether some or all of the insurance contracts such as group variable annuity issued to cover plans will need re-approval. A state consideration of contracts can be a lengthy process.

Similarly, certain types of plans have been pre-approved by Internal Revenue Service. Some such plans include separate trust agreements that have been approved by the service-provider, while for others the trust agreements are included in the plan itself. Such agreements cannot be revised without being resubmitted to the service under the IRS review cycle for pre-approved plans, submissions can only be made in specified years, and even if allowed, would be expensive and time consuming.

Finally, in number six: provide transitional relief. The proposed regulation's focus is on disclosure and fiduciary consideration before a contract is entered into. Given the regulation's complexity, it makes sense to phase in the requirements and allow existing contracts to come into compliance when they are renewed or modified. As indicated by over 30 comment letters requesting an extension of the effective date, 90 days from the publication of the final reg does not provide sufficient time.

In its economic analysis the Department estimated implementation of the regulation will require one work hour for most service providers -- that is incredible -- and 24 work hours for the largest service providers. This is unrealistic. But even if the Department's estimates were accurate, 90 days would still not be enough time.

For example, many of our clients have many thousands of contracts with employee benefit plans. If you assume the regulation becomes final 90 days after the final reg is published and the Department, as the Department projects, it takes these client 3 days or 24 work hours to determine its obligations in the remaining time, it will need to renegotiate hundreds of contracts per business day. The burdens are equally heavy on small service providers.

Fiduciaries will also be overwhelmed. A large plan may have hundreds of effected service providers and the fiduciaries will have to gather required information and renegotiate contracts with each of them within the scope of their obligations under ERISA section 404 within a short time frame. The effective date should be at least a year after publication of the final reg.

We appreciate the opportunity to appear before you today and look forward to working with the Department to find a workable solution.

CHAIR CAMPBELL: Thank you very much.

Let's start down here.

PANEL MEMBER BUTIKOFER: The very last piece of your testimony was talking about the amount of time it would take to implement the regulation. And you've expressed, and several others have as well, that we underestimated how much time it would take to comply. Could you kind of walk me through the process?

A regulation comes out. What happens as you receive the regulation and then you turn around and advise your clients, can you kind of walk me through that process? I don't know if you're comfortable giving me time amounts, but how involved is this process of just communicating what's required to the service providers?

MR. SAXON: Well, in this case it's even doubly more complicated. Because we have the Schedule C and the Schedule A to the 5500 also to work into our compliance protocol. But I think in this case this reg was published or proposed in December. We immediately began to work through and break apart the reg into its different component parts. We solicited comments from tens of clients. We had discussions. We sent out memoranda that described how we thought the regulation, what it meant particularly for things like, what does the concept of a bundled arrangement mean, when does it begin, when does it end, who is included in it, what are the requirements for a bundled provider, you know, so excessive, will bundled providers be able to obtain the kind of information that they need in order to comply with 408(b)(2)? And that process, it took a couple of months. And actually we were pleased with the opportunity that the hearing came up, so that we would have a little bit more time to digest the regulation, have conversations with other folks in the industry and figure out what a workable solution might be.

PANEL MEMBER BUTIKOFER: You said that the existence of other regulations already being needed to be implemented would make it more complex. Could it not also work that some of the things that need changed actually are duplicated across the different regulations, as in, for example, we've heard mentioned the IT systems that need updated or whatnot?

MR. SAXON: Well, yes. I mean obviously we'd like, from an IT perspective, to make sure that what you're saying and the information you're collecting as a service provider, what you're collecting to provide to the plan sponsors so that they can meet their requirements under the 5500 is at least consistent with the information that you're going to provide the plan sponsor in connection with their determination. But it's even more complicated than that.

Right now, all of us are watching very carefully all the litigation that's growing in the 401(k) space. And a lot of what happens in the federal courts, it seems to me, would have an impact on what's happening up on the Hill. There are legislative proposals now under consideration that would expand the disclosure requirements for service providers and plan sponsors.

So we look at all of those things. We look at what's happening on the Hill, we look at the litigation, we look at all the possibility that shortly the Department will develop regulations or amendments to 404(c) that will enhance the disclosure to participants. And we try to take all that into account in advising the clients on what they ought to be saying and what they need to do.

Our clients haven't objected to the concept of fee transparency. There are, however, technological obstacles that have to be overcome and then there are legal obstacles that have to be addressed. The difference between Schedule C to the 5500 or the 408(b)(2) regs is that it's easier for the Department to expand the scope of the disclosure requirements under Schedule C, it seems to me, than under 408(b)(2), because 408(b)(2) just applies to party in interest service providers, although some would argue that the Department has expanded the concept of who a party in interest service provider is to expand the scope of the exemption.

PANEL MEMBER BUTIKOFER: All right. Thank you.

PANEL MEMBER CAMPAGNA: Thanks for your thoughts. I was jotting down everything. I hope I got it all. And I just want to go through some clarification points.

On your first point, service providers to service providers. Do you see some kind of line that has to be drawn here or can you give us some idea as to that kind of line? For instance if a record keeper or a direct service provider subcontracts some of their services, but the charge is against plan assets for that sub-contract as opposed to coming out of the service provider's fees, even though it's a subcontract with that service provider do you see any need there to draw that line or give us a little hint on that?

MR. SAXON: I'll start.

One example, the example in our comment letter is a simple one is where an investment manager -- and let's say we're talking about a collective investment trust or some other vehicle that holds plan assets. So you have a direct charge against the plan assets to pay the investment manager. The investment manager feels like they need a little bit additional expertise. Out of their fee --

PANEL MEMBER CAMPAGNA: Out of their fee?

MR. SAXON: -- they pay the sub-advisor. It seems to me that for proprietary purposes they may not want to share what they're paying the sub-advisor. And it seems to me what the important information from the plan sponsor's perspective is, is what's this investment management arrangement costing us, not so much what the relationship is between the primary investment manager service provider and the other service provider.

I have to admit, Jenny may disagree with me, but in the example you gave, it would be a little bit unusual to see this, but if you had a subcontract where you had an additional charge against the assets of a plan for the services provided by the subcontractor, it would make sense in that case for that subcontractor's compensation to be disclosed.

PANEL MEMBER CAMPAGNA: And you also talked about recognizing the limits of the service provider's ability to collect information. So how do you see this working, say, in the situation where there's a record keeper in a non-affiliated fund. What are the obligations? Should there be agreements between the parties regarding the information of the fund and how do you see that working in your construct?

MS. ELLER: I think it would be difficult for many record keepers that are providing services to plans to put in place contracts with every investment option on their platform. Mostly, the reason the investment option is on the platform, is because they link up electronically. And so to have separate agreements and then to have the record keeper be responsible for sort of tracking the compensation paid out of those investment alternatives I think would be really difficult.

The two suggestions that we had were to, either for the record keeper to pass on the information that's available to it or for the record keeper to ask some questions and pass on the answers that it gets.

I think Doug Kant made a good point earlier that, if the record keeper does act as a conduit, there's got to be some recognition that they can't be double-checking the information that they get. Not only will they not necessarily be able to get a lot of information or be able to ensure that it's correct. And there needs to be some allowance made for that.

MR. SAXON: Yes. This is a big deal. Your question there, it's a difficult one; we've really struggled with it.

Where you have a one-stop-shop bundled contract, if you will, where a record keeper is contracting with the plan or the plan sponsor on behalf of the plan, and they provide administrative services, but they have access to a platform, that platform may include 10,000 mutual funds, many, many families of mutual funds; they're not contracting with those funds. They don't have any legal basis for obtaining information from those funds outside of the prospectus. What we have said, and to the extent that the record keeper gets information about the nonproprietary fund fees from the advisory fees that they charge or the 12(b)(1) or administrative service fees that are made available to pay for services, we can pass that information along.

What worries us is that the record keeper is going to rely on this services exemption for relief, the record keeper or other administrative service provider. And to the extent they don't get this information from this other party that's not legally obligated to give it to them, they're potentially liable for excise tax liability. That seems to me to be a fairly harsh consequence.

And what's happened is, you know, if you have worked in the retirement services marketplace like we have for so long, you understand that what the Department is trying to do is remove from the plan sponsor and the fiduciary the responsibility to collect this information and put it in the hands of

c21020a4-0b71-40d1-bade-e3b09f4800dc

somebody else. The problem is, the record keeper has, to an extent, less of an ability to get that information than the plan sponsor because they don't have a contract with the nonproprietary fund.

PANEL MEMBER CAMPAGNA: Would you have any problems with what we were referring to the preamble that the bundled provider, say, would make reference to the particular, relevant services and where to find that information in the prospectus?

MS. ELLER: If it's not a specific page number for every fund. But some general information about information on fund expense ratios can generally be found in the prospectus. I think that's something that kind of falls in line with passing on information that's available.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

PANEL MEMBER CANARY: I wanted to follow up a little bit on what Lou was talking about. You used a couple of terms, and I wasn't sure they were interchangeable. One was talking about an access provider and then also talking about bundled providers. Can you tell me whether or not those were interchangeable or if they're not, how you perceive them as being different?

MR. SAXON: Well, they can be the same. A bundled provider could be, let's keep it simple, a record keeper that provides record keeping, reporting, administrative services but does not provide investment management services itself. What the record keeper would do was provide electronic link to some platform so that they can access a variety of mutual funds or perhaps other kinds of investment vehicles electronically so that they can conduct their business on a daily basis. But they don't provide investment advice with respect to the funds that are offered.

Now they may provide some

screening because some funds may not electronically link up with them. So if a fund family doesn't link up with a record keeper, they can't be offered under that product. But they would be a bundled provider, but what we were trying to do was kind of limit the definition of when the bundle ends. And the bundle ends with access to the investments, but because that provider doesn't have the legal ability to collect information from the investment provider, we didn't think it was fair to saddle that bundled provider with potentially harsh consequences of failure to meet the terms of the reg.

PANEL MEMBER CANARY: Okay. I think I understand trying to define where the bundle ends was -- the term "access" was trying to capture that in a conceptual way, which follows right to the next couple of questions that I wanted to pursue.

Let's assume that you have an access bundled provider, and one notion I get pretty clearly is that the actual management to that pool, that investment option that, that in your perspective would not be a service provider. And does that make a difference whether or not that's a plan asset pool versus something like a mutual fund that's not holding plan assets?

MR. SAXON: Well, let me ask you a question.

PANEL MEMBER CANARY: Fair enough.

MR. SAXON: If you had a collective investment trust or you had an insurance company pooled separate account, as you know from the plan asset regulations, and underlying the assets of those vehicles, would be plan assets.

PANEL MEMBER CANARY: Correct. And I guess I'm trying to say so I'm an access provider and there's the mutual fund platform, there's the collective investment fund platform and there's the insurance company pooled separate account platform. I'm oversimplifying it. But if I am the access provider here and we go to the mutual fund door and it says - okay management of that would not be part of the service. The bundle would end before you get there. But if I'm in the bank or the insurance company platform, where does the access provider stop in terms of bundle? Would we also exclude the management from there?

It's kind of trying to explore a little bit the mutual fund not being a plan asset vehicle versus these others being plan asset vehicles and what's part of the bundle and what's not. If you could talk to that a little bit?

MS. ELLER: Well, maybe an example might be helpful. Sometimes you'll have a bank that provides investment management services to its own bank collective funds and also record keeping services to a plan. I think that's more akin to a record keeper that also provides investment management services in the mutual fund context.

If you're dealing with a bank that keeps records, access direct to trustee and also manages collective funds, then I think there's more reason to expand the definition of an bundle to include those services to the plan assets vehicle.

Where you have an access provider that has nothing to do with the entity providing the management services to the plan assets vehicle, then maybe you need to look at the entity who is a fiduciary with respect to the plan that's managing those assets for their direct reporting requirements.

PANEL MEMBER CANARY: So the assets provider may define the scope of their bundle and not the circumstance based on what they can or cannot control?

MR. SAXON: Right. Exactly. So to answer to your question, it doesn't matter. It doesn't matter whether the investment is a mutual fund or it's a collective investment trust or an insurance company pooled separate account. The bundled providers, they don't have any better legal opportunity or ability to obtain information from the CIT than they did from the mutual fund. They don't have a contract there.

PANEL MEMBER CANARY: I understand.

I only have two others. But it's sort of interesting when you get the lawyers up here, it tends to facilitate our being able to ask some of the legal questions.

The gentleman from the American Bankers Association was, I think, operationally saying he thought the bank fund should be treated the same as the mutual funds as an operational mater. And I think, as Fil Williams was exploring a little bit is - well legally is that really a comparison? You can say, well no. If I'm the investment manager for the bank, common collection trust or the pooled separate account, I'm the fiduciary for the plan, I'm in fact providing services to the plan. Even if I'm doing it on this level, and frankly I don't even know which plan is which in the day-to-day sort of world, I can obviously figure that out, but then I'd have to allocate who I'm providing services to, and how much I'm getting paid is allocated to which plan. Are you guys challenging on this service provider to service provider that that party for the plan asset fund is providing services to the plan? I guess that's trying to get down to the bottom line.

MS. ELLER: I think the short answer is no. I think where we are asking you, the Department, to draw a line in terms of who is a service provider to a plan in terms of plan assets vehicles we need to live by the same rule.

PANEL MEMBER CANARY: I only have--

MR. SAXON: Let's answer, to make sure that we're all on the same page.

PANEL MEMBER CANARY: Got you.

MR. SAXON: A plan that participates in a 81-100 collective investment trust, the trustee manager of that trust is obligated to provide, for 5500 purposes, the financial information so that the plan sponsors who participate -- the plans that participate in that trust can fulfill their requirements for their annual reporting. So the manager of that collective investment trust already has a communication that's going to the Labor Department or the IRS; right?

PANEL MEMBER CANARY: Fair enough. Which is sort of my last question, which is you've pointed out that it would be desirable to have the 5500 disclosures, these be consistent with the disclosures required 408(b)(2) reg. And the 408(b)(2) reg, obviously, has disclosures which are broader than what is in the 5500.

Do you perceive, currently looking at the final rule in the proposals, that are

c21020a4-0b71-40d1-bade-e3b09f4800dc

particular areas where they're not consistent? And that may be a hard question to hit you cold with, so if you'd prefer to think about it, that would be fine.

MS. ELLER: We have looked, actually, some of the definitions are slightly different. And I think what we've had conversations just internally about, does this particular difference in the definition of compensation, for instance, mean something significant where for 5500 purposes, indirect compensation is anything not paid by the plan. But for 408(b)(2) purposes it's anything not paid by the plan or the plan sponsor. You know, we're kind of left in the situation of trying to figure out whether those differences are significant.

So I think there is some benefit to a pretty parallel nature between the two. On the other hand, in some ways they serve different purposes. So that maybe there would be reasons for them to be different.

MR. SAXON: We actually thought about trying to answer that question, but we said nobody on the Department would go that far. So we said we won't bother doing the comparison, but obviously Schedule C --

PANEL MEMBER CANARY: You obviously underestimated it.

I'm done. Thank you.

PANEL MEMBER DWYER: I'm not totally clear. On the investment manager to the plan assets vehicle, who is a fiduciary but only by virtue of managing those assets. Do you agree that that party is a service provider to the plan? Yes?

MR. SAXON: Yes.

PANEL MEMBER DWYER: Okay. That's all I had.

PANEL MEMBER WILLIAMS: Okay. I would like to revisit this point about how does the responsible plan fiduciary get information that the record keeper doesn't have access to where you were talking about this electronic link to a platform and you have a lot of mutual funds, but they don't have a contract with all of those funds that would enable them to get at information.

And so I was thinking about this in terms of really three concepts. One would be follow the money. One would be follow the information. And one would be follow the contracts.

And so I was coming to the conclusion that perhaps the legal ability to collect information is based on contractual rights. And then I was trying to link that up with the possibility of a record keeper getting compensation. And I think I come to the conclusion, but you may correct me if I'm wrong, because I don't know anything, that a record keeper wouldn't be getting compensation from funds in situations where they don't have contractual obligations that would enable them to have the legal ability to obtain information as a conduit. Does that make sense?

By the way, I'm trying to focus on whether the responsible plan fiduciary, do they really need to get at that information if there's no compensation that's possible that might be flowing from a source on the platform where they can't get at the information about the fund to enable them to pass that along. And, again, my focus here is on the practical delivery of this information, because, if I understand your testimony, if we do the six things, we end up with a workable solution. But we still have issues like this, which I'm focusing on the class exemption as a way to cure the remaining issues. But there could still be issues, I think, for instance, if the class exemption was to exempt a service provider that was not able to provide information because it wasn't their fault, but there's still compensation flowing to them. So do you have any way of addressing my thoughts? If not, we'll just -- but am I on the right track or is there anything that you can add to that?

You see my concern? We could possibly get to a place where there's no solution, which is that they can't get the information but there's still compensation that the responsible plan fiduciary would want to know about, but they can't get the information about that.

MS. ELLER: I think one of the fundamental questions is whether there in fact is compensation that's relevant to the responsible plan fiduciary.

PANEL MEMBER WILLIAMS: Yes.

MS. ELLER: If they are getting the expense ratio of the fund and they have other information like the amount of turnover, that shows you in some indication what's coming out of the net asset value, then is there really more other than the plan's own service provider's direct and indirect compensation that is relevant to a fiduciary's decision.

PANEL MEMBER WILLIAMS: Right. I understood what you said. Once they have this legal ability to correct the information from certain funds on the platform that they're not going to be able to give them any information. They will not be able to be a conduit for information coming from those funds. So I'm back to the question of well how does the responsible plan fiduciary get that information if they are actually, I think as you said, in a better position to get that information than the record keeper would be because the record keeper doesn't have the legal ability to compel someone to give that information. Then the responsible plan fiduciary would have to get it, but they don't know whether or not they need it. But it could be that they do, but they have no way of knowing whether there is compensation coming to the record keeper from these funds.

So is there a way to say well

c21020a4-0b71-40d1-bade-e3b09f4800dc

because they can't get this information that it's not possible for them to be getting any kind of compensation from those funds?

MR. SAXON: We have struggled mightily trying to answer your question. And the solutions that we've developed so far are that's as far as we've been able to take this.

What I said earlier is that it does look like the Department is kind of -- we know that the plan sponsor has obligation under 404 to make a prudent decision with respect to the selection of all plan service providers. And we now know that it's the Department's view that they need the necessary information including information on fees in order to make a prudent decision.

What's happened is is that the plan sponsors haven't had the ability, if you will, to collect that information, at least in the eyes of the Department over time. Although I would suggest to you that there have been some pretty significant changes.

Part of the solution, I believe just looking at the example that we were talking about, is in the case of the record keeper if the record keeper is getting revenue sharing payments, if they're getting 12-B-1 fees from the distributor that that now has to be disclosed on Schedule C the 5500 and that has to be disclosed as part of the 408(b)(2) regs.

So their fee information about that bundled provider is going to be disclosed. What we're trying to be careful about what we said and didn't say is that bundled provider has limitations on their ability to access information about what other service providers might be getting paid.

PANEL MEMBER WILLIAMS: So they will always be able to do --

MR. SAXON: I'm not saying -- yes. Well we're not saying that that bundled provider is not going to disclose to the plan sponsor at least by formula or an estimate the

c21020a4-0b71-40d1-bade-e3b09f4800dc

service income that they're going to receive, even if it's revenue sharing payments, right?

PANEL MEMBER WILLIAMS: Okay. Great.

CHAIR CAMPBELL: All right. Thank you very much.

And I guess Mr. Saxon will stay where you are and Ms. Mazo will come up.

Anytime you're ready.

MS. MAZO: My name is Judy Mazo. And I'm a Senior Vice President of The Segal Company, which is an employee benefit actuarial consulting and human capital firm. And stringing all those terms together annoys me sometimes, but it’s actually relevant to the testimony.

And I'm here with the Steve Saxon on behalf of a group of similarly dedicated organizations and general employee benefit consultants, consultants that do the range of sort of general benefit services.

And our request which is

elaborated in more detail not only in our statement but in comments that my company submitted, is pretty simple. And so I think I'll just describe it briefly and then let you ask questions.

Our suggestion is that employee benefit consulting per se, which I think would have to be defined negatively as consulting on employee benefits other than the number of things that you have listed, insurance, whatever should be treated as a general service in what we call category 3 of your list of service providers who are subject to the rules. That consulting as a general concept should be a profession where the services -- unless the services are in someway compensated indirectly or by a third party, they would be exempt from the disclosure. Excuse me. Not from disclosure, but from the rigors of the proposed regulation.

It's unusual for me to be testifying on behalf of my company and not clients. So sometimes I may trip over a little bit.

The purpose of the proposal, as you all have emphasized a number of times just in the time that I've been here, is to provide information to fiduciaries to enable them to make a responsible judgment about hiring service providers. And our suggestion is that where the service provider is paid exclusively by either a fee or hourly charges with no third party payments or contingencies or gifts, et cetera, that are defined as compensation in the proposal that there's really no further need to lay on some of the formalities of the proposed regulation. And there are certain services that you have specifically identified as kind of integral to other more complex services and arrangements that are compensated in a more complex way, such insurance consulting or asset consulting which you may feel, and we can understand why you may feel you want to just have the extra

c21020a4-0b71-40d1-bade-e3b09f4800dc

layer of demanding disclosure even if the compensation is exclusively fee based. But we don't see how general benefit consulting which in the retirement plan arena would be talking about design issues, talking about gee is this QDRO specific enough. It would be just a giant range of services that are associated with helping a plan sponsor maintain its retirement plan, helping them maintain its health and welfare plan. That there's nothing terribly mysterious about the arrangements and there's nothing mysterious about the compensation.

And so our suggestion is that element of consulting be classified in the category where you've already classified kind of part of it. I mean, you say for services such as actuarial accounting, legal, et cetera that they are subject to the disclosure regime if there is an element of third party compensation or indirect compensation. And we would submit that it's kind of, again, in terms of line drawing. What is the difference between actuarial services and consulting services related to the maintenance of a defined benefit plan? One could argue which one is performed by a credentialed actuary. That's an odd line to draw when in fact you are consulting with the sponsor of a defined benefit plan. Similar on health plans, et cetera.

So just one other point, which is gee if it's so simply why are you complaining about being subject to the disclosure. And that was a position that I took internally when people raised it. And you've heard some of the reasons already, because they apply to all of the service providers. You heard Steve talk about a reasonableness rule.

Gee, what if you left something out or forgot something and didn't -- you know, is that a violation?

And you've heard people -- I know I've read interesting discussions about the

c21020a4-0b71-40d1-bade-e3b09f4800dc

conflict of interest disclosures. I was particularly interested in what I saw in the outline from Hewitt Associates yesterday talking about with a big firm, and all of the companies in our particular group are big firms with a whole array of services that are provided to a whole array of clients, what is the conflict of interest and how often do you have to update your list if you happen to providing actuarial services to a bank? And they're not usually on the list, but maybe your asset consultant branch includes when they're presenting opportunities to clients. But would somebody consider that a conflict of interest?

In my company because we work a great deal with collective bargained plans, among others, we have two specialized internal conflict of interest groups that look at taking assignments. And one is just provider consulting. If we're offered an opportunity to do something for a health insurance company or a record keeper or something. And those are services that we help our clients choose to buy, can we do it and what sort of disclosure do we do with the client so that they know that we're doing it.

And the other is more general kind of conflict. If we are working with a Teamsters fund and they are trying to organize a hospital that the service employees are trying to organize, is that a conflict of interest we'd have to report to both of them?

The client may find that much more important than the fact that we work with a record keeper that's not in their jurisdiction or something like that. It could be endless and meaningless at the same time.

We're worried about the disclosure up front of all of the services that are being provided. Because additional services continue to crop up in the course of just helping the client maintain their operations. Services that have to be provided, they'll be paid for later if the client's willing to do it. If the client says, "Okay, you put in a lot of time but I don't see any value in it and I'm not going to pay you," so we're not going to get paid. They weren't notified before we did, but again with these flat flee or fee for service arrangements the client always has to agree before any kind of money changes hands and goes to the service provider. Because there's nothing indirect, there's no control over the assets where we can be paid.

And I guess that's basically it. And I can answer any questions that you have.

CHAIR CAMPBELL: We'll start down here.

PANEL MEMBER WIELOBOB: A quick one. We've heard the welfare plan folks say that this shouldn't apply to them or if it applies, it should apply in some different form. It's inapposite to the way welfare plans compensate service providers and so forth.

Do you have any views on that, the scope of the proposal?

MS. MAZO: I would make a lot of enemies or offend a lot of people if I were to sort of opine in general.

I will say that a client of mine, one that I do often testify in favor of, the NCCNP has filed a comment supporting the regulation as a general principle because they appreciate the idea of having the information arrayed in some way and made available.

We work with, among others, Taft-Hartley funds which are funded. And I think for a funded ERISA plan the issues are the same. The compensation arrangements are probably not as complicated, but I think it's relevant for the client to know that you're getting a commission and now much the commission is.

PANEL MEMBER WIELOBOB: Thank you.

MS. MAZO: Sure.

PANEL MEMBER WILLIAMS: With

respect to the third category of covered service providers, the accountants, the actuaries, the appraisers, the auditors, the legal services would it be correct to assume that third party compensation would be unusual?

MS. MAZO: Yes, it would in my opinion unless there's --

PANEL MEMBER WILLIAMS: So --

MS. MAZO: In the absence of commissions of some kind, replacement of property, whatever.

PANEL MEMBER WILLIAMS: So you would agree then with the idea that if there was indirect compensation coming to such service providers, that that should be disclosed?

MS. MAZO: Yes.

PANEL MEMBER WILLIAMS: Thank you.

MS. MAZO: I have no problem with that.

MR. SAXON: Really, if you look at

category 2, category 2 includes the term "consulting" without any further definitional help.

The third category includes actuarial services, which is kind of the heart and soul of benefits consulting. If you expand what we're talking about under benefits consulting to other kinds of administrative, managerial, human resources, other things that would not cause the consultant to become a fiduciary, then we're kind of saying why not move those guys into category 3 as well as long as they're not receiving indirect compensation, they're not acting as fiduciaries and they don't have, as Judy said, the conflict of interest issues that present themselves so often on the investment side.

MS. MAZO: I mean, for instance, communications consulting, all of these firms have communications groups that draft SPDs and help set up websites, and that sort of thing. If we or one of them were being paid by

Microsoft, or some website provider or ISP, that should be disclosed. But typically that's not true. We have -- I'm just thinking about the special practice. You advise on helping to upgrade systems or to monitor your systems providers, your IT providers. As long as all you're being paid is what the client is paying you, then I don't see that there's a reason for any special regime other than making sure the client knows what they're paying you.

PANEL MEMBER WILLIAMS: Okay. I'd like to address Mr. Saxon's point. You would want a sort of language fix to address your comments, is that what you're contemplating or recommending?

MS. MAZO: Right. We're basically saying that consulting as a general proposition be taken out of the category 2 automatically subject to this rule and put into the category 3 along with the legal actuarial, et cetera.

PANEL MEMBER WILLIAMS: Okay.

PANEL MEMBER DWYER: Would you be opposed to moving the consulting into category 3 for these types of HR and communication, et cetera, but leaving some category of consulting in category 2? For instance, investment consulting related to investments? Would you have any opposition to that?

MS. MAZO: Not really, no. I assumed that, until Steve corrected me, that we have a subsidiary that does investment consulting and they're registered investment advisors. So I assumed that they were just automatically covered under category 1 until Steve pointed out no, no, no, it's only if they're a fiduciary. But I mean we realize that that is -- and all of our group has some element that does that kind of work. And I can certainly understand why you would feel that it's important to put an extra underscore around the disclosure for those services and would not object to that.

MR. SAXON: Yes. We thought about

asking for relief for investment consultants who are not fiduciaries and who get a flat dollar fee. Because those folks if they're not a fiduciary, they're not in category 1. If they're just getting a $100,000 a year or they're getting some kind of asset-based fee that's not subject to conflicts, they're getting 5 bps, then -- so we would like to reserve the right to follow up with you and we'll send you something if we can make that -- we thought about making that case.

MS. MAZO: Right. We did --

MR. SAXON: But we didn't want to complicate or ask at this point.

MS. MAZO: Right. I was only speaking for us at that point.

PANEL MEMBER DWYER: Thank you.

CHAIR CAMPBELL: Well let me actually just explore that issue a little bit more. In your view then, well not in your view, but sort of playing the reverse question, is there anyone that you would see belonging -- what's the utility of being in category 2 as opposed to being someone who would fall under category 3 by virtue of an indirect payment?

MS. MAZO: I didn't understand. It struck me that category 2 were the service providers that you were particularly concerned that fiduciaries might have difficulty understanding what it is they're actually doing, and thereby divining what they're paying for, or they seem to be service providers that are particularly involved with assets in one way or another.

CHAIR CAMPBELL: Well, and I'm not disagreeing with that. I'm asking, though, do you see that as necessary unless there would be activity that would actually come under category 3?

MR. SAXON: Maybe other folks did, but I think you could look at a number of other service providers in category 2.

MS. MAZO: Right.

MR. SAXON: And depending on the type of compensation that they get, that I think that they would not be subject -- they could easily be argued that they belong in category 3. And this all deals with the concept of who is a fiduciary and who is not. And the Department in the 5500 reg and now seems to be looking at certain enumerated service providers as not being -- although they admit they're not fiduciaries, we call them around the office as fiduciary-lites, like L-I-T-E. Because they're special. But my point to you would be that you could eliminate category 2 as long as you were very clear about the compensation that was received by category 2. If they're just getting a flat dollar fee and they're not a fiduciary.

Now, an investment consultant can cross the line, obviously, when they're providing recommendations. So in that case they would be category 1.

MS. MAZO: In fact we talked -- I

c21020a4-0b71-40d1-bade-e3b09f4800dc

mean before we got involved with the group did talk about that.

We frankly wanted to get what we're asking for so we made our request modest. But logically the idea that someone who is compensated exclusively with an up front fee or a fee for service kind of arrangement, the fiduciary has the information so you don't need an additional elaborate super structure for that.

CHAIR CAMPBELL: So I guess just to put the question one last way, in the fiduciary-lite category is there anyone you would see sort of escaping the intent of the regulation who would not either be in category 1 or category 3, if category 2 did not exist?

MR. SAXON: Not offhand. But I've only looked at it from the standpoint of -- really closely from the standpoint of benefits consultants and the actuarial type services that they provide.

CHAIR CAMPBELL: Okay. Thank you.

PANEL MEMBER CANARY: And I only have one that's sort of related. If you look at category 1, the reference to persons who are fiduciaries under the Investment Advisors Act, how do you think that classification interrelates with the consultant in terms of what you'd be potentially covering anywhere if you removed the word "consultant" from category 2?

MS. MAZO: Well, we believe that whether a fiduciary or not, I mean our assumption, The Segal Company, was that the registered investment advisor, that that status puts somebody in category 1.

This is really the same question about would we object to asset consulting. And Steve is right, I mean we would reserve on that formally. But I think our broader concern is with the more general consulting. And frankly the more general kind of consulting is the one where you run into the logistical problems that concern us. Because on asset consulting you're hired for a specific purpose, it may be a variety of purposes, you know, to monitor, to do a manager search, to review the allocation philosophy, whatever it is and you do that service or those services. You don't tend to be called for from day-to-day by the fund office or the benefits department and have the kind of scope creep that you have in general consulting.

And so I think it would probably be easier from a logistical point of view to meet the requirements than it is the general consulting where the actual what you're going to do for the client and what it's going to take to do it, and how long it's going to take is just so much more unpredictable.

PANEL MEMBER CANARY: Yes, I think it would be hard to do what you're suggesting. We are going to look at that though.

MR. SAXON: Okay.

PANEL MEMBER CAMPAGNA: And I only

have one question, too. I guess moving down to category 3 would depend on one thing in my mind. Are there conflicts of interest that we describe in our reg that are apart from the receipt of indirect compensation? In other words, if you were in category 2 you have the conflict of interest disclosures and you're going to have those in any event, despite receiving indirect comp. So are we going to miss anything in this move that we ask us to make?

MR. SAXON: You know, in thinking about it if you look at the types of service providers described in category 3, you could say that they have the same possibility of a conflict of interest that the lawyer or the accountant to the plan has because they have some financial interest.

Without looking at the other service providers in category 2 and thinking about that, and in fairness to us we would have to think about it, but in terms of what we were thinking about, a benefits consultant is most often the actuarial or the communications consulting that Judy was talking about. I don't see the conflict of interest there. It may be present for some of the other service providers. I don't think so. And I think you can equally make the case that you could move somebody in category 3 up if you're that worried about it. But we would say that the conflict of interest issues should only apply to fiduciaries to begin with.

PANEL MEMBER CAMPAGNA: Okay.

MS. MAZO: Yes. I mean the conflict of interest if you mean the sort of co-investing or the sorts of things that are talked about in the preamble as posed there is likely with any service provider. Sometimes you find --

PANEL MEMBER CAMPAGNA: But I guess assuming Adrienne's fix that you move investment consulting and keep that in category 2. With respect to the type of consulting you're talking about you really don't believe that those kind of conflicts exist?

MR. SAXON: No.

MS. MAZO: Right.

MR. SAXON: Right.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

CHAIR CAMPBELL: All right. Well, thank you very much.

We're about half hour to 36 minutes behind, so we're going to take a 5 minute break which will literally be no more than 5 & 1/2 minutes, and then we'll get going.

(Whereupon, the above-entitled matter went off the record at 3:08 p.m. and resumed at 3:09 p.m.)

CHAIR CAMPBELL: All right. Well in proof that tardiness and procrastination sometimes pay off, we did have one of our witnesses call and say he's unavoidably detained. So we have now gained a bit of time. And I think we're still in the negative, so let's go ahead and get started.

MR. KEMPER: I'm going to try to speed that up, actually.

Good afternoon. My name is Mark Kemper. I'm the general counsel at UBS Global Asset Management of the Americas. And to my left is Karen Barr, general counsel of the Investment Adviser Association.

We appreciate the opportunity to appear before you today on behalf of the Investment Adviser Association to address the proposed regulation under 408(b)(2).

The Investment Adviser Association is a not for profit association that represents the interests of SEC registered investment advisers. Founded in 1937 the IAA's membership today is comprised of more than 500 firms that collectively manage in excess of $9 trillion for a wide variety of individual and institutional clients, including retirement plans governed by ERISA.

The IAA applauds the Department's efforts to ensure that plan fiduciaries receive the information they need in order to assess the reasonableness of the plan's arrangements with service providers. Plan fiduciaries' understanding of the fees paid by the plan is especially important, because such fees directly impact the investment returns realized by the plan and in the defined contribution plan context the actual benefits received by participants.

As reflected in our previously filed comments, investment advisers provide services to both defined benefit and defined contribution plans. We'll incorporate our earlier comments by reference, but we'll devote our time today to the role of investment advisers and defined benefit plans in the application of the proposed regulation in this context.

Now, the basic premise at the beginning of the release of this new rule is that there have been a lot of changes recently in the way that the service providers, the structure that service providers provide services to employee benefit plans. And in our experience we believe that's true in the defined contribution area, but we haven't seen those types of changes in the defined benefit area at all.

The investment managers or investment advisers to defined benefit plans, it's a very traditional structure that plans themselves hire the trustees to provide the custodial record keeping functions. They hire the investment manager pursuant to a written contract to provide the investment management fees. The contract's going to have full disclosure on the investment guidelines as well as on the management fees that we're going to be paid.

Prior to engaging the investment

adviser, we're typically subject to pretty extensive due diligence by defined benefit plan fiduciaries and/or their consultants. They tend to come into our offices on multiple times. We've given them disclosure on our investment processes and various other aspects about the way our firm operates.

After the relationship is started, we provide regular reporting, at least on a monthly basis we provide transaction reports. We provide performance reports. We provide performance attribution. We provide proxy reports, soft dollar reports to the ones that ask for those types of reports.

So we have regular communication. And we have regular meetings, at least annually, with all of our clients to go over all of these issues.

So while we agree that certain additional disclosures are merited even in the defined benefit area, we believe it would be beneficial for the rule to be amended to distinguish between the types of disclosures that need to be given in the defined contribution area versus the types of disclosures that should be given in a defined benefit type of management arrangement.

Now, a primary example of what I'm talking about are the transaction costs. When you look at all the distribution type costs and the revenue sharings that are present in these newer type arrangements for defined contribution plans, those clearly merit further disclosure. And I think that's sort of the whole intent to your rule here. But those types of costs and fees generally are not present in the way you manage defined benefit plans.

Now, when I first read the rule I assumed on transaction costs that I only needed to disclose the transaction costs for my defined benefit clients to the extent it involved some sort of a conflict. So I needed to disclose when I cause a client to pay a commission to my affiliated broker dealer, I need to disclose when I'm getting something in return like a soft dollar benefit.

In discussing the rule with my colleagues further, though, they pointed out where my interpretation may have been wrong. And I think that deals a little bit in the way that the relationship between the adviser and broker dealer works.

As an adviser, we're an agent to the plan with the authority to engage a broker dealer who is also an agent to the plan to execute the trade. The commission's or whatever trading costs are charged in the trade are going to be paid for directly out of the plan assets. That structure just does not meet the definition of a bundled service, so I didn't see that there was any need to make disclosure under the bundled service type of requirements in the rule. However, if you also look at the definition of a responsible plan fiduciary in our position of hiring the broker dealer and engaging the broker dealer to do the trade, do we become the responsible plan fiduciary, therefore do we have an obligation to get this disclosure from the broker dealer? Do we have an obligation to pass it on to the client? Do we have an obligation to make sure the broker dealer passes the disclosures directly to the client? And this all, of course, needs to be done beforehand.

So I'm not really sure how I'm going to do that in either case. And the reason is, I don't know which broker dealers I'm going to trade with before the relationship starts. I don't know what types of instruments I'm going to trade with which broker dealer. So the only way I can figure that I'm going to be able to comply with this is I'm going to go to my broker dealer approved list and I'm going to have to give a disclosure from every broker dealer to every new client. That's over hundreds of broker dealers on the disclosure list, even though I may never actually trade this particular client account with one of those broker dealers.

And also what am I going to do as things change? We trade new instruments, we going to add a broker dealer, a new broker dealer or change the instruments we can trade through a particular broker dealer? If I have to go through, and often times I need to get a new broker dealer approved very quickly to get a trade done, and if I have to go through a full process in giving these disclosures to the clients, I think I'm going to miss a lot of trades that I otherwise could have done because I don't think I'll be able to get the disclosure process done quickly enough.

Now so I guess what I really think is that this process of disclosure of the compensation paid to broker dealers really needs to be clarified in the rule quite a bit. And I'd really hope that you'd adopt my earlier interpretation, which is that I should only have to disclose these commissions to the extent that I have a conflict of interest associated with them. And the reason I think that's the appropriate way to do it is because we don't have any incentive to make the broker dealers rich, unless it's my affiliate or I'm getting something back like a soft dollar. And on the other hand, we do have a lot of incentives to keep those costs as low as possible. You know, our performances, it reduces our performance, and that's our lifeblood that we sell.

Now the other things that we'd like to say about the rule, we would like to-- as you know we give our Form ADV to all of our clients. We believe that the Form ADV should be -- it includes disclosures and conflicts and compensation. We believe the Form ADV should be used as a safe harbor for compliance with this rule. To the extent we provide the ADV it includes all the disclosures it's supposed to include that we would be deemed to comply with the rule.

Now barring that, there was prior testimony, it was about a reasonableness opinion. I would agree, we would like to have something like that. We think it's appropriate that if an adviser or service provider has acted in good faith and given all the material disclosures required by the rule, he shouldn't be subject to a prohibited transaction excise tax just because he's missed some minor amount.

I know in working this rule through my firm I'm going to find out big things that I need to disclose. But the rule's very broadly drafted. I'm just as confident there's going to be a lot of little things on the fringes that I am not going to remember, not going to figure out, I'm not going to see ahead of time.

Also, I have to give futuristic disclosures. I have to estimate how much I'm going to be trading with this and how much it's going to cost. I know those estimates are going to be wrong, probably more often than they're right. So I think that as long as I've acted in good faith and I've gotten the material disclosures into whatever I've given to the client, we shouldn't be subject to the prohibitive transaction rules.

Let's see. Oh, lastly, we also agree that there should be a longer transition period added to the rule. We agree that the amount of time it's going to take us to implement this rule has been underestimated in your impact analysis. And we believe that we'll need a much longer time than the 90 days.

Also, we would prefer that the rule doesn't say that you have to amend all of your existing contracts immediately, but rather that you would amend the contracts as they come up for renewal as they have some other material amendment required so that we aren't in the process of trying to negotiate all these contracts with all of our clients at the same time that they're doing this with all their other service providers.

And at that, open for questions.

CHAIR CAMPBELL: Okay. We'll start down here.

PANEL MEMBER BUTIKOFER: So turn things around a little bit. Yesterday we heard from some fiduciary groups talking about the benefits of the proposed disclosures. And they've mentioned things like more fee transparency, it lowers their search time for information.

From your side of it what do you see as the big benefit to fiduciaries? I know this is not your clientele necessarily. But how do you see all this extra effort? Do you see it as actually going to benefit the fiduciaries?

MR. KEMPER: To benefit my clients you mean, basically?

PANEL MEMBER BUTIKOFER: Yes.

MR. KEMPER: Yes. Sure I do. I think -- and again, you know I started out we like the rule. We think it's good. I think the disclosure in this area is necessary. What my concern and only concern is is that it's a little bit of a good thing is good, too much of a good thing is bad. And if we have such a broad rule that we're going to give so much disclosure to these fiduciaries, we're going to bury them. They're not going to have time. They're not going to have interest to look at it.

And so the boiler plate disclosure that we're going to have to put together to meet all of these broad provisions in here is going to overshadow the important disclosure that you're really trying to get at. And I think if you do shoot a bullet rather than a shotgun, get the important disclosures to those fiduciaries, I think it will improve their decision making.

PANEL MEMBER BUTIKOFER: All right. As far as the decision making, do you see it as actually impact fees charged, just making better choices of service providers?

MR. KEMPER: I think both. I really do. There's downward pressures on our fees, has been for quite a while in the recent past, I would say. And I think a lot of the transparency in the fees results in that. So I would see additional transparency probably putting pressures on the fees.

PANEL MEMBER BUTIKOFER: All right. Thank you.

MR. KEMPER: Sure.

PANEL MEMBER CAMPAGNA: Previous people who testified said that we shouldn't extend the rule to DB plans at all, defined benefit plans at all. I take it you're not there. You're just saying clarify the rule and get more relief in this transactional area?

MR. KEMPER: Absolutely. I think if you specify, and you think about, again,

c21020a4-0b71-40d1-bade-e3b09f4800dc

the types of plans, the DC, DB, the health and welfare. And when you try and make a rule, it's going to cross all of them I think you're going to have untended consequences because the way they operate is just so different. And you should really kind of have a different regime specified for each one so that you can avoid those unintended consequences on their own.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

That's it for me.

PANEL MEMBER CANARY: Okay. You talked about using the Form ADV as a safe harbor. Have you had an opportunity to compare the information that would be in the Form ADV and cross walk that to what's in the proposed rule to see where they're different? And if you have, would that be information you'd be able to share with this?

MR. KEMPER: I haven't sat down and ticked and tied each and every one of them. But generally I think my ADV covers all of the requirements of your rule.

The real reason I want it as a safe harbor is because I'm so afraid of the unknown. I don't know what I don't know, and I'm not going to be able to give those disclosures. And I know that there's something out there. I mean, it's whenever something goes wrong and you start really digging and peeling the layers back, you're amazed that all of a sudden you had no idea that my company owned a percentage interest in this or some other trust or something. Those kinds of things happen. You just have no idea.

And so I'm not going to be able to disclose those. And I know it says to the best of your knowledge, but when your company knows about it, you know, can I really say I didn't know about it? And I've Chinese walls between various entities, so maybe that would protect me. But what I'm worried about is what type of inquiry do I have to do to satisfy to the best of my knowledge.

So the safe harbor to me is really a protection against all the stuff I don't know about.

MS. BARR: And I'd like to, if you don't mind, add to that.

We have looked at the Form ADV as compared to the rule. And I think part of the answer to your question depends on how far you go with this rule.

For example, there are certain items that are not ascertainable at the beginning of a contract that investment managers would not be able to provide actual dollar amounts or even meaningful estimated formulas. And so if you were permitted to use the disclosures sufficient for an investor to judge the reasonableness of the compensation, for example, that would be consistent with what is required in Form ADV.

If you were in the final rule to go ahead and insist on making some more monetary or specific formula or estimate, that may not be in Form ADV, for example. But I think if you go where we're asking the regulation to go, which is to say if you can't ascertain the dollar amounts in any meaningful way in advance, if you give enough disclosures to that a reasonable fiduciary could determine the reasonableness of the compensation, that would be in sync with Form ADV.

In addition, the conflict of interest disclosure, as modified with the comment in our comment letter would be consistent with Form ADV.

PANEL MEMBER CANARY: Okay. Then one question with two parts. It's a soft dollar disclosure. You had mentioned on request, you give clients a soft dollar disclosure. This one part would be in this fear of the unknown or not being able to give an estimate, what do you think of the idea of in serving rather than an estimate, a representation that certain information is

c21020a4-0b71-40d1-bade-e3b09f4800dc

available on request, such that rather than trying to estimate it up front you would tell the client that if they want it, they would be able to get this information at, presumably a time when you'd have the information to be able to give it to them?

And then number two, can you talk a little bit about how you deal with proprietary versus non-proprietary soft dollars when you make these soft dollar disclosures available?

MR. KEMPER: Okay. Yes, the second one I'll take second. It's the harder one.

The on request I think is a great idea. You know, we can give a general disclosure to a client and, on average, you know we only do soft dollars on agency equity trades. And on average, about 10 to 12 percent of our agency equity trades are done soft, and that's a pretty solid number. I can tell them that. But what I can't tell them if

I have a global balanced assignment that they got they got a 60 percent allocation to equities and out of that 60 percent allocation to equities over time, you know, some of it's foreign, some of it's not U.S. and at turnover ratio I can't ever get there. So if I can just give them, generally I do about 10 to 12 percent soft and that if they want to know upon request what I have paid soft, I keep track of everything, I do a pro rata allocation to all of my clients who generate my soft commission credits and I can tell them in retrospect what we paid pretty closely.

So I think on request I think that would be a great solution.

Proprietary, there's no way you can assess a dollar figure to that. I've never figured it out. You're just going to have to be able to give a disclosure that this occurs and it's part of what you generally pay in your trading costs to service broker dealers.

PANEL MEMBER CANARY: So when you

make the disclosure report is that kind of general narrative is what you include about --

MR. KEMPER: Yes, that's all we can ever do. And it's only the third party soft we can actually track back to. Because you do the third party soft, you know how much you're paying Bloomberg, you know you're paying it soft, you can do your pro rata allocation to all your clients that generate those trades and come up with a percentage of that Bloomberg monthly fee or annual fee that that client contributed to pay.

PANEL MEMBER CANARY: All right. Thank you.

CHAIR CAMPBELL: Some of our commenters expressed some concerns about identifying themselves as fiduciaries either under ERISA or the '40 Act. Is that something you all have any concerns or thoughts about?

MR. KEMPER: Well, in the defined benefit context, you're almost always. I mean, you can always come up with an exception. But we definitely are fiduciaries. We're managing ERISA plan assets. We acknowledge we're a fiduciary. I mean, that's part of our sales, actually, is that we provide fiduciary services to you. That distinguishes us from a lot of other service providers.

If your question is relative to -- I'd heard discussions earlier, the manager of the mutual fund is not a fiduciary to the plan. I don't know if you were going there or not.

CHAIR CAMPBELL: Well, I was thinking more we heard from the bankers, they still had concerns about this in part because while they were often fiduciaries serving as trustee and so forth, there might be other services they provide that are non-fiduciary services. And they had concerns about distinctions between those and what they disclose in connection with services. I don't know if that applies to you as well.

MR. KEMPER: It does to my bank as a whole. To the part of the bank I work for, no. All we do is provide the fiduciary services. We don't provide any of the other type services. The rest of the bank would. We tend to have those businesses walled off for a lot of reasons. And so I would give disclosure on what I do. I would not ever deem to give the disclosure for what our investment bank or financial services groups do. I wouldn't know.

CHAIR CAMPBELL: Okay. Thank you.

PANEL MEMBER DWYER: I know you talked about the types of conflicts that might arise in connection with the investment adviser relationship with the plan. You talked about commissions and soft dollars. Give us a few more examples, if you can?

MR. KEMPER: Well, there's a lot. I mean, you can go down the list of prohibited transaction exemptions and kind of look at there is a good place to start.

I'll say when we buy an IPO or a new issue of bonds, I find that a lot of times my affiliated broker dealer is a member of the underwriting syndicate and so that's a conflict of interest. We'll buy from somebody else, but there's fixed compensation within the syndicate and so when I'm participating in there, so you're getting a benefit or not.

I know, I think seventy-five one is the exemption we use there.

Other conflicts of interest.

I think, you know in our industry almost everything is a conflict of interest because, you know, there are limited opportunities when you're managing money. And, you know, even if you had one client, you're going to have a conflict with what the investment manager wants to do with his own money, right?

PANEL MEMBER DWYER: Right.

MR. KEMPER: So you've got the personal trading is another big one.

PANEL MEMBER DWYER: Let me ask

you this: I mean, it looks like the Form ADV requires disclosure of compensation of the adviser's supervised persons under the SEC rules. Can you think if this may require some thought and even a supplemental submission to us, but can you think of situations where there would be a conflict of interest with the plan that does not involve a supervised person of the adviser?

MR. KEMPER: Yes, I'll have to think about that.

PANEL MEMBER DWYER: Yes, please do.

MR. KEMPER: Because off the top of my head of think of any. I mean relative to what we do, I can't think of anything. And, obviously, there might be something outside of what we're doing. But I think focus is I can only disclose the conflicts that arise by my activity, not maybe with somebody else, I don't know how it's doing.

MS. BARR: When you're asking

about a conflict that doesn't involve a supervised person, do you mean a conflict that is with a third party, involving a third party?

PANEL MEMBER DWYER: A third party, yes.

MS. BARR: Because I think there -- if for example you had a referral arrangement and you paid someone for a referral of business, is that what you're thinking of or --

PANEL MEMBER DWYER: Well, I'm not thinking of anything in particular. I'm just thinking that there may be a little bit of a disconnect between the term "supervised person," which is all the ADV is going to cover, and then there's a larger universe of parties out there with whom conflicts could exist. And I think that our reg, the proposed reg may actually be broader than what the ADV is requesting. And so that's what I wanted to know. What conflicts can you think of that would be outside the scope of the SEC's definition of supervised person.

MR. KEMPER: I think --

MS. BARR: Actually -- I'm sorry go ahead.

MR. KEMPER: Go ahead.

MS. BARR: The Form ADV actually does cover disclosure of conflicts of interest with what they call related --

PANEL MEMBER DWYER: Oh, I'm sorry. I meant to say compensation not necessary conflicts.

MS. BARR: Oh.

PANEL MEMBER DWYER: But, yes. But anyway, that's something to think about.

MR. KEMPER: Karen's example is a good one. I mean, we do have certain third party solicitors, they will go out and try and find clients for us. And to the extent they bring a client to us, we will pay them a referral fee out of our management fee, right? So they're a third party unrelated to us and there's clearly a conflict of interest for them to refer the client to us because we're paying them to do it, right.

Now, there's a rule that covers that that's disclosed in our ADV, and there's a rule that covers it and requires what the specific disclosures we have to give them.

PANEL MEMBER DWYER: And so that's covered under the conflict of interest provision of the ADV?

MR. KEMPER: Yes.

PANEL MEMBER DWYER: Not necessarily the compensation provision? I see. Okay.

And switching gears completely, I had a question on contracts. You had talked about when contracts come up for renewal that's when they should be required to comply with the regulation.

To what extent are evergreen contracts in play in the investment adviser world; contracts that just never come up for renewal?

MR. KEMPER: I would say in the majority of our management agreements are evergreen. We have certain ones that do. We have terms on them, but it's the minority rather than the majority.

Now in a renewal, often or it would be less the chance of triggering an amendment here for this than an amendment. Because the amendments do come up frequently, particularly amendments effecting the detailed investment guidelines attached. Those will be looked at at least annually and fairly frequently we'll do amendments on those.

PANEL MEMBER DWYER: So what thoughts do you have on how we can ensure that these evergreen contracts eventually become subject to the regulation?

MR. KEMPER: Well, you could maybe put a sunset provision in and say that if you renew or materially amend them but no longer than X number of years or something like that would be -- so we could at least, you know as we go through time we're going to catch a lot of them and then we know we've got time toward the end to catch the rest of them that are evergreen.

PANEL MEMBER DWYER: Thank you.

MR. KEMPER: Sure.

PANEL MEMBER Wielobob: I have a question. To clarify, the ADV -- your suggestion that it could be a safe harbor, is that also with respect to the conflicts of interest provisions?

MR. KEMPER: Sure.

PANEL MEMBER Wielobob: Okay.

MR. KEMPER: Conflicts of interest and compensation.

PANEL MEMBER Wielobob: Thank you.

MR. KEMPER: Sure.

CHAIR CAMPBELL: Great. Thank you very much. We appreciate it.

And our next witness will be the Managed Funds Association represented by Mr.

Allensworth and Ms. Cho.

MR. ALLENSWORTH: Good afternoon, My name is Benjamin Allensworth. I'm the senior legal counsel of Managed Funds Association. Managed Funds Association is the trade association for the alternative investment industry, particularly for the hedge fund industry. Our members represent over half of the alternative assets under management, and it's approximately $2 trillion in the total hedge fund assets, and our members manage a little over half of that.

With me is Erin Cho, who is counsel at the law firm of Davis Polk & Wardwell.

We appreciate the opportunity to testify today.

I wanted to say up front, MFA supports the Department's goal of ensuring that plan fiduciaries are provided adequate information to enable then to fulfill their fiduciary obligations under ERISA. However, we believe that several clarifications and modifications to the Department's proposed regulation would help focus that regulation more specifically on that goal.

Before I get into the substance of our comments, which will follow the comments in our written comment letter at the end of February. I think it's important to note a couple of points related to hedge funds and benefit plan investors.

Benefit plan investors in hedge funds and other private investment vehicles, such as hedge funds, are predominately large sophisticated defined benefit plans. They're not typically 401(k) or other defined contribution plans.

Also, the typical allocation to hedge funds and other alternative investments is somewhere between two and 10 percent of a plan's asset under management. So it's not a major portion, certainly not a majority of the assets.

c21020a4-0b71-40d1-bade-e3b09f4800dc

We believe these are important distinctions as you're considering the application and scope of the proposed regulation.

I'd also like to say that pension plans conduct extensive due diligence prior to investing in an alternative investment vehicle. According to one study the average diligence period is seven months with an additional three months for internal approval. And diligence periods of 18 months or longer are quite common. In fact, you could talk to some of our members who will tell you that they've been through diligence periods that have gone up to 15 years from the initial contact with the benefit plan.

To help assist the diligence process on an industry-wide basis, MFA has produced a model due diligence questionnaire which we attached to our comment letter. We are in the process of reaching out to pension groups and particularly to pension plans to get additional comments from those plans and also to encourage the use of our model due diligence questionnaire.

Moving on to the substantive comments on the proposed regulation, first I'd like to talk about the scope of the proposed regulation.

The first comment is that we as service providers to non-plan asset pooled investment vehicles, those would be pooled investment vehicles that do not have a class of equity securities owned 25 percent or more by benefit plan investors should not be deemed either parties in interest or fiduciaries to benefit plans, and therefore should not be deemed service providers to benefit plans under the proposed regulation.

MS. CHO: To put it succinctly there's an established legislative regime that private funds that choose to either stay below the 25 percent threshold and keep the number of pension plan investors low or choose to comply with the VCOC rules or REOC rules, they do so so they will not be subject to the ERISA regime.

MR. ALLENSWORTH: That's right. And actually we request that the Department clarify that service providers to pooled investment vehicle that do have a class of equity securities, 25 percent or more owned by benefit plan investors what we refer to as plan asset funds, that those service providers should be able to rely on other applicable exceptions to or exemptions from the prohibition of section 406 without necessarily needing to comply with proposed regulation 408(b)(2).

MS. CHO: Sure. I mean, just to give you an example to pick up on, someone mentioned 86-128 earlier today. Many times a QPAM, a plan asset fund, if they choose to use an affiliated broker dealer they will need to comply with the extensive, not onerous, conditions and requirements of 86-128.

MR. ALLENSWORTH: Okay. Thanks.

Next, we request that the Department clarify or modify as appropriate certain of the compensation disclosure requirements continued in the proposal and these would be with respect to service providers to plan asset funds.

First we request that the disclosure of compensation be permitted in any of the forms listed in the proposed regulation. There is some concern that the proposed regulation calls for a dollar amount followed by other types of disclosure. If a dollar amount is not available, we would request that any of those forms listed in the proposal regulation be an acceptable form of disclosure of compensation.

Next, there are two specific fact patterns that our members have identified that the proposed regulation would cause issues. The first one would be, and this was testimony that you heard previously as well, which is

c21020a4-0b71-40d1-bade-e3b09f4800dc

when a service provider such as an investment adviser to a plan asset fund does not have specific information available at the time the contract is entered into with a benefit plan, for example when using an affiliate broker dealer. We would request that general disclosure should be permissible at the time of the contract followed by subsequent disclosure of any compensation actually paid. The reason for that being that at the time the contract is entered into, the investment adviser likely will not know, be able to provide either a dollar amount or a particular formula with respect to broker dealer compensations. That will be determined after the fact in accordance with best execution obligations.

A second situation arises particularly in the context of funds of hedge funds. And that would be a situation when a service provider to a plan asset fund of funds does not have the ability to determine whether

or not to use an affiliate for services that would be with respect to underlying funds, so the fund of funds manager that's part of a large institution may very well have affiliated broker dealers providing services to underlying funds, but the service provider to the fund of funds has no ability to make that decision. And as a matter of fact, may not know whether or not the underlying fund is using the affiliated broker dealer. So in these situations we believe that more general disclosure about the potential for affiliated service provider to be used by underlying funds should be permissible.

Obviously, to the extent that any service provider to a plan asset fund of funds does have the ability to make that determination and does know about an affiliated service provider being used, then the compensation arrangement should be disclosed.

Next we have a couple of comments

related to the disclosure of gifts and other non-cash items.

First, we would request that disclosure of gifts or other non-cash items not be required if the non-cash item is given to the service provider because of an overall relationship and not in connection with the services being provided to the plan in this fact pattern. And there does not appear to be any conflict of interest that needs to be disclosed.

Secondly, we would ask that disclosure of gifts or the non-cash items in amounts less than the de minimis amounts in Form 5500 also not be required to be disclosed.

Last, we would request that non-cash items not be required to be required to disclosed in advance, as specific amounts will likely not be known, rather at the time of the contract a more general disclosure should be permitted with specific disclosure at a later

point in time. Later point in time on any non-cash items that have actually been received.

Last, our set of comments relate to the conflicts of interest disclosure. We agree with the principle that plan fiduciaries should be aware of service provider material conflict of interest. However, we believe the language in the proposed regulation is extremely broad and could be, if interpreted to require a service provider to know of every entity with which a plan has a relationship, difficult or impossible for the service provider to implement.

We believe that private investment vehicles should be required to disclose the material conflicts of interest and they already do in the offering documents as well as in the due diligence process with investors.

We believe that additional disclosure of conflicts of interest beyond material conflicts dilutes the value of the

information being disclosed and is actually harmful to investors rather than beneficial. As such, we would suggest a requirement that service providers disclose all material conflicts of interest of which they are aware. We believe this would adjust the Department's goal without diluting the value of that information.

Once again, we thank you for the opportunity to present today, and we're happy to answer any questions that you have.

CHAIR CAMPBELL: Okay. We'll start down here.

PANEL MEMBER WIELOBOB: No questions.

PANEL MEMBER ZARENKO: I'd like to follow up on the disclosure of compensation. I mean, as you noted, we included in the proposed regulation flexibility because we realize this is a prospective disclosure and there may not be hard dollars that are known up front.

I guess I start from the proposition that in an ideal world we would have dollars to disclose to a plan fiduciary up front because that's the easiest way for a plan fiduciary to comparison shop. You know dollars compare to dollars pretty easily. So when we put the flexibility into the reg, I guess my concern was getting too generalized, i.e., we said you can use formulas, you can use estimates; it seems like you're asking for an even more diluted manner of compensation disclosure. And, you know, I envision a contract saying we may receive additional forms of compensation from these other parties. But to a plan fiduciary how helpful is that really given that they are tasked when they are hiring a service provider with deciding whether they think the compensation to be received is going to be reasonable?

I think, you know, when we start moving away from dollars and then we start even moving away from estimates or formulas, it's getting really hard for a plan fiduciary to try to determine whether they think the compensation is going to be reasonable. Do you either of you have any thoughts on that?

MS. CHO: Well, I think that we will provide subsequent disclosure where I think it's often the case where the fund starts off and later on they're in negotiations with a prime broker. And I think once the fees are established with the prime broker, then the plan asset funds are willing to make a disclosure to the investors. It's just that initially they haven't hired all of their service providers.

PANEL MEMBER ZARENKO: But wouldn't they have experience based on past client relationships to be able to make some estimates?

MR. ALLENSWORTH: Well, I think with respect to a prime broker, part of it is going to depend on what kind of services you

c21020a4-0b71-40d1-bade-e3b09f4800dc

want. So as you're negotiating future agreements you may negotiate a very different agreement. You may want stock lending from one, you may want -- and it may be a different type of stock lending. So you may go to one prime broker who is great at doing stock lending on regularly available securities and there's going to be a price point there.

You may go to another prime broker who is great at locating difficult to locate securities. And it may be a very different price impact.

So an experience with one prime broker is not necessarily going to carry over to another one.

And then with respect to an ordinary brokerage, again as investment strategies change, as investments actually made change, the price points are going to change. And so a commission for a list of security is going to be very difficult than the charge if you're using a broker on an OTC security or if you're going to use a derivative. And those price points aren't going to be consistent from broker-to-broker and may not be consistent over time as an investment -- as a hedge fund or a fund of funds, underlying fund of funds is changing within its general investment strategies, is changing these specific type of investments that it's making.

So I think to the extent you try to estimate what all those costs are going to be going forward, that disclosure is likely to be misleading. Because it really is just a guess. And I think trying to put somebody in a situation of providing a guess that may be misleading is not particularly helpful.

I think it does benefit to a benefit plan investors or any other investor to say to the extent that we're using brokers, we may use affiliates. To the extent you're using affiliates, then you should say that you're using affiliates. If you've used affiliates in the past providing disclosure, for example, on what the past commissions or the past expenses have been would be helpful.

So for example our due diligence questionnaire, one of the questions there is when you're talking about the expenses that are going to get allocated to a fund, tell us what those expenses what have been for the last three years. We believe that type of disclosure is helpful because that will allow an investor to make a reasonable estimate of what expenses will be like going forward or at least allow them to question if future expenses fall drastically outside of that range.

PANEL MEMBER ZARENKO: Okay. Thank you.

PANEL MEMBER DWYER: I have no questions.

PANEL MEMBER CANARY: Some of this, and this is probably an oversimplification, seemed that the first premise was as a non-plan asset vehicle, that you should be treated, I guess, similar to what mutual funds were claiming, but not really because you're primarily in the defined benefit marketplace with potentially more sophisticated investors. So you wouldn't have the same kind of disclosure regime that would be applicable in the mutual fund marketplace? Is that about right?

MS. CHO: Well, I think there are two elements. One of course is sort of, I guess, obviously contrary to the history of the regime that has applied to private funds. They go through in the VCOC rules and REOC rules definitely can be onerous to funds. They go through these great lengths to avoid this type of regulation or to avoid being ERISA fiduciaries. So we don't even consider a manager of a non-plan asset vehicle to be an ERISA fiduciary. Neither does the benefit plan investor who invests consider -- there's no delegation of fiduciary authority between the plan investor and the manager of the fund.

So I think as a legal, that's sort of the legal premise.

And I think that Ben brought up some, I guess, sort of comment -- they are distinctions, obviously between the industry. I think revenue sharing, 12b-1 fees, it's just not applicable to this industry.

PANEL MEMBER CANARY: Okay.

MR. ALLENSWORTH: And I think the nature of the investors is important. I mean, the security law regime differentiates between mutual fund and hedge funds based on the sophistication of the investor. And I think that makes sense when you're talking about large institutions that have the ability to conduct extensive diligence and ask for the information that they feel is material to their investment, then it's less necessary to have a regulatory regime laid on top of that. And I think that's what you're talking about when you're talking about hedge funds.

PANEL MEMBER CANARY: Okay.

CHAIR CAMPBELL: Well if I can interrupt for just a second.

I mean, to what extent do you think that assumption is accurate that your investments are more in the DB realm rather than the DC?

MS. CHO: They are. They are.

MR. ALLENSWORTH: I can tell you that for at least for the institutional marketplace, so pensions, government plans, unions, endowment foundations of a billion dollars and up there's an SNP database which tracks investments. And out of I believe 1300 or 1400 institutions on there, there are about 65 with defined contribution assets. Most of those 65, the assets are going to real estate, not to hedge funds. It's a very small number of defined contribution plans that have investments in hedge funds. Out of the few that do, it's a very small percentage --

MS. CHO: I think they're doing it

online through a brokerage window --

MR. ALLENSWORTH: Right.

MS. CHO: Also or through a managed account that would mimic the strategy of a hedge fund. There are issues of offering a hedge fund as part of a 401(k) plan platform primary because of everyone has to be either a QP or an accredited investor, and there are discrimination issues about it, you know. Not all of the employees would be able to comply with those types of requirements. And also in terms of for funds that are trying to stay under 100 beneficial owners, well what about offering -- you know, offering it on your contribution platform doesn't really work because you would blow that exemption. So there are like lots of reasons why the hedge fund and private equity fund.

And then also private equity fund investment are illiquid investments. And for the 401(k) plan space when people need to get in out of the -- you know, it just doesn't work with having them tied up in illiquid.

MR. ALLENSWORTH: That's right. So there's a significant legal impediment to getting 401(k) money into hedge funds. Again, hedge funds basically fall under one of two kind of general legal exemptions. One is fewer than 100 investors. If the end participant gets to decide where the investments are going, you count that person, not the plan investor. So for a hedge fund that's relying on the fewer than 100 investors, a 401(k) plan would basically blow their exemption.

The other one exemption for 3(c)(7) funds is qualified purchasers, again, looking through to whoever the decision maker is, means you've got to have $5 million of investments if you're an individual.

So the limited plans that do have 401(k) or defined contribution, for example Goldman Sachs I believe for some of their senior people has a 401(k) plan that allows as one of the options investments in some Goldman Sachs' hedge funds. It's a very, very small universe of defined contribution money in hedge funds. The overwhelming majority is defined benefit.

CHAIR CAMPBELL: Okay. But you're saying so but it does happen, predominately it's happening through a managed fund itself or through an open brokerage window.

MS. CHO: Yes.

CHAIR CAMPBELL: Or through just an open brokerage window.

MR. ALLENSWORTH: That's right.

MS. CHO: Exactly. And then they're subject to whatever the rules are of that.

MR. ALLENSWORTH: Right.

CHAIR CAMPBELL: Okay. Thank you. Sorry to interrupt.

PANEL MEMBER CANARY: That's all right.

Then the other one was on the nonmonetary comp or gift disclosure. You distinguish not making disclosure where the gift or the non-monetary comp is based on overall relationship as opposed to any connection with service that was be provided to a plan.

MR. ALLENSWORTH: Yes.

PANEL MEMBER CANARY: Could you talk a little bit more about that, especially in the context of things that may be formula-lack. Whether you end with a formula is what governs whether you got this non-monetary comp or gift. And, I mean for example in the insurance area with our Schedule A advisory opinion we were reviewing what's the sense of compensation, it was not monetary but your right to it or eligibility for it or the amount of it may be based on business levels, thresholds, breakpoints. And that plans may be involved in establishing that threshold or breakpoint.

When you're talking about overall

relationship, how would you classify that kind of formula in being disclosed or not disclosed?

MS. CHO: I think we just sort of thought about it differently. That there has to be some causal relationship between the relationship between the plan and this, I guess the gift giver. I think someone brought up the example of someone attending a conference or a luncheon at -- I guess that's sponsored by maybe a plan sponsor or an affiliate. And we would hope that that type of arrangement where they got some type of benefit, whether non-monetary benefit wouldn't be captured in these regs.

MR. ALLENSWORTH: I mean, I think our overall goal with that comment was, to the extent that there is a conflict or potential conflict of interest, we recognize non-cash compensation can give rise to conflicts of interest that the regulation should focus on the possibility of there being a conflict between the services being provided to the plan asset fund and the non-cash compensation being received.

So if your example of the total business, and so there's the possibility of something being attributed back to the plan assets, that's sort of there, then that might be a situation where disclosure is appropriate. But really focusing on the conflicts of it and whether or not there's material conflict or a potential material conflict that should be disclosed.

PANEL MEMBER CANARY: All right. Thank you.

PANEL MEMBER CAMPAGNA: Focusing a little bit on the plan asset vehicles, where you are -- do you acknowledge that you would be fiduciary --

MS. CHO: Of course. Of course.

PANEL MEMBER CAMPAGNA: Of course if it's a plan asset vehicle. But I take it your position is that QPAM would cover you for

c21020a4-0b71-40d1-bade-e3b09f4800dc

transactions involving that fund?

MS. CHO: Well, of course the exemption that's used is QPAM. Of course, if the QPAM decides to use an affiliate, they will need to comply with other exemptions for services.

PANEL MEMBER CAMPAGNA: Right. But just the mere investment itself. The QPAM exemption, as I understand it, it's been a while, really deals with transactions that between the fund and related parties, you know buy and sell kind of transactions, it really doesn't deal with the investment in the actual fund. So would you still make the argument that fee disclosures associated with being a fiduciary would not apply in this context or should be covered under the QPAM? I'm just trying to understand where QPAM fits in the fee disclosures if you are, in fact, an acknowledged fiduciary.

MS. CHO: I thought you would ask this question.

I mean I think that, first of all, there's disclosure already to the plan investors as to what the exact fees will be and the expenses will be of the fund.

The QPAMs, you know, as ERISA plan fiduciaries have every incentive to lower fee costs and expenses because they go against net asset value of the fund and will affect the performance of the fund, the performance fees. I think that whether any -- I'm actually personally advising ERISA plan asset funds all the time, I sort of feel that the exemptions that exist sort of work together fairly well and beautifully, actually. And so I do believe that there already is this disclosure on expenses already naturally in OM and the prospectus. So I'm not quite sure as to -- and if they are using affiliates and there might be a conflict of interest, well then there is certainly other exemptions that the QPAM would have to comply with. So I'm not seeing a necessity for an additional layer of

c21020a4-0b71-40d1-bade-e3b09f4800dc

disclosure that's in the QPAM exemption or amendment of the QPAM exemption.

PANEL MEMBER CAMPAGNA: I'm just trying to understand what the investor gets with regard to your fees, if in fact it's a plan asset vehicle? How does that work? Is it just a subscription agreement, that kind of thing that they read and then figure out what's going on with respect to fees?

MS. CHO: No. I mean, the perspective which just goes with the management fees are usually one and a half to three percent from fund-to-fund. And then there's, of course, the performance fee.

The OM will disclose exactly what expenses will be picked up by the limited partners. And, of course, those expenses will have to be necessary, direct and reasonable expenses. Things such as, you know, research that may not exactly benefit the plan asset plan that cannot be charged to plan investors already. I mean entertainments or other gifts that the managers of the fund may get that have nothing to do with it, will not allow that to be charged to the plan investor.

So I think ERISA regime already provides protection as to the types of fees that can and can't be charged to plan investors. And our guidelines when we advise ERISA plan asset funds, the fees have to be necessary, direct and reasonable.

PANEL MEMBER CAMPAGNA: Yes.

Does your organization represent offshore funds as well?

MR. ALLENSWORTH: Yes.

PANEL MEMBER CAMPAGNA: Now what kind of regime would there be with respect to those offshore funds and disclosures of internal fees?

MR. ALLENSWORTH: The disclosure is going to be --

PANEL MEMBER CAMPAGNA: When you have plan asset vehicle?

MR. ALLENSWORTH: Right. And the

disclosure if it's an offshore fund that has a U.S. adviser, which is the typical case although there are actually a number of offshore funds with offshore advisers. But for an offshore fund with a U.S. based adviser, the disclosure is going to be the same. Because it's going to be governed by U.S. securities laws. It's going to be governed by the Advisers Act. And it's going to be governed by ERISA if it's a plan asset fund.

So offshore fund U.S. adviser, you're going to have exactly the same disclosure regime. If it's an offshore fund with an offshore adviser, then you're going to have issues. You know, actually the question is going to become whether or not they're subject to U.S. laws. But if they are, then the fact that it's offshore is not going to change the disclosure.

PANEL MEMBER CAMPAGNA: And what kind of disclosure is there with respect to the use of derivatives, for instance, and fees associated with that? I mean, it is a contract between two parties, yourself and a counterparty, for instance.

MS. CHO: Yes.

PANEL MEMBER CAMPAGNA: Would there be fees associated with that or do you net out something to disclose to potential investors in a plan asset type situation?

MR. ALLENSWORTH: There are fees associated with it. I mean you're paying some sort of fee to the counterparty in exchange for the exposure to the return that you're getting for the derivative contract. That's going to be part of the trading costs which fund will disclose in various ways, some of them may break it out individually. But what every investor is going to get, they know the management fee, they know the performance fees. Those are disclosed very clearly up front. The types of expenses that are going to be passed through to the front are disclosed up front. And then when you're getting performance results, you're getting net performance results. So you're seeing all the other admin expenses backed out of the numbers.

PANEL MEMBER CAMPAGNA: Okay.

MR. ALLENSWORTH: I mean, the market is very competitive. And between broker dealers the rates are fairly, I think, identical. I mean, from my experience. You don't see a great variance between different, I guess, financial institutions--

MR. ALLENSWORTH: For the same type of product.

MS. CHO: -- for the same type of product.

MR. ALLENSWORTH: Right. It's obvious between different products you get different fees. And then to the extent again, I mean I think part of the key is who are the investors are. To the extent a large institutional investor wants additional disclosure, they'll ask for it. And generally speaking if they ask for it, they will get it. And generally speaking if they ask for it, they will get it. So you have both the securities world telling you what you have to disclose as a matter of materiality and then you have the practical effect in the hedge fund world which is when you're dealing with large sophisticated investors, they ask for the information they want that's material to them and that's provided to them; or if it's not, they don't invest.

PANEL MEMBER CAMPAGNA: Okay. Thank you.

PANEL MEMBER BUTIKOFER: We've heard the testimony that it's going to be extremely costly to comply with the disclosures. And my question is is how much of the disclosure is going to require you to tailor the disclosure for each individual customer client versus, you know, kind of a cookie cutter approach, if you want to say that, of I can use the same disclosure for everybody?

MR. ALLENSWORTH: I think particularly in talking about the conflicts language, it's going to be impossible to tailor it or impossible to do a blanket disclosure. Because you're going to have to know what all the relationships are that the plan investor will have to see if their relationships or if you have relationships with anybody they have relationships with. So I think that's going to be on an investor-by-investor basis you're going to be looking at the relationships. And you're going to have to continue monitoring and updating to make sure that you’re capturing new relationships as they come in.

On the fee disclosure, again, as new brokers come on, as new service providers come on, then you're going to have an obligation to update that as well. Although I think that probably -- that's less of a cost compliance burden because that type of disclosure is going to be made after the fact anyway. And I think it's a matter of timing rather than whether or not the disclosure gets made. But I think the conflicts language, as broad as it is, is going to be necessarily tailored to each individual investors and constantly monitored and updated.

PANEL MEMBER BUTIKOFER: All right. Thank you.

CHAIR CAMPBELL: Thank you.

Next up is Ms. Mineka with Covington & Burling. And I hope I pronounced that correctly.

MS. MINEKA: It's actually Mineka.

CHAIR CAMPBELL: Mineka.

MS. MINEKA: But no one gets it right on the first try.

Well, good afternoon. My name is Katherine Mineka. I'm here from Covington & Burling, LLP. We greatly appreciate the opportunity to comment on the proposed amendment to the Department of Labor regulations and to speak with you today.

Covington & Burling represents both unregistered investment funds and their managers, as well as the employee benefit plans that invest in such funds.

Our comments today focus on the impact of the proposed regulation on service providers to unregistered investment funds, particularly those funds that are not deemed to be holding plan assets under the current Department of Labor guidance.

The central issue that I would like to discuss today is the application of the disclosure provisions to funds that are not deemed to be holding plan assets. This is an area that the Managed Funds Association has covered a bit. I think it bears additional discussion.

The fee disclosure regulation interprets section 408(b)(2) of ERISA which provides a statutory prohibited transaction exemption for reasonable service arrangements between plans and their service providers. And while looking at the regulation on its face, the fee disclosure requirement appears to apply only to a person or an entity that is providing services directly to a plan, it's our understanding that the Department is considering applying these regulations to service providers to a fund that is not actually holding plan assets.

As described in greater detail in our written comments, extending the fee disclosure requirement to non-plan asset funds would be contrary to the Department's long standing position with respect to these funds and potentially detrimental to plan's ability to diversity their investments through these funds.

The Plan Asset Look-Through Rule established by the Department makes clear that when an employee benefit plan acquires an equity interest in an operating company or in an entity in which equity participation by benefit plan investors is under 25 percent, the plan's assets do not include any of the underlying assets of the entity. As a result, the manager of the non-plan asset fund is not considered to provide investment management services to the plan and is not subject to ERISA's fiduciary duties provisions.

In addition, a transaction between a non-plan asset plan and a third party is not considered to be a transaction with a plan and, thus, is not subject to the prohibited transaction restrictions in ERISA and under the Internal Revenue Code. This "Look-Through Rule" properly recognizes that when an employee benefit plan purchases an equity interest in a non-plan asset fund, the plan is making an investment, more akin to purchasing a security rather than hiring the fund's manager as a service provider to provide investment management services. And this is a position taken by the Department that's been endorsed by Congress and expanded when Congress added section 3(42) to ERISA in the Pension Protection Act.

So when a plan makes an investment in a non-plan asset fund, the plan fiduciary is not entering into an arrangement to acquire services. And so the fiduciary does not really need to evaluate whether the compensation paid to the managers meets the requirements for the 408(b)(2) exemption any more than the fiduciary would need to evaluate the reasonableness of the compensation paid to the employee of an operating company if the plan were purchasing shares in an operating company on the stock market, for example. And so based on that analysis, if the entity isn't a service provider to the plan, it's unclear how it would be considered a party in interest such that the contract with the fund would be a potential prohibited transaction that would need relief under 408(b)(2) under another exemption.

Furthermore, with respect solely to the manager of that fund, it's difficult to see how we could apply the fee disclosure requirement to the manager without also classifying the manager as a fiduciary for the purposes of ERISA. If the manager of the non-plan asset fund is deemed to be providing a service, that service will be a form of investment advice or investment management which would meet the functional test under ERISA 3(21) to be an ERISA fiduciary. And then that sort of unravels as you then have to look to how was the manager appointed, is the manager acting as an investment manager, were they appointed under 3(38); sort of how all of those established fiduciary rules and the guidance thereunder that the Department has put out, how that will all fit together in that circumstance.

So in this case both the Department and Congress have recognized in the past that the Look-Through Rule is expressly designed to avoid treating the manager as an ERISA fiduciary, and we think that's the proper result in these situations.

On a practical level, employee benefit plans have relied on the Look-Through Rule to diversify their investment portfolios and to invest in sophisticated financial products. And managers of those portfolios have relied on the Look-Through Rule to ensure that they're not subject to additional regulation or fiduciary liability under ERISA if they accept plans as investors. This is especially true for non-U.S. funds that may be subject to regulation in their home countries and that generally try to avoid being subject to U.S. regulation, either under ERISA or under the securities laws through compliance with the relevant exemptions.

If the fee disclosure requirements were extended to non-plan asset funds, this would create an additional compliance burden and the potential for fiduciary liability, or even the potential for confusion regarding whether these managers would be treated as ERISA fiduciaries could cause fund managers to simply exclude employee benefit plans from their investment vehicles. And also if they did allow them to continue, there would be a significant compliance burden that would get passed along in the costs to the investors, including the plans.

So therefore, we think that extending fee disclosure to the non-plan asset funds is inconsistent with the sort of existing fiduciary framework and would not really advance any policy needs at this point. And with the consequences for plan investors, it would be quite negative. And it would limit their investment options and would generally could cause them to have to withdraw from investments that they're currently in at a loss.

So one thing we've mentioned in our comments is to the extent that the

Department feels that the need for further disclosure in this area is something that the Department would like to explore, this is an area where we think that a separate rulemaking and a separate notice and comment period would be appropriate, both because this issue has come up sort of in the discussions that have been ongoing since the proposed regulation was published and I think the plans and the fund managers have not necessary had an opportunity to really understand the Department's position and the Department's concerns and also therefore not been able to think through and give their feedback. And for all of us to come together and understand sort of what the issues are. And if further disclosure is something that the Department's interested in, what an appropriate way to implement would be without causing these other sort of significant issues.

And we think that separate rulemaking would be beneficial both because it

c21020a4-0b71-40d1-bade-e3b09f4800dc

would allow the Department to address the potential conflict that this would set up within the existing guidance under ERISA, but it would also really allow us to develop a more full record with all of the plans as investors and the fund managers. And, you know, sort of allow everyone to participate and be fully aware of this issue.

Now putting aside for a moment the possibility that a service provider or an investment manager to a non-plan asset fund could be required to comply with the disclosure requirements, assuming that that is not the case and these requirements would only be applied to plan asset funds, we think it's important that the final guidance address the possibility that a fund can change its status and initially begin its life as a non-plan asset fund and then either by design or due to a change in the status of one of its investors find itself sort of midstream subject to the disclosure requirements. As written, it's unclear how that fund manager and how those service providers, and how the fiduciaries making investment could comply. And so we think it would be helpful for the final regulation to specify that both those requirements would only be required at the time that that conversion occurs. But also that there's a mechanism and a time frame for actually providing the necessary disclosures that the plan fiduciaries need.

And another issue that we had raised in our comment, and I think it was discussed earlier today, is the ability of employee benefit plan investors to rely on the existing statutory cost and individual prohibited transaction exemptions, most particularly the QPAM and the INHAM exemption.

We request that the Department clarify that service arrangements established in compliance with the QPAM or the INHAM exemption are not required to also satisfy the requirements for relief under 408(b)(2).

Looking at it from a policy perspective, plan fiduciaries are required to avoid entering into prohibited transactions, in part because they represent situations in which there is a meaningful potential for self-dealing or for an undue influence on the plan or some way in which the counterparty can influence the plan's decision. And the statutory exemption 408(b)(2) handles this in one way, which is to say that the relationship and the contract will be deemed not to be a prohibited transaction if it meets certain requirements and if there's certain disclosures made and so that it's viewed as reasonable in that way. And the QPAM and in the INHAM exemptions address this potential for a conflict and for undue influence by saying if the plan has a sophisticated independent third party that is knowledgeable in these areas make that decision, that third party, that QPAM can get the necessary information and make an appropriate decision and cannot be unduly influenced. So we think that it's important to have both options and that they come from sort of different perspectives.

And finally with respect to QPAM and INHAM exemptions, they were obviously developed quite a while ago with careful consideration by the Department of Labor and with input from all of the relevant parties. And the Department has come to a determination that the exemptions are feasible and they're in the best interest of the plans and the plan participants, and that they are protective of the rights of the plan participants.

And, you know, until a determination is made that there is a potential problem with these exemptions or something that needs to be remedied, we think it's appropriate to leave them as they are and to allow plan fiduciaries to continue to rely on them.

A third issue that we would like

to discuss relates to the service providers to an investment fund that is in fact deemed to be holding plan assets. And here this relates to what I think was referred to earlier as the third category of service providers that are required to disclose only their indirect compensation under these rules.

And here the situation that we're concerned about is the situation where a fund is deemed to be holding plan assets, particularly because 25 percent or more of its equity is held by plans and benefit plan investors. And so under these circumstances service providers to the fund could be deemed to be service providers to the plan. And the fund is then paying these service providers out of the fund's assets.

So it's proportional to every investor in the fund. However, if reading the definition of indirect compensation, which is compensation from any source other than a plan, a plan sponsor or service provider, you

c21020a4-0b71-40d1-bade-e3b09f4800dc

have a situation where the plan is perhaps deemed to be receiving a service from this service provider, but part of the compensation that the service provider is receiving could be attributed to the other investors. Sort of everyone's paying their proportional share, but what we would just like to have made clear is that that is not the kind of indirect fee arrangement that the Department is concerned with. And that those arrangements would not be deemed to require a disclosure on the part of the service provider. Mainly because in these situations the service provider -- everyone who is investing in the plan is paying their proportional share of the service provider's fee. So to the extent that the plan is receiving services, they're also paying for them. It's just that it's sort of everyone's included as an investor in the plan.

And then finally, as a number of the comments have mentioned, we would like to request that the Department consider extending the transition period at least to one year from the publication of the final regulation. As has been noted before, there are a lot of complex relationships and contracts that need to be considered and evaluated and renegotiated. And especially in this area because many of the non-plan asset funds particularly take the form of a partnership or an LLC in order to -- sometimes the case that in order to modify their partnership documents or their other disclosure documents they would need to get the consent of all or a majority of the partners. And that's simply just a process that will take more than three months in most cases. So in general we would like to sort of join the group of commentators requesting additional transition relief in that area.

And that, in closing, I appreciate the opportunity comment on the proposed amendment and would be happy to discuss any questions that you might have.

CHAIR CAMPBELL: Great. Thank you.

Let's start down here.

PANEL MEMBER BUTIKOFER: All right. At the very end you mentioned the extension of the contracts because of the cost.

MS. MINEKA: Yes.

PANEL MEMBER BUTIKOFER: There's also been suggestions that instead of sticking the disclosure in contracts would just allow just disclosures. Are you aware of a big cost difference between doing one or the other, other than the cost of having to reopen and redo a contract? Would it make any difference?

MS. MINEKA: That's an interesting question. I think that part of the evaluation for all of the funds would be to determine where they're making these disclosures currently and whether those disclosures need to be updated in the documents they're currently in, whether they could be made selectively to plans, whether other regulations they're subject to might require them to disclose them to all of their investors.

I think that's an area that perhaps would require them to consider other legal considerations and other practical considerations. So I'm not sure I have an opinion on which way would be easier or would be feasible. I think that's one of the reasons I think more time is appropriate is because there are other regulatory regimes that govern disclosure that would need to be considered. And that require input from a lot of different parties.

PANEL MEMBER BUTIKOFER: Thank you.

PANEL MEMBER CAMPAGNA: Basically the same questions of the previous MFA who testified. What is your experience with respect to the 401(k) defined contribution market and non-plan asset vehicles. Do defined contribution plans, directed account plans actually use these non-plan asset vehicles?

MS. MINEKA: I would agree with the earlier comments that it's generally these non-plan asset vehicles, the vast majority are receiving investments from defined benefit plans. And particularly because there are significant securities law regulations that limit -- these funds are generally structured in such a way that they cannot accept either more than 100 investors or cannot accept investments from individuals or entities which do not meet certain levels of sophistication. So although there is some SEC guidance that would permit it to offer one of those funds, even in part to 401(k) participants, is quite difficult and I think is quite uncommon.

PANEL MEMBER CAMPAGNA: And now with respect to plan asset vehicles, you advocate that QPAMs should apply. And again when a QPAM -- I guess you would acknowledge that there would be a fiduciary in that case, right?

MS. MINEKA: When there's a plan asset vehicle, to the extent that the investment manager is also acting as a QPAM, yes, that investment manager by virtue of their status as an investment manager would be a fiduciary.

PANEL MEMBER CAMPAGNA: So when that manager uses other service providers to service the fund, what would be your take on their service provider status with respect to that plan asset fund?

MS. MINEKA: The service providers to the plan?

PANEL MEMBER CAMPAGNA: To the plan asset fund.

MS. MINEKA: Oh, I'm sorry. To the fund?

PANEL MEMBER CAMPAGNA: Yes.

MS. MINEKA: I think in some situations those relationships could be covered by the investment manager and keep him entering into it using the QPAM exemption. I think that obviously that would not apply to relationships with the QPAM itself or its affiliates. Just because those relationships generally are not covered by the QPAM exemption.

PANEL MEMBER CAMPAGNA: Right.

MS. MINEKA: So I think those relationships would need to rely on the exemptions that they have traditionally relied on. And to the extent that they have traditionally relied on the 408(b)(2) relief, they would be subject to any changes in that relief.

PANEL MEMBER CAMPAGNA: So say the investment manager uses a broker to transact business for the plan asset vehicle, they would have to rely on one of the class exemptions, say 86-128 as was mentioned?

MS. MINEKA: Right.

PANEL MEMBER CAMPAGNA: And your belief is that there is sufficient disclosure there regarding conflicts and indirect compensation received by the particular service provider or broker? I mean, that's what we're getting at with this regulation.

MS. MINEKA: Right.

PANEL MEMBER CAMPAGNA: Indirect compensation and conflicts. So when you go to a 86-128 you get commissions and you get a written authorization. You know, how would we square those two things?

MS. MINEKA: Well, I think with any of the existing exemptions, sort of as I discussed earlier, the exemptions offer different ways of addressing sort of the fundamental policy concerns that the prohibited transaction rules under 406 are getting at. And so I think prior to requiring additional disclosure under any of the other exemptions, I think it would make sense for the Department to reevaluate the exemption as a whole and to determine if the rationale still applies, if it's still operating as it was intended. I mean, many of these exemptions date to the '80s and early '90s and seem to have been functioning very well up until this point.

And so I think there it's a situation where if the Department identifies an issue with one of those exemptions, that should be addressed within the context of that exemption rather than sort of requiring the relationship and the contract to go through two different exemptions.

PANEL MEMBER CAMPAGNA: Okay. All right. Thank you.

PANEL MEMBER CANARY: I only have one question and I guess I should have asked the last representative this, too.

So do you think that when you shift from a non-asset vehicle to a plan asset vehicle that you still end up with the same basic investor population? You're still dealing with the institution DB plans or do you think the nature of the investing population changes beyond maybe just more employee benefit plans?

MS. MINEKA: I would say in that context you would not see a change in the plan investor population. Because at least, and this is just speaking broadly, to the extent that we're looking at a situation where it's a partnership or some other vehicle that's comply with security law exemptions, once again a large part of the restriction comes out of the '40 Act restrictions which are not going to change based on the percent of benefit plan investors that are interested.

PANEL MEMBER CANARY: To remain an unregistered investment fund would also have to require with those requirements.

MS. MINEKA: Right.

PANEL MEMBER CANARY: Regardless whether they're a plan asset vehicle?

MS. MINEKA: Exactly.

PANEL MEMBER CANARY: Okay. Thank you.

CHAIR CAMPBELL: Adrienne?

PANEL MEMBER DWYER: How does the plan typically invest in these non-plan asset vehicles? Do they just go to the fund themselves? Who do they go through? What are the scenarios?

MS. MINEKA: I think there are a variety of ways. Once again, these investments are generally entered into by large plans, sophisticated plans. And so there they may have a sophisticated staff in-house that is looking into these investments. They may have outside consultants that they work with or advisors. So I don't think there's any one way there. But I think it's generally -- and there are limits and this is a bit outside my area of expertise, but there are limits under securities law on how things can be marketed. And my understanding is most of these funds are sort of marketed within this limit. So it's generally you have sophisticated parties either in-house at the plan or that are hired by the plan that are investigating these investment opportunities.

PANEL MEMBER DWYER: Would one of these plans be offered, for instance, on a record keeper's platform, you know with IBM stock and everything else?

MS. MINEKA: Do you mean in a 401(k) context or in a -- I guess -- because generally --

PANEL MEMBER DWYER: I guess the plan goes to a record keeper and the record keeper says this is the platform we're offering. I guess that would be a 401(k) context.

MS. MINEKA: Right. In general, as I said, I think there are opportunities to offer these funds in a 401(k) context are extremely limited. So I think that's not something I've personally seen, but that may in fact in certain limited circumstances occur. I think generally that's not been my experience.

PANEL MEMBER DWYER: And who are the investment personnel who get paid in connection with the plan's investment? So I'm not worried about FedEx and those type of service providers. But who are the investment people who are making money on these investments?

MS. MINEKA: In the context of a plan asset fund or a non-plan asset fund?

PANEL MEMBER DWYER: In a non-plan asset fund, even though the plan's investing in it?

MS. MINEKA: In a non-plan asset fund obviously there are different structures, but there usually is a -- you know, in a partnership there would be a general partner. That entity may or may not be the manager. There's usually some entity that is acting as the manager. There is always some entity that

c21020a4-0b71-40d1-bade-e3b09f4800dc

is acting as the manager that is making investment decisions. And so there is -- that is sort of the entity that receives the management fee would potentially receive the performance fee as well. And then, you know, obviously there are other service providers to the fund that provide brokerage or other services.

So I think looking at the investment management level, at least there's usually one entity that's receiving the fee there. And that may or may not be a registered investment advisor.

PANEL MEMBER DWYER: Okay. Thank you.

PANEL MEMBER ZARENKO: I just have one more follow up question on this issue of changing from a non-plan asset fund to a plan asset fund. And I just want to understand what the different reasons of that would be. Is it often the case that that happens inadvertently because it's hard to keep track of these percentages on a day-to-day basis? Is it intentional on the part of the fund's managers and advisors to decide that they just want to take more assets from benefit plans? Is it demand driven because more plans are coming to you? How does that shake out?

MS. MINEKA: I think generally we would be looking at the second situation, which is it's a decision on the part of the fund manager that with that particular vehicle that previously they had limited benefit plan investors. There's the decision that they would like to increase that number or there is a particular investor they're interested in bringing into the fund. But I think perhaps even more importantly for the guidance, it's very rare but there is a possibility for the fund manager that they will be given information by one of their investors that is incorrect as to the benefit plan investor status of one of their underlying investors. One of their investors that's maybe itself a fund might decide to convert to a plan asset plan and spring that change on them.

So I think it's important whether it's addressing both the situation where the fund might intentionally wish to make this change, but even more when the fund manager has done all of its diligence and has made its best efforts to limit benefit investors or to comply with another exemption to operate as a VCOC. Maybe something happens with one of the investments that that no longer complies. You know, that that manager and that fund, there needs to be -- and the other service providers to that fund, there needs to be a mechanism whereby they can comply with this exemption and meet their obligations if there is a change or if there is expected to be a change midstream.

PANEL MEMBER ZARENKO: Okay. So any other fact patterns where that shift occurs that you think we should know about?

MS. MINEKA: I think those are the

c21020a4-0b71-40d1-bade-e3b09f4800dc

major ones. And I once again think that the inadvertent changes is very rare, but I think it would represent a significant enough -- it represents a significant enough concern that it is certainly addressed generally in fund documents and there are restrictions on transfer and things like that to avoid that. So it's certainly something that fund managers I think are aware of and recognize as an unlikely possibility, but still a possibility.

PANEL MEMBER ZARENKO: Thank you.

PANEL MEMBER WIELOBOB: I don't have any questions.

MS. MINEKA: Okay.

CHAIR CAMPBELL: Thank you very much.

MS. MINEKA: Thank you very much.

CHAIR CAMPBELL: Our next witness is David Certner from AARP.

MR. CERTNER: AARP is the preferred.

CHAIR CAMPBELL: All right. AARP

it shall be.

Thank the members of the Panel. I'm David Certner, the Legislative Counsel and Director of Legislative Policy at AARP.

Thank you for convening this hearing. We appreciate the opportunity to discuss these important issues under the proposed reg. And we also appreciate what must be a long two days for you up there on the Panel.

Let me review some points we made in our previous comments, which is that we believe that all workers need access to a retirement in addition to Social Security. As you know, there are approximately 15 million active participants in 401(k) plans which are now the dominant pension vehicle.

As you also well know, and certainly the recent months have born that out even more, given the calls we've gotten from many of our members, those participating in these plans shoulder the risks and responsibilities for their investment choices and ultimately their retirement security. As you also well know, plan fees compound significantly over time, the larger the fees, the bigger the reduction out of one's ultimate retirement security. And what we have found is certainly that our members that we've surveyed, the participants expect that their first line of defense against unreasonable fees is the due diligence that the plan fiduciaries will take in choosing the plan investment options.

You may have seen that we did a survey last year. We surveyed 401(k) participants to get either understanding of fees and investment choices, which needless to say were not high, but the survey results also demonstrated that participants looked to the plan administrators and the plan service providers to provide the plan investment and fee disclosures. And when asked who should be responsible for ensuring that participants have a clear understanding of the fees charged, 61 percent of respondents said employers, while 52 percent replied financial service companies that manage 401(k). Less than half put that responsibility on the plan participants. Thus, it's clear that the participants are relying on plan fiduciaries, both to ensure that plan fees are reasonable and to provide them with the plan fee information.

Now in order for the fiduciaries to meet these expectations, plans need to receive complete and accurate information in one document in order to compare different investment options. This is particularly true of the smaller employers who again, as you know, do not have the same cadre of consultants and attorneys who can help assist in the review and determination.

To the extent that fees impact other plans like health and welfare plans, particularly those for example which may be consumer driven health plans, then fees and expense disclosure would also be necessary and appropriate.

The comprehensive information on plan fees and expenses will enable the fiduciaries to fulfill their responsibility to ensure the reasonableness of fees. Fiduciaries performing the due diligence of service providers and investment options need to have access to cost associated with the various components, not just total costs. And, again, we would emphasize that requiring the service providers to provide comprehensive information to the plan sponsors is very important to the participants since, as you know, the costs are often directly passed on to them.

Now we believe the Department's proposed rules are a good start to ensure that plan fiduciaries receive key information from service providers to enable them to prudently select and monitor their service providers.

We support the regulations general disclosure requirements that all information be disclosed in advance and in writing. There's a full description of all services to be provided to the plan under the contract and that a description of all direct and indirect compensation and the manner in which it was received is provided to fiduciaries.

We believe that fiduciaries should already be examining this type of information, quite frankly.

We recommend explicitly that a statement that compliance with this exemption does not mean they're generally compliance with fiduciary duties. And we would recommend that the final regs explicitly state that compliance with the final disclosure regs does not necessarily mean that the fiduciary has complied with his general fiduciary obligations. Plan fiduciaries, obviously, have the obligation to read and evaluate and make prudent decisions in light of the disclosure they have received. And, of course, fiduciaries must have adequate time to evaluate the information they have provided. And, indeed, we think plan fiduciaries have the obligation to request additional disclosure information if it would be prudent to do so.

The second issue is disclosure of fees for bundled services. We recommend that services be unbundled, but we certainly find with unbundling there are certain broad categories.

We recommended four categories; initiation fees, investment fees, plan administration fees, determination fees. And that the fees for those general categories be disclosed.

We also support a bright line requirement that all indirect compensation including revenue sharing be disclosed to plan fiduciaries.

Now as to the manner of

disclosure. We recommend that the manner of disclosure to plan fiduciaries, and we think a good model for this and being consistent with what the Department of Labor speed disclosure document on your website is. That the fee information should be given to the plan fiduciary in one document in a consistent manner so that the fiduciaries actually can perform an apples-to-apples comparison of the providers and more easily evaluate the reasonableness of fees.

We also would recommend that the fees be set forth as a percentage of assets to allow for a greater ease comparison, regardless of whether they're actually charged in this manner. And, obviously, this is even critical for a smaller employer.

We would say if you're committed to letting service providers provide fee information by incorporation and by reference, then at a minimum the service provider should be required to inform the fiduciary exactly where the information is located, we mean the document and the page number. But still having people go these stacks of documents to find this information is clearly not as useful as it would be to provide this information in one useful document that can compare with other documents.

We also think you should be more explicit about the frequency of review of fees and disclosures. The regulation should explicitly state that the service provider's obligation to provide information concerning fees and a fiduciary's obligation to request information concerning fees doesn't end after the service provider contract is executed. We suggest that either in the reg or in guidance that the Department specifically state that the monitoring of these service provider contracts should occur at a minimum on an annual basis.

I would just conclude by saying that the significant impact of fees on retirement security highlights the need for clear investment and fee information. The greater the disclosure that's required, the better the plan fiduciaries can perform their due diligence and monitor the service providers, the more likely the fees will decrease and ultimately this will lead to greater retirement security for participants.

And I know it's been a long day, but I'll be happy to answer any questions you might have.

CHAIR CAMPBELL: Well, I was wondering if you could start out by explaining in a little bit more details your concern that caused you to recommend that we have explicit requirement in the regulation regarding fiduciary duty beyond the particular disclosure here?

MR. CERTNER: That just because you meet this exemption --

CHAIR CAMPBELL: Right.

MR. CERTNER: -- doesn't mean

maybe your fiduciary obligation is ending. You may need to do more. So if what you've gotten, for example if the information you've gotten had led a prudent person to believe they need to request or get additional information, they still have a general fiduciary obligation to do that as well.

CHAIR CAMPBELL: But that needs to be expressly stated?

MR. CERTNER: I think it would be useful. I mean, it may implicit and understood to you, but I think it's useful to be clear about that in the guidance you put forward.

CHAIR CAMPBELL: Okay. And also you had mentioned the one document containing sort of all the disclosures. We heard a lot of testimony over the last two days about whether it needs to be whatever is currently there, whether there's a summary document or some sort. By one document do you mean literally one place where all the information is complied or simply a document that shows in sort of one executive summary where other information might be by reference?

MR. CERTNER: Well, that would be a less desirable fallback. I think we should have the one document that the fiduciaries can actually look at and compare so they can easily compare apples-to-apples from different kinds of plans, it's all in one document. If you have, well you can go to this document and you find it here and this document you find it here; that would require a lot more work and it would have to be a lot more specific about where you could find that information. And clearly it will not be as helpful if we could have all that information together in one document where you could basically see that readily and easily as opposed to having to go track it down in what may be a multitude of documents and prospectuses that might be in front of the plan.

CHAIR CAMPBELL: Okay. Let's start down here.

PANEL MEMBER BUTIKOFER: So we've heard testimony that this is possibly very expensive to get all these disclosures out. So merely getting the disclosure out doesn't necessarily translate into a benefit either. So the question that arises is if the fiduciary is able to obtain all this information, in whatever form, you've mentioned and we've heard testimony previously that this additional fee transparency has a possibility of lowering fees. But can you think of other benefits that we can obtain by this costly disclosure?

MR. CERTNER: Well, I think the comparison is really if you look at what large companies are able to do versus smaller companies. Large companies are all ready to get much of this data, obviously, and more leverage, they can make better decisions and have better fee arrangements for their employees. Now hopefully just the fact that we have transparency and sunshine and transparency in general we think in many areas has led to reduced fees. I think ultimately for the plan participant, and certainly from our perspective, that's what we're looking at. What is the direct impact on plan participant? I think we've seen cases where arrangements and conflict of interests are too high.

What may seem like small adjustments in fees, as you well know, can compound pretty significantly for individuals over time. We're talking -- well, if you take even just 50 basis points can have absolutely dramatic, you know 15-20 percent impact on your ultimate retirement security. That's a lot of money we're talking about.

So, yes, I agree there may be some additional costs to this, but the providers generally will have this information available, they're providing it to some customers already in most situation, even where you have bundled providers are generally able to provide some of that information in an unbundled way to some of the bigger clients. And so having this information and to extract it and provide it I don't think is necessarily going to be as costly.

And I think that savings on the other end for participants can be pretty dramatic.

PANEL MEMBER BUTIKOFER: I haven't heard any discussion on this topic, but you seem to allude to that the large plans already have the information and the small plans may not. Is possibly another benefit to the regulation is that I think it levels the playing field between these two plans. We've often heard that small employers are at a disadvantage in trying to find and hire employees, or whatnot, because it's harder to get benefits. Is that something you see as a possibility?

MR. CERTNER: Well, I'm not sure that it will complete level the playing field because they'll never the total leverage and the size we're talking about. But in terms of at least being able to get the information, I think it will definitely level the playing field and be more advantageous, particularly to smaller employers and those you may have working for them who very often find it much more difficult to get access to this information.

I mean I think it's actually fair to say from what I've been hearing that just this whole discussion and airing of this issue, both on the Hill and at the Department in the last year, has enabled people to get access to that information much more readily and has helped drive down fees. And we've heard a number of instances where providers were almost voluntarily offering to come in for lower fees, given all this sort of open airiness on this whole fee issue.

So I think we've already seen benefits, quite frankly, from some of this transparency.

PANEL MEMBER BUTIKOFER: All right. Thank you.

PANEL MEMBER CANARY: Thank you.

I'm trying to get the scope of what you're talking about here. It seems like you're talking really about defined contribution pension plans and again maybe individually participant directed plans primarily in the population that you're really focused on with your comments. Is that fair?

MR. CERTNER: Well, I think that's probably from most people's perspective where the focus has been, where the individual is going to be directly impacted by these fee arrangements, which is primarily in the individual contribution area, 401(k) area in particular. But there's certainly other areas where I think it could have direct individual impact.

For example, I mentioned potentially as part of health plans where you have, say, consumer driven plans and there are assets involved.

There could be, for example, in design benefit plans where you have for example certain cash balance arrangements now in define benefit plans, you have individual account plans that actually may have some kind of an individual fee component involved and depending on what kind of assets you're in. So it may extend beyond the typical 401(k) defined contribution. I think that's where the focused and the most heightened degree of sensitivity has been, but I don't think that that's exactly where it should exclusively fall.

It may be that you need to do other things in these areas as well. And then that this is the first and most important area to tackle now. But I don't think exclusively in the defined contribution area.

PANEL MEMBER CANARY: Then the comment like having one document, there's another prong of this initiative, which is really participant level disclosure. And I'd like to get your thoughts on I guess two aspects of that single document approach. Is the feasibility of doing that if you're in some of these other environments where you're not in the individual participant directed defined contribution plan, do you think it's more feasible to do that when you're in that kind of a marketplace?

And number two, is some of this really better served by getting that kind of disclosure to the participant rather than trying to get a single document approach when you're dealing with getting information to the fiduciary?

Sort of two not really related questions.

MR. CERTNER: Well, let me take the second part, which may be easier to answer.

You know, disclosure to

participants is going to be important. But I think our experience is going to be that there are not going to be a lot of participants who going to be able to understand and/or take action on a tremendous amount of disclosure. That disclosure to participants, at least what you provide them, is probably going to have to be a little bit more basic in terms of what they need to look at. With them, providing them the ability, you go somewhere else for those who want more information. I just don't think we're going to be able to throw tons of information at participants and expect them to even be able to understand and analyze it. So we're probably going to have openly think about a more summary, even more different kind of summary than we're talking about for the provider, where we're hoping is certainly a higher level of degree of being able to review these fees at that kind of first line of defense.

What we give to the individual is,

c21020a4-0b71-40d1-bade-e3b09f4800dc

by definition, I think going to have be scaled back. And their ability to elsewhere to get more of that information.

So it's a little bit of a different kind of summary document that we would have I think provide to individuals.

And as much some individuals may be able to really dig down and go into this, and look at this and understand this, I think our experience has been that the bulk of individuals are on automatic pilot in many respects. And for some of these plans, and that may even be increasing with the number of automatic enrollments and other things we're doing. And I think that makes it even more difficult to give disclosure. Because we're seeing that the individuals are, many if not most individuals are not doing what maybe some of us would think would adequate due diligence from any individual perspective. But I don't know how much we're going to change the behavior at that level for most people. And so why it's so important that we're doing at the employer level and the fiduciary level.

PANEL MEMBER CANARY: Fine. Thank you.

CHAIR CAMPBELL: I don't have any further questions.

PANEL MEMBER DWYER: No questions.

PANEL MEMBER ZARENKO: I'd like to follow up on your concerns about the continuing application of 404. I don't think that's anything -- I mean, we clarified in our preamble that a fiduciary is obviously still subject to its general fiduciary obligations under 404. Did not in the proposal have anything in the regulation to that effect. But I just want to understand I had always sort of been thinking about the 404 issue as making sure that plan fiduciary understood that just you get all of the disclosures required by the regulation does not mean it's necessarily prudent to hire that service provider. Prudence may still require that you get other offers. You still have to determine whether the compensation is going to be reasonable. There's more to it.

But now I'm wondering is your concern that you think fiduciaries may have to get more information from that particular service provider than is required by the rule?

MR. CERTNER: Well, only if the -- well, let's put it this way. Let's give you an example. But if the information you're getting from that service provider for whatever reason, if a prudent person in that situation has seen the information you're getting, sees something that would suggest that they ought to get information, that there might be a fiduciary obligation to look into some kind conflict of interest or something that looks out of the ordinary in the disclosure they may have gotten. So it wouldn't necessarily end with the disclosure they got. But if something in there gave rise to the notion well maybe I should ask another question, that any other prudent person here would follow up on something I've seen in this disclosure, there would be a general obligation to do that.

PANEL MEMBER ZARENKO: Okay. So it is sort of that latter issue that you're talking about?

MR. CERTNER: Right.

PANEL MEMBER ZARENKO: That what's required by our disclosure -- our disclosure requirements may not be enough in a particular case --

MR. CERTNER: Right.

PANEL MEMBER ZARENKO: -- with respect to a particular service provider, and that's what you think needs to be clarified?

MR. CERTNER: Right.

PANEL MEMBER ZARENKO: Okay. And then termination fees, I think we've had other commenters just ask, but they don't think it's clear in our rule whether termination fees have to be disclosed. Is your concern are they not currently disclosed or are you just asking that we need to clarify this in our final rule that those fees in fact do in fact have to be disclosed?

MR. CERTNER: Yes. Yes. That they should be disclosed.

PANEL MEMBER ZARENKO: Okay. So you're not aware of issues currently that those kinds of fees are not being disclosed?

MR. CERTNER: Not -- no, not specifically.

PANEL MEMBER ZARENKO: Okay.

MR. CERTNER: We want to make sure those would be included, though, in the fees. Certainly.

PANEL MEMBER ZARENKO: Okay. Thank you.

PANEL MEMBER WIELOBOB: I have a quick -- I hope it's a quick scope question. Sort of the follow up on what Joe was asking you.

I'm more interested in the welfare

plan side of this. And I have to admit, I hadn't really, the interests of your members hadn't really crystallized in my thoughts in that regard, although I know that many of your members are not retired persons. They're just a certain age.

MR. CERTNER: Forty-five percent of them.

PANEL MEMBER WIELOBOB: Forty-five percent?

MR. CERTNER: Are still working.

PANEL MEMBER Wielobob: Interesting.

So against that backdrop could you just comment briefly on the breadth of your membership's interests in the welfare plan side of the disclosures?

MR. CERTNER: Yes. We've actually been discussing this. And I would be the first one to confess that our focus has been like others really not on the health and welfare side of things, but can see how these

c21020a4-0b71-40d1-bade-e3b09f4800dc

issues could be just as important on the health and welfare side as well.

I'm not sure this set of rules you have here is necessarily going to be exactly applicable to the health and welfare side. And it may be that you need to do something additionally or secondary on that issue. Because I am not sure that we have thought through all those issues yet, exactly what the implications would be. But I think there are certainly some areas such as the one point out where there could actually be that direct impact on the participant as opposed to issues that maybe the plan sponsor themselves is just directly dealing with where this kind of fee disclosure would have a direct impact on people and should be disclosed as well.

So we have not thought through all those ramifications, I will tell you quite honestly. And our thinking is that there is probably going to be a need to maybe break it off and think some of those things through separately.

PANEL MEMBER ZARENKO: Thank you.

CHAIR CAMPBELL: All right. Thank you very much.

And with that we come to Mr. Kevin Wiggins of Jackson Kelly.

MR. WIGGINS: Good afternoon. My name is Kevin Wiggins. I'm an attorney with the law firm of Jackson Kelly. Jackson Kelly is based in West Virginia. It has offices in Colorado, Kentucky and here in the lovely city of Washington, D.C.

Jackson Kelly provides two types of services to employee benefit plans. It's a law firm and it provides legal services in connection with ERISA. And it also acts as a record keeper, a third party administrator if you will, for many plans.

And before I continue, I think I need to say that what I say here is my own informal opinions and does not reflect the official opinion of Jackson Kelly or its members, much like you all say when you go to your seminars at the Department of Labor.

I'm here today to discuss primarily the distinctions between legal services and consulting services. And I missed Mr. Saxon's, I believe it was, testimony. But I believe he discussed that.

Our firm provides both consultant services and legal services to our employee benefit plan clients. And for the most part it's going to be easy for us to distinguish between a consulting client that is part of our TPA practice and our other clients who are not part of TPA practice but come to us for legal advice. The distinction I think can be important, though, because as you know either you're in or you're out on these regulations. And if you're providing legal services and don't get any indirect compensation, you're out. That's the way I read the regulations.

I think it would be -- I would like to recommend that the Department in its final regulations somehow recognize that when it talks about legal services, first I would like for it to -- if it believes prudent to do so, to focus on the practice of law. Because the practice of law is more a term of art that is more understood, I think, than legal services. So maybe it could be legal services in connection with the practice of law.

And then also look at the focus of the services being provided. Are the legal services incidental to the services being provided or are they primary focus? And there's precedent for this in the case law looking at what is the practice of law. I think that might be helpful.

And that's all I have to say. It's late in the day, and I know you've a hard two days.

CHAIR CAMPBELL: You know, we had a discussion with Mr. Saxon and Ms. Mazo, looking at the different categories, the three categories established in the regulation governing its applicability. And so legal services with respect to the practice of law or otherwise would fall under the third category. But I guess some of the other services would likely be in the second.

And I'm wondering if you had any thoughts in the discussion we had there that dealt with is the second category superfluous in that the third category might capture anyone who had an indirect relationship? Is there some uniqueness to the second category that's not captured by the third?

MR. WIGGINS: Let me clarify what I think you're asking. Are you asking about consulting services and legal services, or all of the categories in the second category?

CHAIR CAMPBELL: Well, either one. I mean, the original context of the question in the previous testimony came up with respect to non-asset advising consulting services.

MR. WIGGINS: Yes.

CHAIR CAMPBELL: And then we went

into a discussion of generally if the second category were eliminated, do you lose anything with respect to the intent of the regulation given that the third category would capture anyone with indirect comp if it were not limited to certain types of services.

MR. WIGGINS: So are you asking if you include the second category and the third category, all the services in the second category and third category and required disclosure only if they get indirect compensation? Is that what you're asking?

CHAIR CAMPBELL: Right.

MR. WIGGINS: Yes. I have not thought about that. I don't know the answer to that without further reflection on it. But it seems to me that the two categories are certainly different. They're not superfluous. And it gets into how do you define these terms, which is one of our questions.

But for example, how is accounting in the third category different from record keeping? In many ways accounting is just keeping the books of the entity.

I'm not sure what the answer to that. But I think most practitioners would say that there is a difference. Most in the field would say record keeping is maintaining records, particularly I'm talking about the individual account balance plans. Record keeping is maintaining the account balances for participants on a participant level. I mean, you may have record keepers who -- usually trustees, who keep records of the entire plan assets. But throughout all those services there's a lot of auditing going on and all that accounting work going on. There is some overlap, but I think the terms of art there are some distinctions.

But to answer your question, I've not given thought to whether you should put all of those in the B categories within the C categories and require disclosure only when there's indirect compensation. I guess that would make sense. Because your focus I understand is the indirect compensation.

CHAIR CAMPBELL: Okay.

PANEL MEMBER WIELOBOB: All right. With the change you're talking about, legal services becomes legal services incident to the practice of law. That's what you said, correct? Something like that?

MR. WIGGINS: Legal services that primarily that are primarily focused on the practice of law.

PANEL MEMBER WIELOBOB: Okay. When I was at a big law firm and the employee benefits group had these people that were called non-professionals. They were non-lawyer professionals, that's what it was. And in the benefits group people used to refer to them as “practicing law without a license.”

Who are you trying to get at with the distinction? Paralegals? I'm just trying to get my brain around the practical reality of what you'd like to do.

MR. WIGGINS: What I'm trying to get at is I will often provide what I think as consulting services to our clients that are not our TPA clients. But I think those consulting services are incidental to the practice of law, not the primary focus. And I think many lawyers in many law firms do provide consulting services that are incidental to providing legal services, or to the practice of law in connection with advising the plan. But by inserting that distinction I think it would be much easier for law firms and our firms to take the position that we're not primarily consulting, we're primarily practicing law and therefore we are a C category service provider not a B category service provider.

CHAIR CAMPBELL: So would your concern there be that the test for that might vary from state-to-state based on what the ethics rules in that given state are about when you are providing legal services and when

c21020a4-0b71-40d1-bade-e3b09f4800dc

you're not?

MR. WIGGINS: Again, I think this comes down to how you define it. And maybe you want to put definitions in the regulations itself. But I think it's very difficult to articulate a precise definition that distinguishes consulting services from legal services.

I think what you're suggesting is if you do default to the practice of law as a term of art, then that could incorporate state law principles and it could be considered to vary from state-to-state. I don't think that would be a good idea. I think it would be contrary to congressional purposes to cram state law and not to subject traditional plan parties to state-by-state regulation.

CHAIR CAMPBELL: Okay. Oh, for the record, I wasn't suggesting that. I was just trying to see what you were getting at. If we didn't address this issue, what your concern might be about what would apply in

c21020a4-0b71-40d1-bade-e3b09f4800dc

lieu of addressing the issue.

MR. WIGGINS: My biggest concern is I don't want to look over my shoulder every time I give a consulting advice and think, oh my goodness do I have the right contract with this engagement letter with this client now that I'm giving --

CHAIR CAMPBELL: Right.

MR. WIGGINS: -- then consulting advice and do I need to hang up the phone and draft a new engagement letter and send it to the client --

CHAIR CAMPBELL: Gotcha.

MR. WIGGINS: -- and say "Oh, now I'm your consultant." If I'm primarily providing legal advice.

CHAIR CAMPBELL: Okay. Sorry I jumped in front.

PANEL MEMBER WIELOBOB: No, that's -- I'm good. I'm done.

PANEL MEMBER DWYER: So I just want to make sure I understand what you're asking us to do. That you have two sets of services you provide, TPA services to plans and administrative and then consulting services that are really part of your practicing law. And what you would like to do is take that latter category and make it clear that that's in category 3 under the reg?

MR. WIGGINS: I don't think that's quite accurate. If that's what I said, I misspoke.

I don't think that I provide consulting services on a regular basis. If I do, it's rare and it's only incidental to providing the legal advice, the legal services to perhaps a plan administrator or the plan trustee. I think it would be very rare for me to provide consulting services. But I think it does happen from time-to-time and it depends on how you define consulting services.

But what I'm concerned about is, as I said before, if I do happen to be asked a question that involves consulting, do I need to look over my shoulder and pull out my engagement letter and say "Oh, gee, this is a legal client and I don't have all those disclosures there that I should have in order to avoid a prohibited transaction."

PANEL MEMBER DWYER: Thank you.

PANEL MEMBER CANARY: There's one thing that came up with Mr. Saxon and Ms. Mazo was a possible adjustment to the language to make it limited to investment consulting in the category 2. Would that address your concern?

MR. WIGGINS: Yes, that would.

PANEL MEMBER CANARY: Because what you're doing, you would not perceive to be investment consulting?

MR. WIGGINS: No.

PANEL MEMBER CANARY: It would be -- I see.

MR. WIGGINS: I would never provide investment consulting.

PANEL MEMBER CANARY: All right.

c21020a4-0b71-40d1-bade-e3b09f4800dc

Thank you.

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

And with that, we'll bring to a close our hearings on this proposed regulation.

And we very much appreciate the comments that we've received from all the witnesses. We appreciate their time.

And also, of course, want to thank everyone from the Department who was here and helped out and helped us put these on. We don't typically do these for every regulation. So this is something that was fraught with all sorts of potential administrative pitfalls. And we avoided those, logistical pitfalls. So we appreciate that.

Of course, we will take all these comments under consideration, as we have and do all the comments in the written record that we'd received previously and that we'll be receiving to a certain extent on an ongoing basis as we come up with a final regulation, which we will complete this year.

Thank you very much.

And that concludes this hearing.

(Whereupon, at 5:15 p.m. the hearing was adjourned.)

D