<u>TO:</u>	**Kristen Zarenko**	**<u>AT:</u>**	**EBSA**
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<u>FROM:</u>	**Robert Unger**	**<u>AT:</u>**	**URI Consulting**
<u>DATE:</u>	**November 19, 2014**		
<u>SUBJECT:</u>	**Brokerage Window RFI (RIN 1210-AB59)**		

<u>URI Consulting</u>
URI Consulting provides consulting services in the areas of strategy, marketing, and education consulting predominately to the financial services sector, the retirement service provider industry as well as qualified plan sponsors, specializing in ERISA qualified employee retirement benefits.

<u>Executive Summary</u>
We are sensitive to the need of EBSA to gather more information regarding the use of brokerage windows in participant-directed individual account qualified plans, and how, if at all, new regulations (or interpretations of existing regulations) need to be formulated around brokerage windows made available to plan participants. However, we are concerned with the RFI's context, given both the manner in which the RFI was written and the way questions are posed. Our concern rises from what we know to be the current market failure found within the individual participant directed qualified plan marketplace, and the market failure found within the actively managed investment management services marketplace, which is embedded in the overall marketplace for retirement plan services. Nevertheless, we have endeavored to respond to the RFI as best as possible.

As to the above reference market failure in the retirement services marketplace specific to individual account, participant-directed qualified retirement plans (generally 401(k), 403(b) and 457 plans), the process of how plan sponsors select "designated" or" core" investment options, and monitor them over time. Without a more complete understanding of that process, and determining what is truly appropriate in establishing a set of core options offered to plan participants, EBSA can come to two very different conclusions about regulating the brokerage windows made available by some plan sponsors to their participants. In the current environment of significant market failure found in the large majority of plans, a much higher degree of regulation would be called for on brokerage windows. However, if EBSA regulates (or interprets current regulations) more appropriately regarding the process of selection and ongoing monitoring of core options, then a more laissez-faire (current) regulation of brokerage windows would likely be more advantageous for plan participants.

One pending example of this regulation of core investment selection and monitoring is the fiduciary status of brokers rule currently under consideration. If this rule is adopted, and if it is written in a manner that actually creates a more capitalistic and competitive market environment for retirement services to these types of plans, it could go a long way to turning this market failure system into a more capitalistic, balanced supply/demand curve system. Hence, our recommendation is to temporarily shelve the potential regulations around the lesser issue of brokerage windows in favor of regulations/interpretations on core investment option selection and monitoring.

<u>Background</u>
When we speak of market failure in the qualified-plan, participant-directed individual account marketplace, we are referring to the manner in which tens-of-millions of plan participants are provided

with a set of core or designated options. Our research conducted over more than a decade into hundreds of different plans, from micro-market through mid-market size plans reveals a simple truth. That over almost any given time period of 5 years or longer, that in any individual year, participant accounts would have been far better off (often to the tune of 100 basis points or more annually) had the plan sponsors simply replaced the current investment lineup with the lowest-cost, open-ended mutual fund passive index equivalent option. This includes accounting for the necessary separation and independent billing that may be required for recordkeeping services, administration services, broker/advisory/consulting services, legal services, custody/safekeeping services, clearing/settlement services, employee communication services, trustee services, investment services, etc. Specifically, our research indicates that 83% of all such plans and their participants, in any given year, would be better off, and in most cases much better off with this simple approach. We combine this cost into what we have termed the "Universal Retirement Investment Limitation Expense™" (URILE™). This URILE™ cost largely comes from a combination of what the industry calls bundling, but what would be more recognized in economic terms as vertical, horizontal, and in some cases diagonal integration of the various vertical supply chain of services required to sponsor these plan by employers. It is worth noting that this so-called vertical supply chain is in actuality a cyclical supply chain of services which is one reason why service providers are able to create this additional cost, and indeed have made it a marketplace standard. In doing so they drive excess profit for themselves (and in some cases reduced expenses for the plan sponsor), while raising total costs, often significantly, for plan participants. It is not uncommon for us to examine a block of plans in which the average URILE™ is in excess of 100 basis points.

So why don't plan sponsors do this? The answer is different from one plan to the next, but there are some clear and recurring themes:
1.] The participant-directed, individual-account industry is aligned, and often part-and-parcel of the active investment management services industry. As such they have a vested interest in avoiding the use of passive index style investment options. That is to say, their profit margins, competitive stance, and most importantly market power would be greatly curtailed, for the large majority of service providers.
2.] Plan sponsor fiduciaries are often ignorant of these facts and will more-or-less accept whatever is offered or recommended to them. That is to say, and to put in more economic terms, there is a significant amount of asymmetry of information between consumers and purveyors of these services which serves to rotate supply and demand curves in a clockwise fashion, pegged at the high quantity side of the curves.
3.] Some plan sponsors are enticed to engage in this market failure knowingly, and to have such relatively poorly performing plans, because certain plan expenses which would traditionally be paid for from employer assets (e.g. recordkeeping and administration costs), are shifted into the investment performance results and therefore paid for by the plan participants. That is to say, the current market failure system encourages employers to shift their costs to their employees, with little or no understanding or appreciation of this fact by the employees.

We estimate that the ultimate cost amounts to a re-distribution of qualified plan participant account assets from those accounts into service provider's revenue, reduced employer costs, and/or lost to market inefficiencies in the several ***tens-of-Billions*** of dollars ***annually***. Not nearly all of this inures to the benefit of service providers or plan sponsors, but certainly enough of it so that the industry players work extremely hard to keep market power in their favor and continue to prop up the active investment management industry. It should be noted that one way to view this anti-capitalistic inefficiency cost found within the marketplace for retirement services is from "bundled service provider to bundled service provider." There are very clear trends in business models and industries that offer bundled programs and which amongst them are noticeably more likely to generate URILE™, and re-distribute participant assets into excess profits for themselves and create more inefficiency in the overall marketplace. Most of these service provider segments are well known and easily identifiable through application of the URILE™ analysis. As previously mentioned, the approach used in which such players may now be designated as plan fiduciaries subject to the full weight and force of potential ERISA fiduciary liability, may be one potential solution to this significant problem found within the retirement services marketplace. This will no doubt take time, but could have a positive effect at normalizing the supply and demand curve and bring overall participant costs in-line to a more efficient and capitalistic system. Again, subject to the exact wording and implementation of such a fiduciary standard for brokers.

Questions

The following are our responses to the specific questions posed in the RFI:

1.] We see approximately the same number of SDBAs as we do mutual fund windows, but we are concerned that our view may be non-representative. It appears that independent recordkeeping platform providers are more oriented towards SDBAs while other bundled providers are more oriented toward mutual fund windows. Though it does appear that the SDBAs are being more frequently employed over mutual fund windows in terms of selection by plan sponsors.

2.] An SDBA should be defined as a process by which a plan participant removes some or all of his or her assets from the primary separate account in which they are limited to the core options, and those assets are transferred to a separate account, still within the prevue of the retirement trust, but for which the ability to purchase non-core securities are enabled which minimally should include the option to buy or sell individual equity securities. This definition should provide sufficient separation with the notion of a mutual fund window.

3.] Probably not, but our response to this question is highly dependent upon the discussion provided in our executive summary and background sections above.

4.] They tend to be more independently minded committees/fiduciaries that have at least some employee segment which perceives themselves as being more investment sophisticated. Generally they also have higher incomes and are upper level management or professions (e.g. lawyers, doctors, engineers, etc.).

5.] We see only a small segment of the plans offering SDBAs (less than 5%), and that is growing but slowly. Adoption of SDBAs is largely driven by the broker, advisor, or consultant to the plan. And the limitations of bundled-product availability that they have.

6.] The designated number of options is truly disparate from one plan sponsor to the next. We have seen some which rely on only 5-6 core options plus a target date series as the default, to some which will offer 12 – 18 options with a target date series, and some which will offer well over 30 options with a target date series. There is no discernible trend from our perspective other then the significant disparity found. Once again, this seems to be more driven by the bundled provider platform selected/utilized and the broker/advisor/consultant to the plan. It is worth noting the remarkable growth of Target Date Funds (TDFs) availability and their ability to garner the lion's share of a plans assets.

7.] Previously provided.

8.] For regulatory purposes (e.g. 404(c) compliance, fiduciary status and duties on selection and monitoring) we would strongly recommend avoiding the designation of a specific number of core/designated options as meeting the definition of an SDBA or mutual fund window. For example, many GVA products, or the plan sponsors who adopt them, make their entire fund options (sometimes in excess of 200 separate accounts) available. But the plan sponsor and the platform provider should be held to the higher fiduciary standard of these being considered all core options.

9.] This is highly variable from one plan to another. It is often based upon the total size of the employer (number of employees) and the industry of the employer. A law firm or engineering firm of moderate size may have a very high adoption rate due to the self-perceived investment knowledge/sophistication of the majority of employees (and the relatively high average compensation). Conversely a larger manufacturing firm may have a low adoption rate, but still a fair number of senior level executives participating in an SDBA.
10] None that I can share specifically due to client privacy and non-disclosure agreements.
11.] Our limited experience of this level of specifics is that the tendency has been to put the entire account, or most of it, into the SDBA.
12.] We typically do not examine these accounts to this level of specificity.
13.] Our estimation is that the investment performance results mirrors that of the plan sponsor results in selection and performance of core options. That is to say, the majority of these SDBAs would have been far better off simply by purchasing the lowest cost passive index mutual fund equivalent to whatever they purchased in the SDBA.
14.] The largest benefit for participants in SDBAs is that they are enticed into participating in the plan at all. Specifically in that they now save because they have the sense of freedom that they demand but would otherwise not receive had they been restricted to the core options, and therefore might have elected to not participate in the plan at all. There may be some of the same residual effect for other non-SDBA participants.
15.] Our experience is that they do not consider more than one vendor as the platform provider will often limit them to just one option.
16.] Yes, affiliated SDBAs are prevalent. Note that affiliation does not necessarily mean part of the same corporate structure, but can often be in the form of joint marketing arrangements, strategic alliances, and many of the myriad forms of vertical and horizontal integration that permeates this entire market place. And for which are very problematic for plan participants even though they may be unaware of those problems/costs.
17.] Whether it is available on the recordkeeping platform or not.
18.] Response to employee requests or desire by plan sponsor fiduciaries. Potential fiduciary responsibility and liability is usually considered.
19.] Yes, but it is often part of the standard plan setup paperwork requirements of the provider.
20.] Yes, in addition to the plan sponsor selection of the SDBA option.
21.] Plan fiduciaries usually select the recordkeeping platform which creates a natural restriction of a specific brokerage platform(s) available. Very little review or monitoring of the individual investments available in the SDBA accounts typically take place by the plan fiduciaries (noting that there is an expectation of SEC/FINRA supervision and suitability requirements are being met).
22.] They typically do not monitor.
23.] No.
24.] Depending upon the recordkeeping system utilized and their technology links to the B–D platform, oversight may be easy or difficult. Our experience is that it is possible but often requires plan sponsor separate web access from the core assets of the plan.
25.] Wide variety of costs, but $100 per account, usually charged to the account may be applicable from a plan recordkeeping perspective. Then there are of course the costs associated with the actual trading activity (commissions, sales loads, etc.). More often than not, the plan sponsor will pass these costs onto the participant who elects the SDBA option.
26.] This is a difficult question to answer because it depends upon your definition of subsidy. In a broad definition, the subsidy could be significant if there are enough of the assets depleted from the core options which in turn make unavailable some of those core options, or otherwise require a higher cost

version of those options (e.g. an institutional share version of the same option versus and R-class share with additional 12B-1 fees of the same option).
27.] Beyond the plan recordkeeping charge, the costs would often be more-or-less identical to investing in an IRA account utilizing the same B-D platform.
28.] These brokerage costs are generally considered, but it is not usually a major concern because many of the plan recordkeeping platforms have adopted links to the so-called discount brokerage firm business model.
29.] In our opinion and as discussed previously, disclosure is more-or-less sufficient subject to sufficient changes in regulations such that core option selection and monitoring regulations are adopted such that plans are held to the minimum URILE™ standard.
30.] Not sure.
31.] Not sure.
32.] Managed Account options are a separate issue and should be disassociated from the SDBA option issue. In our option, and with specific regards to SMAs, they should be subject to the same URILE™ standards we provided earlier.
33.] Advisors, brokers, or consultants (and there are significant differences amongst these), are usually queried by plan sponsor fiduciaries when they consider SDBAs. Often, it is the Advisor, broker/consultant that will raise it as an option for consideration, some actively "selling," "promoting," or "recommending" this option.
34.] Rarely in any given annual period. Typically less than 2%.
35.] Yes, but infrequently is it a separate contract. In the case of brokers (Registered Representatives of Broker-Dealers) it is almost always offered as an "included Service." In the case of advisors (Investment Advisor Representatives of Registered Investment Advisors) it is often provided as part of the employee communications services section of their Investment Advisory Agreement/Contract. In the case of consultants it is rarely provided.
36.] Rarely.
37.] Probably, but great care needs to be taken in constructing such guidance as the relative complexity of the cyclical supply chain of services and the manner in which the various retirement services industries have vertically, horizontally, and diagonally integrated and disintegrated portions of these services has enabled them to utilize such guidance to further their own objectives and in direct opposition of the ultimate goal of the original guidance. The best example of this is the use of the very fiduciary standard found in ERISA §404, and how many in the industry use it as a sales and marketing tool rather than its original purpose to guide plan providers related to following the best interests of plan participants. Most notably how brokers and some advisors use this to promote the sale of the platform products they offer whilst actually incurring URILE™ for the plan and its participants, extracting excess profit for themselves and at least some of the service providers, and often limiting or eliminating their own potential liability for the very decisions they are promoting.
38.] Yes. And if the recordkeeper and/or administrator can create the links necessary to offer SDBAs in the first place, clearly they have the capacity to recapture Schedule H data from the B-D to include on Schedule H, a level of data that every B-D is required to have for normal accounting requirements (i.e. unrealized gains and losses).
39.] Most of the ones we have seen simply list it as a total dollar figure (beginning and ending balances with contributions and transfers/distributions) and do not recapture any of the B-D statement specifics.

Respectfully Submitted,

Robert L. Unger