Testimony

of

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and

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Good afternoon. My name is Steve Saxon, and I am a principal at Groom Law Group. My colleague, Jennifer Eller, also a principal at Groom, is here with me. We are testifying on behalf of a number of financial institutions and administrative services providers. The companies we represent today offer a variety of services to employee benefit plans subject to ERISA, including administrative services, recordkeeping, consulting and advisory services. A number of them also offer investment and insurance products. In total, this Group provides services with respect to thousands of ERISA plans with many billions of dollars in assets.

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 witnesses at this hearing have raised similar concerns. Instead of restating the problems with the proposal, today we want to share some thoughts on how the Department may be able to craft a workable solution.

We are suggesting the Department 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 court. These changes are:

1. Limit the regulation to transactions between plans and "parties in interest" providing services to the plan.
2. Hold plan service providers to a "reasonable efforts" standard in complying with the regulations.
3. Recognize the limits of a plan service provider's ability to collect information regarding payments made in connection with plan investment options.
4. Require yearly (rather than monthly) updates of information from plan service providers to plan fiduciaries.
5. Do not mandate specific contract terms. Allow written disclosures to be made outside of the contract.
6. Provide transition relief. Existing contracts should remain in place until renewed or amended. The requirements should not be effective until at least one year after the final regulation is issued.

These six points form the basis of a workable set of requirements that will accomplish the core objectives of the proposal – providing plan fiduciaries with targeted information that will facilitate, rather than obscure, their assessment of whether a services arrangement is "reasonable." At the same time, the Department must recognize that certain changes to the proposal are necessary to keep the final regulation within the framework of existing statutory authority.

I'll now discuss each proposed revisions, in turn.

I. 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 service transactions between a plan and a party in interest. Otherwise, there is simply no "transaction" for which section 408(b)(2)'s exemptive relief is required. Under the Department's plan assets regulations, an entity managing an investment vehicle that does not hold plan assets is not "indirectly" providing investment management 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 the section 408(b)(2) exemption. For this reason, we ask the Department to recognize the limits of section 408(b)(2) and not to require disclosures from entities not providing services to a plan. We also ask that prior DOL guidance regarding "service providers to service providers" be respected. Such entities should not be deemed parties in interest for purposes of the final regulation.

II. Hold Plan Service Providers to a "Reasonable Efforts" Standard in Complying with the Final Regulations

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 unwary, 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.

III. Recognize the limits of a plan 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 to 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 many 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 these access providers should be expected to know.

If the Department intends to require service providers, such as 401(k) recordkeepers 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 the relationships.

For instance, one option would be for the final regulation to require that plan service providers offering access to investment alternatives disclose any information about the fees and compensation paid from the investment alternative that is contained in the investment's disclosure documents and available to the access provider. Alternatively, the Department could identify the types of information it expects that access providers will request from investment providers or platform providers and require that the access provider disclose the responses to these information requests to plan fiduciaries. As noted above, to the extent service provider makes necessary efforts to obtain information and cannot, the service provider's contract with the plan should not fail to be 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 sub-advisor, the manager should be required to disclose only the aggregate compensation for the investment management services.

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.

IV. Require yearly (rather than monthly) updates of information from plan service providers to plan fiduciaries.

The proposed regulation requires providers to update their disclosures within 30 days of the service provider's 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 in the bundle to give notice of a change to a provider and for the bundle provider to give notice to the plan. In any case, plan fiduciaries may be inundated with notices of piecemeal changes to their services contracts.

Instead, the Department should require updates on a yearly basis, or upon reasonable request by the plan fiduciary.

V. Mandate specific disclosures, but not contract terms. Allow written disclosures outside of the services contract.

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 <u>require</u> that the disclosures be provided.

If the service contract has to include specified 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's insurance commission before they can be issued to the public. If the contracts are materially modified, they must be resubmitted for approval. It is not clear whether some or all of the insurance company contacts, such as group variable annuities, issued to covered plans will need re-approval. State consideration of contracts can be a lengthy process.

Similarly, certain types of plans (such as prototypes and volume submitters) have been pre-approved by the Internal Revenue Service. Some such plans include separate trust agreements that have also been approved by the Service, while for others, the trust agreements are included in the plan itself. Such agreements cannot be revised without being resubmitted to 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.

VI. Provide transition relief. Existing contracts should remain in place until renewed or amended. The requirements should not be effective until one year after the final regulation is issued

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 regulation does not provide sufficient time. In its economic analysis, the Department estimated implementation of the regulation would require one work hour for most service providers, 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 not enough. For example, many of our clients have many thousands service contracts with employee benefit plans. If you assume the regulation becomes final 90 days after the final regulation is published, and, as the Department projects, it takes this client 3 days (24 work hours) to determine its obligations, in the remaining time, it will need to renegotiate and sign hundred of contracts per business day. The burdens are equally heavy on smaller service providers.

Plan fiduciaries will also be overwhelmed. A large plan may have hundreds of affected 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 regulation.

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We appreciate the opportunity and look forward to working with the Department to craft a workable solution.