From: Chris Tobe [mailto:tobecb384@gmail.com]
Sent: Wednesday, March 12, 2014 5:17 PM
To: EBSA, E-ORI - EBSA
Cc: 'Chris Tobe'
Subject: Attention: RIN 1210-AB08; 408(b)(2) Guide.

My comments are in the attached article "The Big Loophole in the DOL Fee Disclosure Regulations"

Abstract:
401(k) fee disclosure has a big loophole in one of the largest asset classes. Stable value, or guaranteed funds, typically constitute 10-40% of assets in most 401(k) plans and have varied and complex structures which complicate fee disclosure. Billions of dollars in what I call spread based fees remain undisclosed under the new US Department of Labor (DOL) fee disclosure rules.

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The Big Loophole in the DOL Fee Disclosure Regulations

by Chris Tobe, CFA October 26, 2012

401k fee disclosure has a big loophole in one of the largest asset classes. Stable value, or guaranteed funds, typically constitute 10-40% of assets in most 401(k) plans and have varied and complex structures which complicate fee disclosure. Billions of dollars in what I call spread based fees remain undisclosed under the new DOL fee disclosure rules.

Last month I saw my wife's statement from Lincoln. It showed the stable value or fixed product with 0% in fees, when I know they may make as much as 2% or 200 basis points (bps) in spread profits based on my nearly 7 years experience as an officer of insurance companies. I was recently quoted in the Wall Street Journal's Marketwatch *"These excessive profits, even if called spread, act like fees and are used like fees,"* [i]

Insurance companies are manipulating loopholes for excessive profits. While they may disclose some fees, it may only tell 25% of the story as they make the majority of their profit on the spread. Even if the DOL continues to ignore this loophole I believe their hidden spread fees will probably put them in danger of class action lawsuits. In addition they continue to pay commissions out of the hidden spread which drive even more sales.

Currently if the insurance lobby gets their way these higher risk and higher fee bundled products will appear to have lower fees (and higher returns) compared to a diversified low risk low fee product, like the Vanguard Stable Value collective trust. In this scenario an advisor with an insurance license can get a kickback in commissions for a product he can show is DOL approved with higher yields and no fees.

Loophole

We need to look more closely at the loophole that the insurance companies are using. *" The preamble to the participant-level disclosure regulation provides that designated investment alternatives with fixed returns are those that provide a fixed or stated rate of return to the participant, for a stated duration, and with respect to which investment risks are borne by an entity other than the participant (e.g., insurance company). 75 FR 64910".* [ii] I believe insurance companies are twisting and manipulating this rule.

I believe that the intent is to exempt a traditional GIC which functions like a bank CD, 3% rate for 3 years that is sold in a competitive bidding environment. For example Vanguard in their stable value plan has had a 20% allocation to a diversified basket of traditional GIC's. When they purchase a GIC which is never over 5% of their total holding they go to 5 or more insurance companies and get bids to get the highest rate for a GIC of say 3 years. This process eliminates the excessive fees and the diversification eliminates excessive risk. Vanguard discloses a management fee, but does not add any additional fees for the internal spread of insurance company.

Insurance company General Account products are usually part of a bundled arrangement. There is no competitive bidding so they essentially set their own rates and their own profits without any disclosure. Historically they have been allowed to vary their rates at the will of the insurance company depending on their thirst for profit. However, I think in their attempt to manipulate this loophole they will try to keep rates more constant to appear to fit the exemption which states fixed or stated rate of return. The other qualification for the exemption is a stated maturity or duration, and none of the insurance products I have seen do this and should be eliminated from exemption based on that alone.

The insurance industry and its lobbyists have this spin on the loophole. *"For general account products or fixed income products, the Department of Labor (DOL) acknowledges that for a product with a stated rate of return and term, it is not pertinent to have some type of expense ratio related because the real driver of income is the rate being offered"*[iii] I have never heard this directly from the DOL, but neither have I heard them deny it. Again I think this applies to diversified product in a competitive bidding situation, not in a captive bundled product.

Analysis

One of the reasons this loophole exists is because the vast majority of the largest plans abandoned insurance products for their liability, risks and excessive hidden fees 10 to 20 years ago. To understand this I think it is helpful to split the $4.5 trillion 401(k) market.
The top $3 trillion (68% of assets) is large fortune 500 type plans account for only 1% of the plans and for the most part do not use single entity general account products [iv] However the bottom $1.5 trillion is spread over 650,000 plans (99%) ranging from small Dr's offices to mid-size manufacturers. The battleground for fee disclosure will be in bundled insurance company products in small to midsized plans.

The financial crisis allowed some room for growth of these products to some larger firms as reported in the Wall Street Journal in May 2010. *Amid the shortage of wrap insurance, though, some firms are seizing an opportunity to reintroduce older types of stable-value products that are backed by a single insurer and carry considerable risks. OneAmerica Financial Partners Inc.'s American United Life Insurance Co., for example, last month launched a stable-value product backed by its own general-account assets. In such products, investors are taking on the risk that this single issuer could go belly up.*[v]

In 2008 Federal Reserve Chairman Ben Bernanke said that *"workers whose 401(k) plans had purchased $40 billion of insurance from AIG against the risk that their stable-value funds* *would decline in value would have seen that insurance disappear."* [vi] Many investment professionals believe that a plan sponsor is taking a severe fiduciary risk by having a single contract with any one entity such as AIG. The only counter to this relies on assuming that the single insurance company backing the stable value option is too big to fail and has an implied government guarantee which is problematic on its face.

The National Association of Government Defined Contribution Administrators, Inc. (NAGDCA) in September 2010 created a brochure with this characterization of general account stable value that got beyond the high risks and right to fee disclosure. *"Due to the fact that the plan sponsor does not own the underlying investments, the portfolio holdings, performance, risk, and management fees are generally not disclosed. This limits the ability of plan sponsors to compare returns with other SVFs [stable-value funds]. It also makes it nearly impossible for plan sponsors to know the fees (which can be increased without disclosure) paid by participants in these funds—a critical component of a fiduciary's responsibility.* [vii] It is hard to comprehend why the DOL lets these products escape disclosure.

Conclusion

1. High hidden stable-value spread fees are subsidizing administrative costs. Revenue from general and separate account stable value options have typically subsidized administration costs, making some participants pay higher administration costs than those in mutual funds, and making products appear competitive in requests for proposal that look at per head administrative costs.

2. Fees and commissions are not being fully disclosed. Insurance companies are still fighting not to disclose any spread profits. These excessive profits, even if called spread, act like fees and are used like fees. Commission kickbacks to consultants with insurance licenses are common in plans with general and separate account stable value.

3. The structure creates a higher level of fiduciary duty for vendors and risks for plans. Since general and separate account stable-value assets are on the balance sheet of the insurance company, this creates an inherent conflict between the fiduciary care of pension investors and company shareholders. If the firm needed more income they could get it by lowering rates paid to plans since they are in captive non-bid bundled arrangements.

Most stable value products (IPG) provided in bundled insurance company products do not fit this exemption in my opinion since its fixed rate is variable and the duration is variable. If the DOL continues to listen to the insurance lobby higher risk and higher fee bundled products will appear to have lower fees (and higher returns) compared to a diversified low risk low fee product like the Vanguard Stable Value collective trust.

Chris Tobe, CFA, CAIA is a top expert on DC investing and Stable Value and is the founder of Stable Value Consultants. He has worked recently with a number of large DC plans and has been quoted in Wall Street Journal and Barron's on Stable Value and published a number of whitepapers on stable value. He provided written testimony on stable value to DOL's ERISA advisory committee and testified in person at the joint SEC-DOL hearing on Target Date Funds in summer of 2009. He has over 25 years of experience working with DC Plans working as a consultant, money manager and regulator. He was a Trustee for the Kentucky Retirement Systems and served as a Sr. Consultant for BCAP & NEPC. His stable value consulting practice over the last 3 years included 8 clients, with a total of 23 different stable value pools and over $34 billion in Stable Value assets. For nearly 7 years he served as a director for the Pension & Savings Group of AEGON Institutional Markets, where he was responsible for a number of major relationships with the over $40 billion wrapped stable value book. Tobe has published a number of articles on Stable Value and related topics including "The Consultants Guide to Stable Value," in the Journal of Investment Consulting and ""Stable Value – An Asset for All Seasons" (Plan Sponsor Magazine), He has spoken at a number of SVIA conferences and national conferences such as IFEBP, NAST, CIEBA and NAGDCA on stable value and other DC investment. He holds a BA in Economics from Tulane University, and an MBA in Finance from Indiana University – Bloomington.

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[i] _http://www.marketwatch.com/story/these-funds-give-retirement-savers-stability-2012-10-16_

[ii] http://www.dol.gov/ebsa/pdf/2012-02262-PI1.pdf pg.29

[iii] http://plansponsor.com/Fee_Disclosure_Guidance_Provides_403bs_Comfort.aspx_

[iv] http://plansponsor.com/Large_Plans_Account_for_3_Trillion_Dollars_in_DC_Assets.aspx

[v] http://online.wsj.com/article/SB10001424052748703572504575214723494032604.html?mod=WSJ_PersonalFinance_PF2

[vi] http://www.federalreserve.gov/newsevents/testimony/bernanke20090324a.htm

[vii] www.nagdca.org/documents/StableValueFunds.pdf_