U.S. DEPARTMENT OF LABOR

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

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PUBLIC HEARING

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

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Tuesday, April 1, 2008

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

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

2 9:08 a.m.

3 CHAIR CAMPBELL: I'd like to open

4 up the second day in our two days of

5 administrative hearings on our proposed

6 408(b)(2) regulation.

7 I won't burden you with an opening

8 statement as I did yesterday, but since some

9 of you weren't here, I thought I would just

10 briefly go over a couple of the issues, and

11 we'll also have Lou Campagna recap our

12 procedures for how we're handling the

13 proceedings today.

14 I just wanted to point out, as I

15 did yesterday, that we are big believers in

16 the notice and comment process. Not only is

17 it, of course, required, but it's also a

18 process that helps us get to the best

19 regulation possible, and it's one where we

20 will take and consider all the comments that

21 we receive here today with a great deal of

22 consideration as we work through this, because

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1 though we will complete this regulation this
2 year, equally important, if not more
3 important, than getting it done timely, is
4 getting it done right. And that's certainly
5 the paramount goal we have, as we have to
6 always remember that ours is a voluntary
7 system, and that we need to foster both the
8 accessibility of plans, as well as the
9 protection of workers covered by those plans.
10 So with that, we will go ahead and
11 open up. We're open to your praise and your
12 criticism, as I said yesterday, your arrows
13 and your laurels; give them all to us, and we
14 will take them and come out with a better
15 product.
16 Lou?
17 PANEL MEMBER CAMPAGNA: I just
18 want to go through the procedures for the
19 hearing.
20 Speakers will be called in the
21 order listed.
22 We ask that each speaker stay

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1 within the allotted ten minute time period.
2 To the extent that members of the
3 panels have questions for the speakers, the
4 questions and answers part of the testimony
5 will not be counted towards the designated
6 time limit.
7 Once a speaker's opening remarks
8 have concluded, we will allow approximately 15
9 minutes for additional questions from panel.
10 We wish to note that you should
11 read nothing into the way questions may be
12 phrased, and draw no inference as to the
13 Department's views from the questions asked.
14 If you have filed a written
15 statement with us, copies have been furnished
16 to the members of the Panel. Accordingly, we
17 encourage speakers to summarize their views or
18 the views of their client in their oral
19 testimony.
20 Prior to beginning your testimony,
21 we ask that you identify yourself, your
22 affiliation, and the organization you

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1 represent, for purposes of the hearing
2 reporter who will be transcribing this
3 proceeding.
4 For those who wish to supplement
5 the record, the record for this proceeding
6 will be kept open until the close of business
7 Monday, April 21, 2008.
8 The official record of this
9 proceeding will be open for public inspection,
10 and copies will be available in the Public
11 Disclosure Room of EBSA, Room N-1513, U.S.
12 Department of Labor at 200 Constitution
13 Avenue.
14 Let me just introduce the Panel
15 members. We have Joe Piacentini, myself, Fil
16 Williams of ORI, of course Brad, Adrienne
17 Dwyer, Kristen Zarenko, and Allison Wielobob.
18 CHAIR CAMPBELL: All right. And
19 with that, our first witness this morning is
20 Paul Schott Stevens of the Investment Company
21 Institute.
22 MR. STEVENS: Thank you very much.

1 It's a pleasure to be here.
2 I have with me Mike Hadley, ICI's
3 associate counsel for pension regulation.
4 We're delighted to have the
5 opportunity to share some thoughts with you
6 today. I will take note of the fact that
7 we're your opening witness on April Fool's
8 Day. I hope it's not a comment on ICI or our
9 testimony.
10 CHAIR CAMPBELL: We have a dry
11 sense of humor.
12 MR. STEVENS: We would like to
13 commend the Department for the comprehensive
14 way it is seeking to address 401(k) disclosure
15 in the Form 5500 revisions, in these proposed
16 regulations, and the anticipated participant
17 disclosure regulations, as well.
18 We strongly support disclosure
19 rules for the 401(k) marketplace that will
20 help assure that plan fiduciaries have all the
21 information they need to make the decisions
22 entrusted to them under ERISA.

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1 My testimony will address the
2 features of the proposal that we believe the
3 Department should retain, as well as the
4 features of the regulation that should be
5 revised, in our view, to achieve a more
6 workable and useful disclosure regime. First
7 the good features, the laurels, as Secretary
8 Campbell put it.
9 The proposal would require service
10 providers to disclose the direct and indirect
11 compensation they or an affiliate receive in
12 connection with services to a plan. This
13 straightforward requirement would fill a gap
14 in existing regulations. It will help assure
15 that fiduciaries understand the ways in which
16 the fees of investment products compensate
17 plan service providers. Let me give two
18 examples.
19 First, mutual funds commonly make
20 payments to unaffiliated 401(k) service
21 providers to defray the costs of plan record
22 keeping, or other administrative services.

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1 These payments go by various names; service
2 fees, 12b-1 fees; sub-transfer agent fees, et
3 cetera. But whatever the label, the
4 Department's proposal contemplates that the
5 recipients inform plan fiduciaries about all
6 such payments. Although, in the case of mutual
7 fund fees, these payments come from fees
8 disclosed in a mutual fund's prospectus, the
9 prospectus does not and cannot provide the
10 kind of individualized disclosure to the plan
11 that the recipient of the fees can, and we
12 believe should, provide.
13 Second, a 401(k) record keeper
14 affiliated with a financial services firm may
15 make investment products of an affiliate
16 available to a plan. If so, the plan
17 fiduciary should understand the full picture
18 of the compensation received by the firm,
19 including the fees going to the record
20 keeper's affiliate. The Department's rule
21 captures this. It would require the record
22 keeper, in effect, to tell the employer the

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1 direct charge for record keeping is X, but
2 remember that you have selected a proprietary
3 investment, so our affiliate will also receive
4 Y in investment advisory fees.
5 This is an appropriate disclosure
6 structure, and we urge the Department to
7 retain it.
8 The Department also should retain
9 the rule that, when a bundle of services is
10 priced as a package, the service provider is
11 not required to create an artificial
12 allocation of fees for services, such as
13 between investment management and record
14 keeping. Some record keepers that do not
15 offer proprietary financial products would
16 have the Department require that their full
17 service competitors "unbundle" investment
18 management and administrative expenses, even
19 if these components are not separately
20 contracted for or priced. In effect, they
21 asked the Department to impose their business
22 model on the entire industry.

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1 The Department is correct to focus
2 on disclosure of real payments, and not
3 require the disclosure of artificial
4 allocations. The key for plan fiduciaries is
5 to compare the total cost of record keeping
6 and investments of one provider with the total
7 costs of record keeping and investments of
8 another provider, or group of providers.
9 Secondly, features of the proposal
10 that should be clarified. These are fully
11 detailed in our comment letter, and I will
12 confine my remarks this morning to two key
13 issues.
14 First, it's imperative that the
15 Department make clear that this regulation
16 does not turn service providers to mutual
17 funds into service providers to plans. Mutual
18 funds do not hold plan assets, and their
19 advisors are not ERISA fiduciaries. Mutual
20 funds have dozens, sometimes hundreds of
21 service providers, none of whom has any idea
22 about the extent to which particular employee

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1 benefit plans are invested in the fund. If
2 these entities were turned into service
3 providers to every plan that invests in the
4 fund, it would, at the very least, become
5 extremely costly and difficult for mutual
6 funds to be offered to employee benefit plans.
7 It also will exponentially expand the
8 information that plan fiduciaries must review.
9 And all or most of that information will not
10 be of assistance to them. Quite the contrary;
11 avoiding information overload is especially
12 important for smaller plans.
13 And I would note what you all
14 realize, that about nine out of every 10
15 401(k) plans has fewer than 100 participants.
16 Now this is not to say that plan
17 fiduciaries do not need to know the fees and
18 expenses of all plan investments, including
19 mutual funds, to fulfill their duties under
20 ERISA to select and monitor prudently plan
21 investments. They do, and our letter suggests
22 two ways the Department can reach that result

1 without upending ERISA.
2 The Department could issue
3 guidance on ERISA's general fiduciary rules,
4 reminding fiduciaries of the need to obtain
5 and consider fee and expense information about
6 investment options. For example, by reviewing
7 a mutual fund's fee table, and reviewing and
8 comparing similar information for other
9 investment products.
10 Alternatively, the Department
11 could require that service providers offering
12 access to investment options on a platform
13 undertake to provide the responsible plan
14 fiduciary with basic fee and expense
15 information about the investment options
16 chosen by the fiduciary. This is, in fact, a
17 routine practice now.
18 In either case, the information
19 required about mutual fund fees should not, in
20 our judgment, extend beyond the information
21 the SEC requires funds to provide to all their
22 investors. In this regard, SEC regulation

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1 already assures comprehensive and consistent
2 disclosure of mutual fund fees and expenses.
3 Put another way, the Department of
4 Labor should not create special disclosure
5 items about mutual funds that would apply just
6 to one set of their investors.
7 Second, the Department should
8 scale back the broad sweep of the disclosures
9 regarding conflicts of interest, which, as
10 written, would require a service provider to
11 determine whether any relationship with anyone
12 may create a material conflict of interest in
13 performing services.
14 In our view, the purpose of this
15 disclosure is already largely achieved by the
16 requirement to disclose all direct and
17 indirect compensation, as well as compensation
18 earned by an affiliate in connection with plan
19 services.
20 The conflict of interest
21 disclosures of the Department's rule, along
22 with the other items of the proposal, should

1 be designed to avoid redundant disclosures
2 that obscure relevant information. We
3 therefore recommend the Department narrow the
4 conflict disclosure rule to situations in
5 which a recommendation is being made.
6 Now admittedly, these are complex
7 issues, and it's important that the Department
8 develop a final rule that is workable, and
9 calculated to assure that plan fiduciaries
10 receive the kind of information that assists
11 them in fulfilling their obligations to enter
12 into reasonable service arrangements.
13 We look forward to assisting the
14 Department in this endeavor, and I would be
15 happy to take any questions the Panel may
16 have.
17 CHAIR CAMPBELL: Okay. Why don't
18 we start with Director Piacentini?
19 PANEL MEMBER PIACENTINI: Good
20 morning.
21 We heard a lot -- a little bit in
22 your testimony just now, and a lot in comment

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1 letters from your industry and others that
2 there are substantial compliance costs that
3 would be associated with the rule as we
4 proposed it. We didn't see as much, I think,
5 in the written comments about what the basis
6 for those compliance costs would be, what are
7 the actual compliance activities, are they
8 more of an up front kind of issue that would
9 be defrayed in a couple of years as systems
10 changed, and so forth, or is it an ongoing
11 issue? Can you elaborate a little bit on what
12 you see as the compliance challenges, and the
13 activities that would be required to comply
14 with a broad approach to the regulations?
15 MR. STEVENS: Well, you may well
16 ask that question of the specific companies
17 that will be testifying after me who may have
18 looked at those in more dollar and cents terms
19 than, at least, the Institute's had occasion
20 to do as yet.
21 PANEL MEMBER PIACENTINI: Okay.
22 MR. STEVENS: But I would focus on

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1 the question of whether service providers to
2 mutual fund become service providers to plans.
3 It is not uncommon for funds to have scores
4 of service providers. In fact, we have a
5 service directory for our industry that the
6 Institute publishes. There are 175 categories
7 of service providers in this book, which I'd
8 be happy to provide for your review.
9 It is not uncommon, for example,
10 that an individual fund may have relationships
11 with 100 or more brokers.
12 So if you begin to think about all
13 of those as service providers to the fund
14 becoming service providers to the plan, you
15 then begin to contemplate, as would be
16 required under this proposal, that each of
17 them have to have a contract with the plan.
18 And that would be with every plan that invests
19 its assets through the fund. And that, in
20 turn, may be many, many plans indeed.
21 I don't know that anyone has yet
22 tried to size the compliance costs that would

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1 be implicit in that. It would subject all of
2 them, presumably, to their prohibited
3 transaction penalties of ERISA.
4 So whatever the compliance regime
5 around it would have to be very robust indeed
6 to make sure that the requirements of the
7 proposal are met, and when you have so many
8 different service providers involved, I think
9 you can see that the compliance costs begin to
10 expand greatly. In fact, I would say so much
11 so that it would be a tremendous disincentive
12 for many funds to offer their shares through
13 the retirement plan market at all, which in my
14 view would be a shame, because, and I'll bang
15 our drum here a little bit, of all of the
16 investments that you see in the 401(k)
17 universe, I don't think there's any that has
18 more disclosure, greater transparency, than
19 mutual funds, or a stricter compliance
20 environment around them that's administered
21 under detailed SEC regulations.
22 And that's the best I can do.

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1 PANEL MEMBER PIACENTINI: Okay.
2 Another question: you've proposed, in some
3 sense, a narrower approach to disclosure. The
4 approach that you've outlined, do you see that
5 as a change? I mean, that's not what's going
6 on now exactly. Would that introduce more
7 transparency than exists now, or would that be
8 close to current business practices?
9 MR. STEVENS: It might be close to
10 the best business practices out there. I would
11 not necessarily say that it is a uniform
12 business practice, and I think it's important
13 to understand that we look at the benefits of
14 the proposal to extend beyond mutual funds to
15 comparable kinds of disclosures with respect
16 to other investment products that aren't
17 subject to the kind of comprehensive
18 disclosure regime and other regulations that
19 we have.
20 So I would say it's lifting all
21 the boats perhaps to what is an acceptable
22 level. Elements of the industry, I think,

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1 probably do observe these kinds of practices
2 already. And that's good.
3 PANEL MEMBER PIACENTINI: This
4 will be my last question. You said that what
5 a fiduciary needs to be able to do is compare
6 the total cost of one alternative provider,
7 plan provider to the total cost of another,
8 whether it's bundled, unbundled, whatever
9 sector the provider might come from. But it
10 seems like part of what is challenging us in
11 our conversation yesterday and today is, what
12 do we mean by "total?"
13 You're talking about whether a
14 broker to a mutual fund, for example, would be
15 a service provider to a plan, but the
16 underlying question, perhaps, is whether those
17 brokerage costs for the broker who is making
18 trades for the mutual fund are part of the
19 total or not. So I guess, rather than focusing
20 on who should be a service provider to a plan,
21 and who should be obligated to provide the
22 information, what in our regulation do you

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1 think, if anything, was in our total that
2 doesn't even belong in the total, and why?
3 MR. STEVENS: Well, if the focus
4 here is on brokerage costs, let me --
5 PANEL MEMBER PIACENTINI: That's
6 an example.
7 MR. STEVENS: Let me address
8 myself to that. And it sort of poses the
9 question, at least in the mutual fund
10 industry, if you're a fiduciary, and you're
11 looking at our disclosure, what can you find
12 out about brokerage to inform yourself in
13 making a decision. This is not a new issue in
14 our world, and it's one that's been wrestled
15 with, and I think we've come to a pretty good
16 state of providing information.
17 And remember, when you're talking
18 about mutual fund disclosure documents,
19 they're documents that are used by lots of
20 fiduciaries already. They're not only used by
21 ERISA fiduciaries, they're used by trustees,
22 they're used by investment advisors who have

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1 discretionary authority over client funds, who
2 have thoroughgoing fiduciary responsibilities,
3 and many others in a relationship of trust, as
4 well. So all of them would ask themselves the
5 same question: what can I find out about
6 brokerage from the fund's disclosures?
7 First and foremost, it's important
8 to understand that the brokerage costs are
9 reflected in the fund's performance. And in
10 the mutual fund world, we have standardized
11 performance requirements that treat brokerage
12 on a standard way across the board. It's net
13 of all fees, and brokerage costs are
14 capitalized. They're added to the cost of
15 acquiring a security when you buy, they are
16 subtracted to what the proceeds that you
17 receive from a security when it is sold, and
18 all that then is reflected in performance.
19 That gives a manager a very strong
20 incentive not to be trading wildly in the
21 portfolio, because the most important thing
22 that many clients are looking for is, what's

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1 the fund doing for me in terms of increasing
2 my wealth? What's the performance that I'm
3 getting out of the fund? So it asserts a kind
4 of discipline, if you will.
5 What we find across our industry
6 is, in fact, that the amount of trading in
7 fund portfolios has not really increased over
8 time. It's remained steady at between 45 and
9 50 percent turnover on a dollar weighted
10 average basis across our industry, but we also
11 know, looking at the costs of equity trading,
12 that trading costs have been going down. So
13 in fact, there are circumstances in the market
14 that are making transaction costs more
15 reasonable for all investors, not just for
16 mutual funds.
17 The SEC, though, has included a
18 specific requirement on our prospectus that we
19 provide to investors the portfolio turnover
20 rate as a reasonable proxy for the degree of
21 transactional activity in the portfolio, and
22 if you want to dig further, you can, in our

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1 statement of additional information, which is
2 filed with the Commission and available to any
3 investor upon request, find what the total
4 commission costs incurred by the fund have
5 been for each of the last three years, as well
6 as a description of the fund's trading
7 policies.
8 Now I'm hard pressed to think what
9 more any fiduciary, including a plan sponsor
10 here, would require to inform themselves
11 adequately about brokerage costs than what we
12 already provide to our investor universe at
13 large.
14 So singling that out and saying,
15 "Well gee, perhaps that's not sufficient,"
16 just seems to me to be a red herring.
17 Now there may be issues with
18 respect to other investment options in a plan
19 that aren't subject to the same disclosure
20 requirement, and you can address yourselves to
21 that with respect to transactional activities
22 of collective investment trusts, and things of

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1 that nature, that I'm not competent to comment
2 on. But I would say the regime that we have
3 has proved adequate, both for fiduciaries, and
4 for other investors with respect to brokerage
5 costs.
6 PANEL MEMBER PIACENTINI: Thank
7 you.
8 PANEL MEMBER CAMPAGNA: Thank you,
9 Mr. Stevens.
10 When plans approach, say, a
11 bundled provider, what are they told about the
12 bundle? Are they told it's a bundle of
13 services? What is their understanding of what
14 they're getting when they are purchasing this
15 bundle?
16 MR. STEVENS: What they should be
17 getting, and you can ask individual companies
18 about their practices, is a total description
19 of what the services consist of. If it's
20 administrative services and record keeping,
21 precisely what the complement of services
22 that's involved there; if it's investment

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1 products in addition, what they may be, and
2 what the total cost that is associated with
3 all those services that are being provided. In
4 other words, it should be full picture, both
5 in terms of the money that's being paid, as
6 well as what's the benefit of the bargain
7 that's being received.
8 PANEL MEMBER CAMPAGNA: I see. So
9 the investment advisories are seen as
10 services, as well, the investment advisory to
11 the mutual fund, what the investment advisor
12 does is seen as a service to the plan?
13 MR. STEVENS: Well, in the sense
14 that the plan's assets are being invested
15 through the fund, and there are expenses that
16 are being incurred in connection.
17 I don't think of it, as I had
18 already said, as services being provided to
19 the plan. The mutual fund is an investment,
20 it's not a plan service.
21 PANEL MEMBER CAMPAGNA: I just
22 want to try and boil down your view of the reg

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1 and what it should look like. So you're
2 thinking that the record keeper or the
3 platform provider would be responsible for the
4 totality of disclosures regarding the fund,
5 but the fund shouldn't be involved in having
6 to be a service provider themselves to be
7 responsible for any of that?
8 MR. STEVENS: Well, with respect
9 specifically to fees, what we had described in
10 my testimony was that you could have the
11 record keeper provide to the plan sponsor
12 those fee elements which are disclosed in the
13 fund's prospectus for all investors. But
14 perhaps that addresses itself to your
15 question.
16 PANEL MEMBER CAMPAGNA: Right.
17 And you see a component regarding
18 section 404, how would that fit in? So there
19 would be this component of 408(b)(2) regarding
20 the record keeper, or the platform provider,
21 and then there would be a component regarding
22 404, is that kind of your view?

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1 MR. STEVENS: You know, I'm out of
2 my depth, you know, pretending to be an ERISA
3 lawyer.
4 PANEL MEMBER CAMPAGNA: Okay.
5 MR. STEVENS: That's why I have
6 Mike Hadley here. Perhaps Mike can address
7 himself to the question.
8 MR. HADLEY: Yes. I think the
9 point that we were making was that, if you're
10 trying to ensure that fiduciaries have
11 information about the fees of investment so
12 they can make informed investment decisions,
13 that's an obligation under 404. And you've
14 said in other contexts that that's information
15 that plan fiduciaries need. And we were
16 pointing out that, to make sure that that
17 happens, that you could issue guidance under
18 404 addressing the issue of what information
19 do you need to make an informed investment
20 decision.
21 PANEL MEMBER CAMPAGNA: Now
22 yesterday we heard from a lot of people that

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1 the prospectus just wasn't enough. It doesn't
2 tell -- it tells about the fees in the mutual
3 funds, and what are the fees regarding mutual
4 funds, and brokerage as well, as you pointed
5 out, but not who receives them. And the focus
6 of our reg is indirect compensation, so that
7 is about who receives those fees. Could you
8 react to that comment?
9 MR. STEVENS: Well, just to take
10 another example. No, the prospectus won't
11 give you the list of the 150 brokers that may
12 receive the commissions. The prospectus may
13 not give you a comprehensive list of all of
14 the some 175 categories of service providers
15 that may be working for a fund in various
16 respects. You know, the fact of the matter,
17 it was never intended to, and I'm not sure,
18 particularly in this context, that all of that
19 is very useful information.
20 Again, it's a question of whether
21 you were looking at service providers to the
22 fund as service providers to the plan, or the

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1 fund as an investment that the plan makes.

2 It seems to us the fabric of ERISA

3 from the very beginning has been not to look

4 at the fund as plan assets, and not to look at

5 the fund's service providers as plan service

6 providers.

7 So I think that it doesn't bear

8 comparison to what you might find in other

9 circumstances. Now you may ask, well, that's

10 fine, but why should we think of funds

11 differently than other investment options?

12 Well, at a practical level, I think it's

13 because of the complement of disclosure that

14 you already have with respect to funds.

15 The issue, it seems to me, with

16 respect to informing plan fiduciaries here,

17 plan sponsors, is not, gosh, how can we create

18 massive new disclosure about mutual funds, but

19 how we can bring the disclosure with respect

20 to other plan investment options up to the

21 same standard that mutual funds have been

22 meeting for a long time. It would really turn

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1 the world on its head to me to look at this
2 project as saying, we have to multiply
3 exponentially the amount of disclosure we have
4 about funds in retirement plans, especially if
5 the notion is somehow that you're going to
6 help the employer, the plan sponsor, maneuver
7 through all this information to make an
8 intelligent decision.
9 PANEL MEMBER CAMPAGNA: So the up
10 front record keeper, the up front service
11 provider, would be responsible then for
12 disclosing any indirect compensation it
13 receives? It wouldn't be in the prospectus?
14 MR. STEVENS: Correct.
15 PANEL MEMBER CAMPAGNA: It
16 wouldn't be coming out of the mutual fund?
17 MR. STEVENS: Yes.
18 PANEL MEMBER CAMPAGNA: Okay.
19 Thank you.
20 PANEL MEMBER WILLIAMS: Okay. I
21 have a number of questions. I'll try to be
22 brief.

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1 When you talk about hundreds of
2 servicers to funds, and the possibility, given
3 the possibility of the number of parties of
4 interest that you would have to a plan --
5 sorry about that. The system's working
6 against me.
7 It seems that part of the problem
8 a responsible plan fiduciary would have would
9 be connecting the dots, which is, to what
10 extent are all these service providers, that
11 we know are service providers to plans, may
12 have relationships with one or more of the
13 servicers to the mutual fund. And we know
14 that those relationships exist. And so part
15 of what would be important to a plan fiduciary
16 would be, you know, connecting the dots.
17 Now in the comment that you made
18 on the class exemption, you were concerned
19 about service providers serving as conduits
20 for information that would come from
21 unaffiliated parties. And I'm wondering in the
22 context of really two basic questions: who

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1 should be the conduit for information that
2 would be provided to a plan, and do you have
3 any thoughts about how best to avoid
4 duplication of information that could be
5 delivered to a plan by a service provider?
6 MR. STEVENS: With respect to the
7 class exemption, I think our point was simply
8 that, if a service provider is passing along
9 information about a third party to a plan
10 fiduciary, a plan sponsor, that it should be
11 able to rely in good faith upon the
12 information that it's provided, and if it
13 happens to be wrong, through no fault of the
14 record keeper, for example, that is passing,
15 that it should not have committed a
16 prohibitive transaction, or have some
17 liability.
18 PANEL MEMBER WILLIAMS: Okay. But
19 what if there's still missing information,
20 then who should be the conduit for that
21 information?
22 MR. STEVENS: Well, I think that

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1 our comment letter indicates that, with
2 respect to fee information, that the record
3 keeper could assemble that, the function could
4 assemble that information, and provide it with
5 respect to mutual funds, or other investment
6 options under the plan.
7 PANEL MEMBER WILLIAMS: For
8 affiliated parties only, or for unaffiliated?
9 MR. STEVENS: I would think it
10 should be able to do so with both. For
11 example, if there were a third party fund that
12 were offered, it would receive the information
13 with respect to fees from that third party.
14 It could rely in good faith upon the
15 information that is passed along, and then
16 provide it to the plan sponsor. So it could
17 so with respect to both.
18 PANEL MEMBER WILLIAMS: So how
19 does the responsible plan fiduciary know
20 they're getting all the information, though?
21 Is it just relying on the one record keeper
22 who is serving as a conduit for all the funds,

1 or is there some other way that he can make
2 sure that they're getting information? I
3 guess I foresee a plan having a number of
4 service providers, and there's a possibility
5 that there would be duplication of information
6 coming from various service providers. But in
7 any event, I don't want to belabor the point.
8 So --
9 MR. STEVENS: I think the whole
10 structure of the rule, at least as I
11 appreciate it, provides legal requirements,
12 and potential liabilities to the parties
13 involved with respect to making sure that all
14 the information is passed along.
15 PANEL MEMBER WILLIAMS: Okay.
16 Because I sort of see it, they may be getting
17 duplicative information, and in other cases,
18 they may not be getting the information at
19 all. And assume that the service provider
20 would say "well, it wasn't my fault," that's
21 only part of the missing piece of the puzzle.
22 The other piece, of course, is well now what

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1 does the responsible plan fiduciary do to get
2 that information. And they were relying on
3 the service provider to get it, and the
4 service provider says they can't. So it would
5 seem that the service provider is in a better
6 position to get than the plan fiduciary. So
7 they would have to rely on some other person
8 to get that information. And if they don't
9 end up getting the information, then we're not
10 going to get where we want to be.
11 All right. I'll defer to some
12 other people here for a moment. I might get
13 back to you in a minute.
14 MR. STEVENS: Thank you.
15 CHAIR CAMPBELL: We heard some
16 testimony yesterday with respect to bundling
17 versus unbundling concerns, that at least one
18 person testified that it's not a matter of
19 separating out every element of a bundle, but
20 rather dividing it into two parts, one
21 administrative, and one investment, and
22 looking at the aggregate totals for both.

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1 And if I heard you correctly, you
2 were suggesting that that's also not
3 appropriate, and I'm just interested in how
4 you would respond to those questions.
5 MR. STEVENS: Well, I think the
6 issue is how the business model is put
7 together, how the provisions are contracted
8 for, and whether they are separately priced.
9 I mean, in some business models, they in fact
10 will be, that you could make a clear
11 distinction between the two. In others, they
12 are not, and it would require essentially
13 engineering some cost allocation, pricing
14 allocation, between an administrative category
15 and an investment category that may not have
16 immediate relevance to how the business is
17 operated or managed.
18 I think the important point here
19 is that they should be real numbers that are
20 provided to the plan sponsor, and that they be
21 put in a position based upon those real
22 numbers to compare apples and apples. And

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1 that's possible whether you have a group of
2 providers, in one case, and a bundled provider
3 in the other.
4 So I think the real issue is how
5 the business is run, how it's managed, and
6 whether that's a meaningful exercise within
7 that context to unbundle it between these two
8 broad categories that you cited.
9 CHAIR CAMPBELL: And also, if I
10 understood what you said correctly, your
11 general view is that the disclosures provided
12 under the rules applicable to mutual funds are
13 currently sufficient. One of the questions
14 that came up also in yesterday's testimony is
15 whether all the materials separately arriving
16 are themselves useful to fiduciaries, or
17 whether there's some way to either create a
18 specific document that puts them in one place,
19 or alternatively some form of an executive
20 summary that points you to the relevant
21 portions of the other documents. I would just
22 be curious what your thoughts are on that

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1 issue.

2 MR. STEVENS: Yes, thank you very

3 much, because this is an issue that we have

4 been wrestling with in the broad mutual fund

5 marketplace with respect to the prospectus.

6 Today's prospectus for funds, or

7 put differently, the totality of the

8 disclosure that funds are required to make,

9 satisfy two purposes. Much of the disclosure

10 goes to a variety of market participants that

11 may be different from investors as such:

12 commentators, analysts, investment advisors,

13 and the like, who really like to look under

14 the hood in great detail at the fund. There

15 are competing purposes, though, and they were

16 probably the original purposes for a

17 prospectus, and that is to inform an investor

18 with respect to an original purchase of the

19 fund, or with respect to an ongoing holding of

20 the fund.

21 And the SEC has worked hard to

22 accommodate both of those broad purposes

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1 through its disclosure regime. We have
2 focused at the Institute very specifically
3 over a period now of almost 15 years, on the
4 need for penetrating this large mass of
5 information to provide a quantum of high
6 quality targeted information to investors that
7 looks to the most useful information about the
8 fund that helps an investment decisions, and
9 frankly, I believe would help in this context
10 to inform the fiduciary obligations of an
11 ERISA fiduciary.
12 So what's happened? The SEC, in
13 the '90s, did put together that executive
14 summary at the front of the fund's prospectus.
15 It's called the Risk Return Summary, and it
16 was the result of considerable work, including
17 empirical surveys of investors about how they
18 use the documents, what the most important
19 information is, and it includes things like
20 our fee table, the standardized performance
21 index comparisons, descriptions of investment
22 policies and objectives, the risk

1 characteristics of the fund, and the like.

2 We have been urging the SEC, and

3 the SEC now has an ongoing rulemaking, as you

4 know, to go beyond that, and to develop a

5 standalone summary with the balance of the

6 information available to an investor 24/7 on

7 the internet, or upon request in hard copy

8 form through the mail. And we have high hopes

9 that the summary prospectus proposal will be

10 acted on favorably at the SEC.

11 But it seems to me that then

12 addresses itself to the question, how can a

13 fiduciary cut through the massive information

14 to the key information they might need about a

15 fund? You can do so now looking at the Risk

16 Return Summary, perhaps you will be able to do

17 so in future looking at the summary

18 prospectus, but with the confidence that, if

19 there's more information you want, it will be

20 there on line for you, or it will be there in

21 paper form if you need it.

22 The net of all this is that

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1 there's no loss of information about a fund
2 through the simplification process, but there
3 is a way of addressing the need for more high
4 quality, concise and targeted information that
5 sponsors of small plans may very well need,
6 quite critically, to do their duties.
7 CHAIR CAMPBELL: Okay. I don't
8 want to take up all the time here, and we
9 actually are expired, and out of fairness to
10 the other witnesses, we are going to need move
11 on. But if you all can see if you have some
12 key questions you want to ask quickly, because
13 I would like to give the rest of the panel a
14 chance, as well.
15 PANEL MEMBER DWYER: You talk
16 about SEC disclosures.
17 MR. STEVENS: Yes.
18 PANEL MEMBER DWYER: Okay. Isn't
19 it true, though, that in those disclosures,
20 that is only going to show the plan fiduciary
21 the costs of investing in the mutual fund?
22 It's not going to show who is sharing the

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1 revenue that's produced by the mutual fund
2 that the plan may be interested in. I mean,
3 are there -- talk about that.
4 MR. STEVENS: Well, it certainly
5 identifies the major recipients of the
6 revenue. I mean, you will have the mutual
7 fund's manager or investment advisor that will
8 be identified. It's major service providers,
9 the transfer agent, for example, principle
10 underwriter will be identified. So the large,
11 if you will, constituents that make a mutual
12 fund go will be identified in a prospectus,
13 and the fees that are being paid to them will
14 be reflected there, but it's the huge category
15 of subsidiary service providers, if you will,
16 that will not be. And frankly, it would be
17 impractical to try to have to disclose them in
18 a fund prospectus. It would be of no value, in
19 my judgment, anyway, to an investor.
20 PANEL MEMBER DWYER: Well let me
21 ask you, some of the commenters talked about
22 situations where, for instance, a broker is

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1 given a bonus of some sort for putting money
2 into a particular fund, or investment product,
3 or keeping it there at the end of the year.
4 Does that happen with mutual funds, and if so,
5 would that be disclosed anywhere?
6 MR. STEVENS: I'm not sure I
7 understand what the example is that you're
8 citing. Funds don't pay bonuses to investors
9 for those purposes. In fact, the great thing
10 about the mutual fund is it's highly
11 democratic. The returns to all of the
12 investors will be the same, at least investors
13 in a given class of shares of the fund. And
14 the SEC rules pretty much guarantee that.
15 Now, there may be arrangements,
16 revenue sharing arrangements which funds are
17 required to disclose with brokers that could
18 come out of compensation that is received by
19 an investment advisor to the fund, but it will
20 not be paid out of the fund to an investor as
21 a bonus in the way that you put it.
22 PANEL MEMBER DWYER: And that is

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1 disclosed? Where would that be disclosed?
2 MR. STEVENS: To the extent that
3 revenue sharing is permitted, the SEC has
4 required that it be disclosed in funds'
5 prospectus.
6 MR. HADLEY: I just want to add
7 that, to the extent you're talking about,
8 payment to a service provider to the plan, a
9 record keeper or somebody who's actually
10 providing services, as we said in our
11 testimony, your rule covers that gap which
12 doesn't exist now. The prospectus does not
13 provide individualized disclosure about every
14 person who is going to receive a 12b-1 fee.
15 It's certainly there, and covered by the
16 expense ratio, but it doesn't say, X person
17 received it.
18 The great thing about your rule is
19 that it makes sure that the recipient who is
20 actually servicing the plan discloses that
21 compensation.
22 PANEL MEMBER DWYER: And where

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1 would you ask us to draw the line in the rule?
2 To the direct contractor, the party directly
3 contracting with the plan?
4 MR. HADLEY: The rule is intended
5 to deal with people that have to worry about
6 406. That's your universe, and that's the
7 right place to draw the line is somebody who's
8 a party in interest.
9 PANEL MEMBER DWYER: All right.
10 Thank you.
11 PANEL MEMBER ZARENKO: A couple of
12 quick questions.
13 You're talking about the concern
14 that the rule seems to imply that some
15 providers to funds might be moving into the
16 providers to the plan, and making that
17 distinction. But yet you were talking about
18 how compensation received by an investment
19 manager would be relevant to a plan fiduciary.
20 So I'm just wondering, is the investment
21 manager, do you view that differently as all
22 the other providers to a fund, and you think

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1 that information is relevant to a plan?
2 MR. STEVENS: No. My point was
3 rather that, to the extent that part of the
4 fiduciary obligation is to understand the cost
5 structure of investments that are being
6 offered to plan participants, that all that
7 information is available with respect to the
8 cost structure of a fund. And again, it's in
9 gross terms in the fee table, but the
10 investment advisory fee, administrative costs
11 in accordance with the way the SEC has
12 structured the fee table, will all be there.
13 So the net economics of the fund
14 investment will be apparent, and I think
15 that's the key thing from the point of view of
16 the fiduciary looking at the fund as an
17 investment option. The subsidiary economics,
18 all the categories of service providers that
19 the fund's management or its board have
20 decided are appropriate to make the fund work
21 effectively for shareholders, that, it seems
22 to me, is not relevant.

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1 PANEL MEMBER ZARENKO: Okay.
2 MR. STEVENS: So my answer to you
3 is that, no, we don't look at one provider of
4 services as perhaps a service provider to a
5 plan as opposed to others.
6 PANEL MEMBER ZARENKO: Okay. And
7 my second question has to do with the conflict
8 of interest provisions, which leaving aside
9 that they're too broad, you talk about
10 limiting those disclosures to service
11 providers that make recommendations. Are you
12 really saying, limit it to fiduciaries? I
13 mean, when I hear "making recommendations," is
14 that a provider with discretion, it's an ERISA
15 fiduciary, are you trying to use that as the
16 line, or no?
17 MR. STEVENS: Well I guess, and
18 I'll let Mike talk about it in legal terms,
19 but in common sense terms, where money is
20 changing hands here, your regulations go a
21 long way to making -- and in fact, all the way
22 towards making those things apparent. All

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1 right. Where there may a conflict of interest
2 that arises is where someone is making a
3 recommendation to a plan, and is also in
4 receipt of that compensation. And that, it
5 seems to us, is the area where "conflict of
6 interest disclosures" perhaps are appropriate.
7 The way the provision is written
8 now, at least as I appreciate it, is it's
9 almost six degrees of separation. And I just
10 don't see that that's very useful. It's really
11 where an economic interest bumps up against
12 some recommendation or similar activity on
13 behalf of the plan.
14 PANEL MEMBER ZARENKO: And when
15 you talk about recommendations, are we talking
16 principally about recommendations of
17 investments?
18 MR. HADLEY: Or services.
19 MR. STEVENS: Or services.
20 MR. HADLEY: Or services.
21 PANEL MEMBER ZARENKO: Or other
22 services?

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1 MR. HADLEY: Yes.
2 PANEL MEMBER ZARENKO: Mike, do
3 you have any comments on the issue of whether
4 we're talking about ERISA fiduciaries, or is
5 that not --
6 MR. HADLEY: No. I think, if it's
7 a fiduciary, ERISA's rules already cover that
8 situation. If you're making a recommendation,
9 and you're receiving compensation because of
10 that recommendation, I think ERISA already
11 prohibits that.
12 PANEL MEMBER ZARENKO: Okay.
13 MR. HADLEY: So we understood part
14 of what you're trying to do here is to deal
15 with situations where somebody does not
16 identify themselves as an ERISA fiduciary.
17 Maybe they are, maybe they aren't, but they
18 claim they're not. But they still might have
19 some position of influence over the decisions
20 made by the plan fiduciaries. And that's -- we
21 thought that was a good place to nail the
22 focus of the rule.

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1 PANEL MEMBER ZARENKO: Okay.
2 Thank you.
3 PANEL MEMBER WIELOBOB: I just
4 have one question, and this is going to -- I
5 want to clarify, and try to understand
6 something both of you have discussed in your
7 testimony, and it sort of follows up on what
8 Fil was asking you about.
9 I think, if I understood what you
10 said, one of your suggestions for the proposal
11 would be to require fiduciaries to obtain fee
12 and expense information, and I think you said,
13 under the rubric of 404, you know, service
14 providers should help fiduciaries understand
15 what they need to understand in order to make
16 decisions.
17 One of the things we heard
18 yesterday during the day of testimony from
19 several witnesses was that people on the other
20 side of the equation encounter reluctance and
21 sometimes refusal to provide information from
22 some service providers, that it's not that

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1 easy, and I just would be interested in your
2 reactions to that, what we heard.
3 MR. STEVENS: Well, it seems to me
4 that's the justification, perhaps, for this
5 regulatory project that you have, and with the
6 teeth that you will have in it, making it
7 subject to the prohibited transaction
8 standards of ERISA.
9 You know, I'm not aware of
10 specific circumstances, and could not comment.
11 PANEL MEMBER WIELOBOB: Well, I
12 guess, were you suggesting, it sounded like in
13 your -- and this is what I wanted to clarify,
14 in your testimony, were you suggesting that
15 the onus be placed on the fiduciary to obtain
16 the information, or --
17 MR. STEVENS: Well, I think in my
18 comments I said there are two ways that you
19 could, and correct me if I'm wrong about this,
20 Mike, but there are two ways that you could
21 approach it. With respect to our information,
22 it's available in our disclosure documents, or

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1 if the issue is facilitating the collection of
2 that information with respect to a number of
3 different plan investment options, the record
4 keeper could be put in a role where that
5 information is gathered together, and provided
6 to the fiduciary.
7 Did I get that right, Mike?
8 MR. HADLEY: Yes, that's right.
9 I think ERISA already requires a
10 fiduciary to know what the basic fees before
11 they put an investment on a menu, or make an
12 investment for a DB plan, they need to get
13 that. If they cannot get it, for example, by
14 looking at the prospectus, or some kind of
15 compilation of that, then it's hard to imagine
16 that it would be appropriate to investment in
17 it.
18 PANEL MEMBER WIELOBOB: Thank you.
19 CHAIR CAMPBELL: Okay. Well,
20 thank you very much.
21 MR. STEVENS: Thank you.
22 Appreciate the opportunity.

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1 Would any of you like a copy of
2 our 2008 Service Directory?
3 CHAIR CAMPBELL: We'll be happy to
4 take whatever you'd like to submit.
5 MR. STEVENS: I'll submit it for
6 the record.
7 Next up would be Mr. Kant, with
8 Fidelity Investments.
9 Whenever you're ready, sir.
10 MR. KANT: Thank you.
11 Good morning. I'm Doug Kant. I'm
12 an ERISA lawyer with a group of companies
13 known as Fidelity Investments. We provide
14 investment management, and a range of
15 administrative services to thousands of
16 retirement and welfare plans governing
17 millions of participants.
18 Since this is for the record, I'm
19 going to mention that today is the completion
20 of my 19th year at Fidelity. In an odd way, it
21 seems like an appropriate way for an ERISA
22 lawyer to celebrate such an event.

1 We have already filed detailed
2 written comments on the proposal, and like
3 everybody else, we appreciate the opportunity
4 to testify today.
5 We certainly support the
6 Department's desire to promote a more
7 consistent disclosure framework for the plan
8 service provider hiring process. However, the
9 proposal won't accomplish that goal unless
10 certain disclosure responsibilities are
11 clarified, and service providers have
12 sufficient flexibility for discharging those
13 responsibilities.
14 I'm going to basically talk about
15 six points. The first, you've probably heard
16 more than you want to, which is I'm going to
17 join the ICI in encouraging the Department to
18 confirm that those persons who provide
19 services to a mutual fund do not become,
20 solely by virtue of those services, a service
21 provider to a plan that invests in such fund.
22 It's just that sort of position would be

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1 contrary to existing law, and would cause lots
2 of legal problems unrelated to the topic at
3 hand.
4 The second issue of the bundled
5 provider language in the proposal. The
6 proposal acknowledges a bundled service
7 provider as one who offers an array of
8 services that are priced as a package, rather
9 than as a separate fee for each service.
10 Bundled pricing and servicing is
11 common and appropriate for 401(k) plans.
12 The same firm provides plan
13 administrative services, and at least some of
14 the investment products. Because the mutual
15 fund expense ratio, that is, the fees charged
16 to operate the fund, defray the costs of some
17 of the same services that are required for
18 plan administration, mutual fund companies can
19 sometimes provide plan record keeping services
20 without charging an additional record keeping
21 fee. However, any attempt to assign a
22 percentage of the mutual fund revenue as

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1 revenue received for plan administration is
2 arbitrary. The mutual fund structure does not
3 allow the investment management to be
4 purchased separately from the shareholder
5 services that facilitate plan administration.
6 The proposal would require a
7 401(k) record keeper to disclose revenues
8 received by affiliated manager's mutual funds,
9 as discussed earlier, and the compensation
10 paid to other servicing affiliates included in
11 the plan's investment lineup. This is
12 necessary, and we agree with this, so the
13 fiduciaries can evaluate the total cost of the
14 plan, and the compensation paid to that firm.
15 We believe, however, that the
16 current wording of the proposal may improperly
17 disclose or impose disclosure obligations on a
18 bundled provider for investment products
19 offered by unaffiliated parties. Where
20 Fidelity is the bundled provider for a 401(k)
21 plan, for example, we commit to provide record
22 keeping services with respect to both Fidelity

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1 and non-Fidelity mutual funds. However, we
2 only provide investment management and related
3 services for Fidelity funds, not non-Fidelity
4 funds.
5 It seems to us inappropriate to
6 impose this add-on disclosure responsibility
7 as a condition for a statutory exemption for
8 the service provider's contract with a plan,
9 that is, for our service provider's contract
10 with a plan.
11 Moreover, this would be
12 inconsistent with the definition of a bundled
13 service arrangement in the proposal, and that
14 your recently finalized 5500 regulations. We
15 encourage the Department to clarify the
16 proposal by restricting a bundled provider's
17 disclosure duty to aggregate compensation for
18 services provided directly or through its
19 affiliates or through its subcontractors.
20 If you are determined to pursue
21 this course of action, and we understand this
22 is a tough one for you, the Department must

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1 clearly address the service provider's limited
2 responsibility to provide the prospectus or
3 other fee information that we receive from the
4 unrelated third party and our lack of legal
5 exposure for the problems arising from such
6 third party's disclosure. That is if they make
7 a mistake, it's their mistake not ours.
8 Turning to the conflicts
9 disclosure provision in the proposal. And,
10 again, you've heard this several times.
11 We do understand the concerns --
12 we think we understand the concerns expressed
13 by the Department trying to make sure that a
14 fiduciary can assess the objectivity of a
15 service provider's decisions or
16 recommendations. And this was talked earlier.
17 The fiduciary conflicts are generally
18 prohibited or else accommodated pursuant to a
19 statutory or administrative exemption under
20 ERISA.
21 **A good example is the Pension**
22 **Protection Act of 2006 exemption for**

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1 investment advice. The statutory exemption
2 imposed certain conditions including
3 disclosure on an investment provider subject
4 to potential conflicts and provided advice. So
5 we assume, really, that the focus has to be on
6 non-fiduciary services.
7 Now the proposal would require
8 that service providers disclose both direct
9 and indirect compensation in the service or
10 services provided in return, which should
11 acquaint the hiring fiduciary with the
12 financial interests and the role of each party
13 that it hires.
14 It is the potential mandate to
15 characterize each relationship as a potential
16 conflict that causes the concern.
17 In terms of methods of disclosure,
18 the proposal preamble states that the required
19 disclosures may be provided in electronic
20 format. We agree that greater flexibility will
21 help to lower the cost of plan administration
22 to the benefit of plan sponsors and

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1 participants alike. We encourage the
2 Department to consider the approach followed
3 in Field Assistance Bulletin 2006-03 which
4 provides transitional guidance for participant
5 statement recorded under PPA. In the bulletin
6 the Department concluded that effective access
7 to a secure website would constitute statement
8 delivery, subject we understand to the
9 condition that participants be provided with
10 notice of such availability and of their right
11 to request paper documentation instead.
12 We currently provide plan sponsors
13 with online access to prospectuses for
14 Fidelity mutual fund, and with fee disclosure
15 regarding payments received from unrelated
16 fund companies for servicing those funds on
17 our platform.
18 In both cases this manner of
19 disclosure is documented in the trust and
20 service agreement that we enter into with the
21 plan sponsor.
22 Finally, we note that the proposal

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1 would permit service providers some
2 flexibility in disclosing fees, for example,
3 by using a formula or a percentage of assets
4 and by using separate documents such as a fund
5 prospectus or brokerage fee schedule. We urge
6 the Department to promote flexibility in the
7 use of existing disclosures whenever possible.
8 Our experience demonstrates that
9 the timing of disclosures will vary greatly
10 from contract to contract. Therefore, we agree
11 with the Department and we ask that you retain
12 the approach in the proposal and not include a
13 specific time frame or try to dictate a
14 specific time frame for when the disclosures
15 need to be made before a contract is entered
16 into. In contrast, however, we believe that
17 the effective date contained in the proposal
18 is completely unrealistic.
19 We are confident, and that's in a
20 negative but respectful manner, that the
21 proposed 90 day rule does not provide enough
22 amount of time needed for us to analyze and

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1 prepare for the final regulation in advance of
2 contract negotiations for which such
3 disclosure will be required.
4 We do appreciate the desire to
5 bring this project online as expeditiously as
6 possible. Nevertheless, we strongly believe
7 that the final regulation effective date must
8 be extended to a full year at least to allow
9 service providers sufficient time to get ready
10 for negotiations.
11 The Department should also confirm
12 that the new disclosure mandate would only
13 apply to contracts entered into or
14 renegotiated after the effective date of the
15 final regulation.
16 We as a firm maintain thousands of
17 service contracts with retirement and welfare
18 plan sponsors. And we would literally be
19 unable to amend all those contracts, other
20 than in the normal course of contract changes.
21 As an alternative approach you
22 could impose the new fee disclosure

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1 requirement on service providers without the
2 need for full scale contract provisions.
3 Again, we would strongly suggest that we'd
4 need a full year to get ready for
5 implementation under this approach.
6 And finally, service provider
7 recourse. The prohibited transaction class
8 exemption that you propose in conjunction with
9 the guidance would give a plan fiduciary
10 relief if they unknowingly enter into a
11 contract with a service provider that has not
12 satisfied the disclosure requirements of the
13 regulation. In order to retain the exemption
14 relief, the fiduciary would be require to
15 request the misinformation from the service
16 provider who would then have 90 days within
17 which to respond.
18 Until now our primary concern is
19 whether a mistake or omission in disclosure
20 may cause a loss or expense to plan
21 participants or fiduciaries. The new rule
22 could result in the imposition of an excise

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1 **tax on the service provider in the event of a**
2 **disclosure failure, regardless of its impact**
3 **on plan administration. We ask the Department**
4 **confirm that the 90 day notice rule in a**
5 **proposal would provide the service provider**
6 **with the opportunity to correct the error or**
7 **omission in timely fashion and appropriate**
8 **fashion without financial penalty.**
9 **In the alternative, we ask that**
10 **the Department republish the proposed class**
11 **exemption and expand it to provide service**
12 **provider relief in appropriate cases.**
13 **In conclusion, I would be pleased**
14 **to respond to any of your questions.**
15 CHAIR CAMPBELL: All right. Why
16 don't we start on this side.
17 PANEL MEMBER WIELOBOB: No
18 questions.
19 PANEL MEMBER ZARENKO: A couple of
20 questions.
21 MR. KANT: Sure.
22 PANEL MEMBER ZARENKO: The first

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1 one has to do with the burden and the time
2 frame for compliance. I understand under this
3 rule there's a lot of contract issues --
4 MR. KANT: Yes.
5 PANEL MEMBER ZARENKO: --
6 renegotiating, revising, redrafting. But a
7 lot of commenters also suggest that there's
8 changes in their systems and their record
9 keeping that would need to take place. And I'm
10 wondering if some of those changes are already
11 underway because of the final Schedule C
12 reporting requirements, and whether that might
13 help offset what would be necessary to comply
14 with this rule?
15 MR. KANT: I'm going to confess
16 we're in the industry probably having trouble
17 deciding which guidance to focus on more. But
18 we're going back and forth.
19 I think part of it depends on what
20 the final regulation looks like. And that may
21 be part of what you're hearing.
22 From our end, for example, when

1 you're focused on disclosure of our free
2 structure, that is within Fidelity, I think
3 it's more of a startup cost we're talking
4 about, you know rather than a huge cost going
5 forward. If you're talking about how we deal
6 with third parties, unrelated third party's
7 fees, you know we get into that. We often are
8 with plan sponsors looking at sort of proposed
9 option-by-option expense ratio, for example.
10 Even for non-mutual funds. Was an attempt to
11 put the fees in there. But it's really on
12 more of a well this is just the two of us
13 talking this out rather than formal process of
14 getting that information and then putting it
15 in front of the plan sponsor before you could
16 really do the contract negotiation.
17 So if you're talking about third
18 party responsibility, that's an area where we
19 could be talking about a lot more expense.
20 And it's hard to be useful to you without kind
21 of knowing the magnitude of that third party
22 responsibility.

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1 Another example is the fact that
2 we now do some of the disclosure, for example
3 dealing with payments we may get from other
4 fund companies to help defray our costs for
5 record keeping those funds on our platform. We
6 currently disclose that with a secure website.
7 And we did that, in part, because in the mid
8 late '90s when more and more plan sponsors
9 were asking us to take designated options
10 managed by other parties, it got to be a very
11 big universe. So this is one place we can have
12 people come to to get all that disclosure.
13 If the final regulation doesn't
14 allow that, you know, if we don't have that
15 flexibility, that's going to require a lot
16 more expense, frankly. A lot more lead time
17 and a lot more expense to do because it's
18 going to require us the kind of cut and paste
19 it plan-by-plan, and that would be painful.
20 So really a lot of this is really going to
21 depend on what it looks like.
22 PANEL MEMBER ZARENKO: Talking

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1 about what goes on right now in terms of
2 disclosure to plan fiduciary, you spent a lot
3 of time talking about the prospectus and
4 passing that through --
5 MR. KANT: Yes.
6 PANEL MEMBER ZARENKO: -- and
7 that's effectively communicating information
8 about investment costs to plan fiduciaries.
9 I'm just wondering from your perspective do
10 plan clients ever say "I don't want a pile of
11 20 prospectuses. Can you boil this down for
12 me? Can you reformat it somehow?" Do you get
13 those kind of requests? Do you accommodate
14 them?
15 MR. KANT: Well I know we get
16 those requests. And I think part of it is to
17 some degree it's sometimes if you want to know
18 the fee, if someone wants to know I want to
19 know what this fund costs because I want this
20 compare this fund to that fund, really it's a
21 matter of okay, on page 1 is the index. And
22 you see the topic fees. You go to page 14

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1 there's an expense ratio right there. And so
2 it really isn't that complicated once you
3 tell, yes I know the prospectus is long.
4 Because a prospectus is designed and it was
5 originally designed for the retail world where
6 you're selling individual-to-individual. So
7 it tells you everything and, yes, sometimes
8 more than you'd like to know. But it will tell
9 you everything that you could want to know
10 about the fund, it's operation, the board,
11 everything. But in terms of, okay, that's
12 what you need; that's easy to find, easy to
13 point to.
14 Yes, we do. We will pull that out
15 for Fidelity funds and we do it often in the
16 contract process or even in a review process
17 in terms of let's look at where you are in
18 terms of your lineup. But we've never had to
19 do it, and if you will, we've never had sort
20 of a legal framework which kind of ups the
21 risk.
22 PANEL MEMBER ZARENKO: Right.

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1 MR. KANT: And particularly
2 knowing that, okay, if you transfer that and
3 you missed one. And, you know, you missed ten
4 basis points transferring with the prospectus
5 is still clear, so what does that mean to us.
6 And that's sort of what you hear. And I
7 think some of what you're hearing is
8 discomfort with whether now in helping, we
9 take on more legal exposure at the same time.
10 PANEL MEMBER ZARENKO: Do you
11 think a lot of plan fiduciaries end up
12 focusing on the expense ratio?
13 MR. KANT: They certainly do more
14 now than they did a couple of years ago.
15 Because it's in the news, and we've had
16 several plan sponsors who have asked now to
17 agree to contract language generated by the
18 408(b)(2) guidance. And, unfortunately, we've
19 had to then remind that it's not final yet and
20 so we don't really know what it should look
21 like yet.
22 But I mean, they know fees are in

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1 the news. Once you remind that, okay, it's
2 just the expense ratio, I think often the
3 rhetoric dies down pretty fast. And part of
4 the reason is just there's a lot of talking,
5 there's a lot of noise in the industry in
6 general, and I mean the 401(k) and DC plan
7 industry in general, a lot of noise about
8 fees. So I think it's understandable, a lot of
9 questions. I do think that once you've sort
10 of laid it out, I think a lot of that concern
11 is allayed.
12 PANEL MEMBER ZARENKO: Okay. And
13 your comment whether -- you talk about how we
14 incorrectly assumed that it's the record
15 keeper in a bundled construct that is the
16 bundled provider. But then the example that
17 you give is in the health and welfare plan
18 context. So I'm wondering is that only true in
19 the health and welfare context or in the --
20 MR. KANT: I think the concern was
21 that the bundled provider concept seems to
22 work the best in the 401(k) world, and it's

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1 the easiest to see. And I think that our
2 people on both the DB servicing and health
3 servicing side were sort of concerned well if
4 we're providing, for example, participant
5 disbursement service to defined benefit plan
6 or if we're doing communication service for a
7 health plan, are we bundled? We're just not
8 sure what that means.
9 The term, it's harder to define.
10 It's hard to articulate in the other practice
11 areas. And I think that's part of what you
12 heard yesterday. I think.
13 PANEL MEMBER ZARENKO: But the DC
14 side, would you say it typically is the record
15 keeper that's a bundled provider?
16 MR. KANT: We certainly know that
17 we're viewed as kind of the focus. And our
18 concern is we understand that. The problem is
19 that our lack of control over other people's
20 managed funds. And some of the mutual fund.
21 And there you sort of know it all kind of
22 works the same way. But, you know, you get

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1 into bigger plans, individually managed
2 options, bank group trust products, employer
3 stocks; you know various types of things,
4 there's sometimes it means -- you know,
5 bundled to us means what you have control
6 over. We don't control over that.
7 We have plan sponsors who are
8 still talking to other firms about one or more
9 of the options as we're trying to get our
10 service contract in place. And so that we're
11 concerned about that being viewed as part of
12 the bundle. We're going to record keep it.
13 And we're going to have to tell you if that's
14 going to cost extra for us to record keep it.
15 And if the other provider, the unrelated
16 party is going to make payments to us to help
17 defray the costs, you need to know that and we
18 disclose that now. And we will certainly keep
19 doing it whether you enacted this guidance or
20 not. But, we'll take care of that.
21 Our concern is we don't -- as I
22 once have said, I don't view these other

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1 people as part of my bundle.

2 PANEL MEMBER ZARENKO: My final

3 question is whether you have any comments on

4 any similar need for transparency in the IRA

5 market?

6 MR. KANT: I don't. I mean I think

7 the IRA market I think has been worked well in

8 terms of it's different in part because it

9 really is you're dealing with the person who

10 is going to open up the IRA account. And there

11 is a disclosure regime in place there already.

12 And I think it works. I'm not aware of

13 problems, but I'm also not sure how you do it.

14 I mean sort of the contract

15 process really doesn't happen in an IRA

16 account. I mean, IRA documentation is pretty

17 much here it is. If you want ours, here's the

18 stuff, here's the disclosure. And if you want

19 somebody else's, that's where you go.

20 You know, it is certainly true

21 that you see a wide range of investments in

22 IRAs, and that's kind of a problem in itself.

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1 Because more and more IRAs are represented on
2 brokerage platforms. So you've got kind of
3 array of stuff that can be bought.
4 But I'm not sure, frankly, it's an
5 arena that would benefit from adding this into
6 it. And I'm not sure how it would work.
7 PANEL MEMBER ZARENKO: Some people
8 have suggested that the IRA market would be
9 more akin to any requirements for disclosure
10 to plan participants and beneficiaries rather
11 than to disclosures to plan fiduciaries. Do
12 you have any thoughts on whether you think
13 that's the way to go?
14 MR. KANT: I'm not sure, because
15 I'm not sure what's the perceived lack. I
16 mean, I know in the 401(k) you know you're
17 going to publish more guidance and we're going
18 to have to respond to that. We already have
19 pretty extensive participant disclosure in
20 place that we use with our clients. But we
21 understand that we're going to see more and
22 deal with that.

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1 In the IRA world I just don't have
2 a good sense of what the perceived need is. I
3 could ask.
4 PANEL MEMBER ZARENKO: Thank you.
5 PANEL MEMBER DWYER: Let's say
6 you're the record keeper and often on your top
7 form. Affiliated funds and unaffiliated funds.
8 Okay. What is the universe of your source of
9 revenue on those two respective type of funds?
10 And I'll tell you my follow up question in
11 advance.
12 MR. KANT: Sure.
13 PANEL MEMBER DWYER: Which of
14 those sources of revenue are not disclosed
15 under the current SEC requirements?
16 MR. KANT: I think this is the
17 follow up question. I think it's sort of
18 pursuant to a question you asked the earlier
19 speaker.
20 I mean the prospectus, in terms of
21 what we get, what Fidelity gets from our
22 funds, that's totally disclosed in the

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1 prospectus and we'll also lay it out for you
2 if you ask us to make it simple.
3 PANEL MEMBER DWYER: So any kind
4 of revenue sharing would be disclosed?
5 MR. KANT: You mean revenue share
6 within the --
7 PANEL MEMBER DWYER: Well, you
8 tell me. What happens in there, what's going
9 on?
10 MR. KANT: I mean from our
11 perspective when you buy mutual fund, you're
12 buying all in. When you're buying our mutual
13 fund, you're buying all in. And so the
14 prospectus will tell you the expense ratio;
15 that's it. If the expense ratio is 67 basis
16 points, that means pretty much we get 67 basis
17 points.
18 PANEL MEMBER DWYER: Yes.
19 MR. KANT: If you look at
20 prospectus you'll seem, a little far back, it
21 will lay out -- at least in our prospectus,
22 for example, it will tell you not only what

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1 that is but okay, let's show you in a
2 hypothetical, say, $10,000 investment. And
3 let's say, I think the earning assumption was
4 5 percent a year. We'll show you the dollars
5 what you would end up paying the first year,
6 second year, third year. Kind of give you a
7 sense of what this means. And so they have
8 all that detail in our mutual funds.
9 With respect to somebody else's
10 mutual fund, I don't think their prospectus
11 will tell you what they might pay us. So we
12 would do that.
13 PANEL MEMBER DWYER: What will
14 they pay you? Record keeping plus what?
15 MR. KANT: It's just an agreed fee
16 for servicing, if you will.
17 PANEL MEMBER DWYER: So it's just
18 record keeping? There's nothing -- I mean,
19 what other fees might there that would --
20 MR. KANT: That's it. I mean, you
21 know, there's just a basis point charge, which
22 is the agreement. Because we need to work out

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1 -- usually with a fund group we're going to
2 have to work out an agreement. I mean, we're
3 passing information and money back and forth
4 in a daily record keeping environment. And so
5 we have to work out the methods by which we do
6 that. Okay. And in return for our servicing
7 their funds as part of the 401(k) world, they
8 may agree to pay us, it could be 25, 35 basis
9 points. If that helps to --
10 PANEL MEMBER DWYER: What would
11 you call that fee? Is there a name for that
12 type of fee?
13 MR. KANT: Payment for
14 administrative services.
15 PANEL MEMBER DWYER: Yes.
16 MR. KANT: I think you're going to
17 get different firms to be different names.
18 PANEL MEMBER DWYER: And is that
19 disclosed currently in the SEC disclosures?
20 MR. KANT: I don't think their
21 prospectus will tell you that. That's frankly
22 why when we started doing this back in mid

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1 late '90s we did bill a separate disclosure
2 regime. So that piece of it we're sort of
3 looking forward to your guidance because then
4 everyone will have to do it. But we make sure
5 that a plan sponsors know what we get from
6 anybody else. So they understand that for
7 Fidelity, because for Fidelity you get record
8 keeping, all the options, and we manage say a
9 finite set of the options in your plan. And
10 for all of that we want you to know everything
11 we get.
12 PANEL MEMBER DWYER: Right. See,
13 we understand that you're saying you
14 voluntarily disclose it. But where from a
15 regulatory perspective, we're interested about
16 what's not being disclosed right now that
17 exists in this --
18 MR. KANT: Yes, and I understand.
19 PANEL MEMBER DWYER: Right.
20 MR. KANT: I don't think that
21 detail --
22 PANEL MEMBER DWYER: Yes,

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1 generally. Yes.

2 MR. KANT: I mean and part of the

3 problem would be to get that into the

4 prospectus the fund company would kind of have

5 to know year-to-year everyone they could enter

6 into arrangements with, third parties. And I

7 think that's probably why you don't see it.

8 And so we felt particularly in the 401(k)

9 world you need to tell your plan sponsor so

10 they know what's going on so they can decide,

11 frankly, whether our earnings are appropriate.

12 PANEL MEMBER DWYER: And another

13 question. You may just have to give me

14 examples. But you know there's been all of

15 the comments on bundled versus unbundled.

16 Let's say we break up the bundle. You're the

17 record keeper. What's in there? Tell us

18 what's going to be in the bundle. What are the

19 components?

20 MR. KANT: Yes. I always struggle

21 with this one. Because to me the bundle

22 simply means you get it all. You get your

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1 record keeping investment management. And one
2 of our problems has been, because we've talked
3 about if we unbundle, how would we do that. We
4 spend more time arguing about how we'd have to
5 describe what the breaking out is not.
6 For example, we can come up with a
7 number, but this will not reflect your record
8 keeping fee but the Government told us we have
9 to give you a record keeping fee number. I
10 mean, we don't do it that way. We don't
11 charge it that way in the mutual fund. The
12 mutual fund was designed, it is priced, the
13 compensation is earned to allow us to do it
14 all in. You know, it's not broken out.
15 In terms of I've heard people
16 argue that well it's hard to compare a bundled
17 service arrangement to an unbundled. And I
18 really struggle to understand why it's
19 difficult.
20 Bundled means you look at each
21 option, investment option and there's the
22 expense ratio and you're done. If you look at

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1 unbundled well each fund still has an expense
2 ratio, so that doesn't go away. And there's an
3 additional record keeping fee. Well, you add
4 that on in a participant basis and again
5 you're done. It just takes a little more work.
6 Since in the end from the
7 participant's perspective if you're going to
8 pay 67 basis points, whether you decide well
9 we're going to tell you that 17 is record
10 keeping but if you don't like that, we'll tell
11 you that 20 is record keeping. You know, it's
12 just not made to be broken out. And so we
13 are--
14 PANEL MEMBER DWYER: But would it
15 be impossible to break it out?
16 MR. KANT: We could make up a
17 number, but we'd want you to tell us --
18 PANEL MEMBER DWYER: But would
19 that number be real or --
20 MR. KANT: No, it wouldn't. And
21 we'd want you to assure us is it okay that
22 it's a made up number.

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1 Part of our problem is how do we
2 describe to people what it is without trying
3 to tell them what it's not. And what it's not
4 is a number that is useful to them. Because
5 what it's not is -- and I've heard -- I even
6 heard one consultant refer to it as hidden
7 fees. I'm really struggling to understand
8 what's hidden about 67 basis points. I just
9 don't understand. For 67 you get investment
10 management record keeping and you're done.
11 PANEL MEMBER ZARENKO: Just
12 internally --
13 MR. KANT: Yes.
14 PANEL MEMBER ZARENKO: -- you
15 don't try to attribute your costs between
16 record keeping and investment --
17 MR. KANT: I'm sure we try to keep
18 track of costs. But --
19 PANEL MEMBER ZARENKO But that in
20 no way though you're saying would translate
21 into the compensation made by a plan?
22 MR. KANT: You may give people

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1 credit, you may give an organization credit
2 for bringing business in. You know, I mean
3 that's how you pay people if you think they're
4 doing a good job. But it doesn't really tell
5 -- but telling a plan what you're paying--
6 what you were paid in compensation for record
7 keeping. We really don't run our business that
8 way on that side.
9 You know, to a plan we could sell
10 record keeping only. And then it would be
11 record keeping only, and so we give you a
12 price, a separate price. And if you're a
13 third party record keeper, that's what we're
14 going to disclose. Obviously if they're a
15 third party record keeper and they get
16 payments from fund companies and that reduces
17 that, they'll tell the plan sponsor as well to
18 make sure the plan sponsor knows exactly who
19 gets what.
20 But, you know, Fidelity is a firm.
21 It's a firm, it's a common economic interest.
22 All the pieces of Fidelity, and we do have a

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1 lot of pieces. In the end it's one economic
2 entity. Just as, you know, on the fiduciary
3 side if one part of Fidelity tried to exert
4 any fiduciary authority regarding the plan
5 that might benefit another part of Fidelity,
6 you would quite properly say that's a
7 fiduciary breach. You can't do that. Because
8 it's one economic -- you know we have a common
9 economic industry.
10 PANEL MEMBER WIELOBOB: So it's
11 hard to say how the component parts affect the
12 whole?
13 MR. KANT: It is in the context of
14 the way mutual fund work, yes. You know, you
15 can run a business model and some firms run a
16 different business model in which there's a
17 separate investment management arm and a
18 separate record keeping arm and they are
19 priced separately and you can buy either one.
20 You know, I can take, I can take that; I
21 don't need to take them together. With mutual
22 funds it's all put together.

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1 PANEL MEMBER DWYER: Thank you.
2 CHAIR CAMPBELL: Okay. I just had
3 one question. We had received some comments
4 from folks who were concerned about the
5 requirement that they disclose in their
6 arrangement or contract whether they're a '40
7 Act fiduciary or an ERISA fiduciary. I was
8 curious if you had any comments on that.
9 MR. KANT: I think it was, at
10 least from our end, our concern was that the
11 '40 Act reference to us seemed to imply that
12 we're sort of getting back to the investment
13 advisor to a mutual fund, whether that might
14 be construed as a party interest relationship.
15 I think that was more our concern. And the
16 other thing, maybe it was just within the
17 industry some questioning why you care about
18 '40 Act fiduciaries because we always thought
19 you only cared about ERISA fiduciaries. But
20 that may have been our oversight.
21 CHAIR CAMPBELL: Okay.
22 PANEL MEMBER CAMPAGNA: Back to

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1 your conflict of interest testimony.
2 MR. KANT: Yes.
3 PANEL MEMBER CAMPAGNA: You had
4 problems with the way we characterized it. I
5 think it was that we characterized it as
6 conflicts of interest disclosure.
7 The ICI suggests, for instance,
8 that we focus perhaps just on service
9 providers who make recommendations. Could you
10 just give me your thoughts on what you would
11 see as appropriate and react to that?
12 MR. KANT: And this probably may
13 be more of a concern in the consulting
14 industry, just in terms of if you're a
15 fiduciary, you just can't have conflicts. If
16 you're providing help to people in whether
17 it's selecting a vendor or selecting funds,
18 whatever it is, you may get into the sort of
19 recommend mode but not step over the fiduciary
20 line.
21 I think the plan fiduciary
22 absolutely has to know, oh by the way I'm

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1 going have you pick the lineup, and by the way
2 some of the manager share income with me. And
3 you, the fiduciary, should know that.
4 I think it may be just the
5 characterization as a potential conflict, does
6 that add anything and is there a
7 characterization there that causes concern. I
8 think for us it's more a matter of just being
9 clear what's meant by potential conflict.
10 PANEL MEMBER CAMPAGNA: But you
11 see it as valuable information?
12 MR. KANT: I think the critical is
13 the plan sponsor understands all your
14 financial interests.
15 PANEL MEMBER CAMPAGNA: Okay.
16 MR. KANT: You know, what are you
17 getting. When you're talking about, for
18 example, a fund lineup if you will, what's in
19 it for you.
20 PANEL MEMBER CAMPAGNA: Okay.
21 Just one last question for interest of time.
22 You say that for some of your clients you

1 actually take the prospectus and refer to
2 various places in the prospectus where the
3 relevant information is. Would you have any
4 problem with that being part of the
5 regulation?
6 MR. KANT: In terms of disclosing
7 the plan sponsor is this where you find it?
8 PANEL MEMBER CAMPAGNA: Yes.
9 MR. KANT: Well, I don't think I
10 would except the page -- the fee information
11 will be different from prospectus-to-
12 prospectus.
13 PANEL MEMBER CAMPAGNA: Right.
14 MR. KANT: So as long as we don't
15 have to cite page numbers, I guess I'm good
16 with that.
17 PANEL MEMBER CAMPAGNA: Okay.
18 Thank you.
19 PANEL MEMBER PIACENTINI: Two
20 questions. I'm trying to get a clearer sense
21 of the dynamics of some of this market. I'm
22 understanding more and more about the

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1 arrangements, but you talked about Fidelity's
2 role as a record keeper. I know that it's
3 also, of course, a fund vendor. You talked
4 about how you might receive revenue sharing as
5 a record keeper from unaffiliated funds that
6 you offer. I wonder if you might also provide
7 revenue sharing to other record keepers who
8 offer your funds.
9 But in thinking about maybe both
10 of those types of flows, my question is we
11 heard I think yesterday and today how in some
12 sense investment options are bought. That is,
13 plan sponsors might ask a record keeper please
14 make it possible on your platform for me to
15 investment in this fund. I wonder to what
16 degree funds are also sold where a fund vendor
17 might go to a record keeper and say please add
18 my fund to your platform and make an offer of
19 what the revenue sharing arrangement might be
20 that might that attractive? Can you just talk
21 about that dynamic a little bit and how that
22 plays out?

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1 MR. KANT: Yes. And by the way,
2 some plan sponsors ask quite strongly that we
3 would record keep other people's options.
4 I think it's inevitable in some
5 cases to get in conversation in terms of
6 payments to be made to a service provider, if
7 you will. But you know it comes down to the
8 plan sponsor needs to know what's going on.
9 And if they need to know what's going on in
10 terms of, okay, you're going to get X basis
11 points. If I pick those three funds, I now
12 know that you're getting 40 basis points
13 instead of 30 basis points. The critical to
14 me is the plan sponsor knows that's happening.
15 The dynamics, I think disclosure
16 cures a lot of the concern. The problem is
17 when it's not disclosed, then you don't know.
18 PANEL MEMBER PIACENTINI: So you
19 said that as a record keeper, Fidelity does
20 disclose revenue sharing that comes back --
21 MR. KANT: Yes.
22 PANEL MEMBER PIACENTINI: -- to

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1 defray the record keeping costs. Do you know
2 whether the record keepers, on whose platforms
3 Fidelity funds are sold, whether they also
4 disclose revenue sharing from Fidelity? Is
5 that something that you're concerned about.
6 MR. KANT: Well, when we contract
7 with third party record keepers, we would
8 normally require in our contract that they do
9 that disclosure. And I don't work on --
10 Fidelity has several different business models
11 that operate. So I tend to operate more on
12 the direct side. But my understanding is that
13 when we contract with a third party's meter,
14 then when we're going to require as a matter
15 of contract that they take on the disclosure.
16 Because, again, we want to make sure the
17 ultimate users, if you will, the ultimate
18 payor knows what's going on.
19 PANEL MEMBER PIACENTINI: Okay. I
20 have one question about the idea of a single
21 cost in the expense ratio that might include
22 defraying the cost of record keeping in the

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1 direct offering arrangement.

2 MR. KANT: Yes.

3 PANEL MEMBER PIACENTINI: I

4 understand what you said in response to an

5 earlier question about how dividing those

6 costs up is kind of artificial. But I guess

7 the question that poses for me, if I

8 understand correctly for investors in a given

9 share class, they'll all have the same expense

10 ratio. But some of those might be record kept

11 by your company and some might not. So is

12 that correct?

13 MR. KANT: I'm sorry. For the same

14 plan -- not for the same plan? I mean, again-

15 -

16 PANEL MEMBER PIACENTINI: No, for

17 two different plan clients.

18 MR. KANT: Okay.

19 PANEL MEMBER PIACENTINI: One is

20 record kept by your company and invests in

21 fund A.

22 MR. KANT: Yes.

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1 PANEL MEMBER PIACENTINI: Has a
2 particular expense ratio associated with that.
3 And then another has a different record
4 keeper, but also invests in fund A. Would they
5 have the same share class and pay the same
6 expense ratio even though they're not getting
7 record keeping from you?
8 MR. KANT: Yes. Historically on
9 the direct side we have not had much in the
10 way of different share classes. So I'm
11 probably not the world's expert on this.
12 My guess is the answer is yes, at
13 times depending on -- for example, it could be
14 the given share class imposes a minimum dollar
15 amount as an investment before a plan can get
16 that share class. And so it could be that a
17 smaller plan is ineligible for a given share
18 class. And the way you define eligibility may
19 differ a lot from fund group-to-fund group
20 and, frankly, from fund-to-fund. But I'm sure
21 the answer has to be yes. Yes, there are
22 situations in which either we're record

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1 keeping plans in different share classes,
2 somebody else's different share class or
3 somebody else record keeping in different
4 share classes.
5 PANEL MEMBER PIACENTINI: So in a
6 case like that the client who is using a
7 different record keeping might actually be
8 able to separate out from your expense ratio
9 how much is going for record keeping if the
10 record keeper disclosed to them a revenue
11 share that was coming back to defray a record
12 keeping expenses.
13 MR. KANT: I don't think that
14 would tell them at all. It would tell them if
15 there is a difference in share classes. What
16 they make with that information, I don't know.
17 PANEL MEMBER PIACENTINI: Okay.
18 Thanks.
19 MR. KANT: I don't think that was
20 very helpful, but it's the best I could do.
21 PANEL MEMBER PIACENTINI: It was a
22 strange question.

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1 MR. KANT: Thank you.
2 CHAIR CAMPBELL: All right. Well,
3 with that, having already consumed our 15
4 minute break with questioning, we will take a
5 five minute break and then come back after
6 that.
7 Thank you very much.
8 MR. KANT: Thank you.
9 (Whereupon, the above-entitled
10 matter went off the record at 10:33 a.m. and
11 resumed at 10:47 a.m.)
12 CHAIRMAN CAMPBELL: All right.
13 Our next witness is Ms. Fallon-Walsh with The
14 Vanguard Group.
15 MS. FALLON-WALSH: Thank you.
16 Good morning. My name is Barbara
17 Fallon-Walsh. I'm the principal at The
18 Vanguard Group in Valley Forge, Pennsylvania,
19 who is responsible for our Institutional
20 Retirement Plan Services Group.
21 My remarks will be relatively
22 brief to leave time for discussion and the

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1 questions I know you'll want to ask.
2 Vanguard is the world's second
3 largest mutual fund company, managing
4 approximately 1.3 trillion in assets invested
5 in some 150 U.S. mutual funds. We are also
6 one of the nation's largest full service
7 providers of investments and record keeping
8 services for 401(k) and other retirement
9 savings plans. Vanguard administers some 240
10 billion of retirement savings plan assets on
11 behalf of some 2,000 plan sponsor clients and
12 more than 1.3 million plan participants.
13 We have long advocated and
14 provided full and candid disclosure of plan
15 and investment fees and we support the
16 Department's proposal to provide full
17 disclosure of direct and indirect fees paid by
18 retirement plans and their participants to
19 service providers.
20 For a number of years Vanguard has
21 regularly provided all-in fee reports to our
22 bundled defined contribution plan clients so

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1 that these plan sponsors can easily understand
2 the fees the plan and participants pay.
3 Clients consistently tell us that this report
4 is clear and quite effective at helping them
5 satisfy their fiduciary duties under ERISA
6 because the report provides a concise
7 breakdown of all indirect or asset-based fees
8 that the plan is paying and a breakdown of all
9 other direct fees paid by the plan.
10 In our comment letter to the
11 Department we provided a sample of an all-in
12 fee report, and I did bring copies of that
13 report today for submission into the record.
14 We believe the Department's
15 proposed disclosure will fulfill its
16 objectives of helping plan sponsors understand
17 the services provided to the plan, all fees
18 paid directly and indirectly by the plan and
19 its participants for those services so that
20 sponsors can determine whether those fees are
21 reasonable, and any compensation that third
22 parties receive in connection with the

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1 services provided to the plan so that plan
2 fiduciaries know that the service provider has
3 no hidden or conflicted interest in the
4 services it's providing.
5 These disclosures will help plan
6 sponsors fulfill their ERISA responsibilities
7 which, in turn, should help participants
8 achieve their retirement savings goals.
9 Although the 401(k) market is
10 extremely price competitive, it's not always
11 easy for sponsors to compare fees. It can
12 take considerable effort by sponsors to
13 compare fees among providers because of
14 varying reporting formats, differing service
15 models and unique fee structures associated
16 with different investment vehicles. We
17 endorse the Department's goal of moving toward
18 a more uniform fee disclosure regime where the
19 onus is on the service provider receiving fees
20 to affirmatively provide regular disclosures
21 to the plan sponsor.
22 This initiative will reduce the

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1 effort and time sponsors spend on gathering
2 and comparing price information, and
3 importantly facilitate apples-to-apples
4 comparisons of different service models and
5 investment products.
6 The proposed disclosures will be
7 most effective if they are clear, consistent
8 across all investment types and free of
9 redundant information. To ensure that plan
10 fiduciaries understand their precise legal
11 obligations with respect to the disclosed
12 information, we believe the proposed
13 regulation could be clarified in several
14 respects. The comment letter we submitted to
15 the Department on February 11 covers these
16 recommendations in detail. Today I'll just
17 highlight a few of our suggestions.
18 First, we recommend that the
19 Department require service providers for all
20 types of plan investments, whether separate
21 accounts, insurance products or collective
22 trusts to provide fee disclosures in a form

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1 similar to the expense ratio disclosures
2 required of mutual funds. The expense ratio
3 is a widely understood method of expressing
4 asset-based fees and sponsors could easily use
5 such ratios to compare varied types of
6 investments and fee structures.
7 What's more, such a simple and
8 uniform disclosure format would provide a
9 level playing field for all types of plan
10 investments. Tens of millions of investors
11 regularly use expense ratio type disclosures
12 mandated by the SEC in comparing mutual funds.
13 And we believe the Department could develop
14 standards similar to those required by the SEC
15 to ensure that disclosures for all retirement
16 plan investments are similarly comparable.
17 In practice, Vanguard provides
18 expense ratio type disclosures for our non-
19 mutual fund products such as separate accounts
20 and collective trusts and these disclosures
21 are well received by our plan sponsor clients.
22 At the same time, we think that it

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1 is important for the Department to confirm
2 that plan sponsors are not required to receive
3 mutual fund expense information that goes
4 beyond what the SEC requires today. Today the
5 SEC requires the disclosure of all shareholder
6 fees, fees charged directly to an investor
7 such as the sales load or redemption fee and
8 the disclosure of all annual fund operating
9 expenses; the ongoing expenses that are
10 deducted from fund assets and thus are born
11 indirectly by investors.
12 In our experience this disclosure
13 regime works well for all fund investors,
14 individual investors and retirement plan
15 sponsors alike and it would be very helpful
16 for plan sponsors in the industry if the DOL
17 would confirm that compliance with the SEC
18 disclosure requirements is sufficient for the
19 purposes of ERISA section 408(b)(2).
20 Similarly, we believe that it is
21 important for the Department to confirm that
22 service providers to mutual funds are not

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1 service providers directly to the plans that
2 invest in the mutual funds. In other words,
3 the providers of services to mutual funds such
4 as fund investment advisors, custodian banks,
5 auditors who have no direct connection to the
6 plans that invest in the mutual fund should
7 not be required to provide disclosures that
8 are contemplated under the Department's
9 proposal.
10 If the Department were to take a
11 different approach and require a look through
12 to the underlying service providers of mutual
13 funds, plan sponsors would be overwhelmed with
14 disclosures that would be of limited value and
15 completely duplicative. These service costs
16 are already reflected in the fund's expense
17 ratio. What's more, these service activities
18 are already governed by existing federal
19 securities laws designed to protect all
20 investors in the mutual fund.
21 Also, in many cases it would be
22 impossible for a mutual fund service provider

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1 to know the identity of any specific plan
2 invested in the mutual fund since the mutual
3 fund service provider does not enter into
4 contracts or arrangements directly with the
5 plan sponsor.
6 When a plan invests in a Vanguard
7 fund but does not use Vanguard plan record
8 keeping services, we will provide fund fee and
9 expense information through the fund's
10 prospectus to the plan's record keeper. The
11 record keeper will then provide the expense
12 information directly to the plan sponsor.
13 That is what happens when Vanguard is the
14 record keeper for a plan that invests in a
15 non-Vanguard fund on our bundled platform. We
16 collect fee and expense information for each
17 of the non-Vanguard funds offered in our
18 clients' plans and report this information to
19 our plan sponsors.
20 You can see an example of how this
21 disclosure works in the non-Vanguard asset-
22 based fee section of our all-in fee report. We

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1 have found that this consolidated disclosure
2 form is reviewed by fiduciary committees which
3 regularly monitor the reasonableness of fees
4 charged on their plan's investments.
5 With regard to revenue sharing
6 payments, we strongly support the Department's
7 approach that requires a service provider
8 receiving a revenue sharing payment from a
9 mutual fund or other investment to disclose to
10 the plan sponsor the amount of the payment
11 that is being received. In that way the plan
12 sponsor can monitor who is receiving such
13 payments and whether or not such payments are
14 appropriate given the services being provided.
15 In addition, we would encourage
16 the Department to remind plan sponsors that to
17 the extent the revenue sharing payment is
18 coming from a fund, under the plan that
19 charges an additional fee such as a 12b-1 fee,
20 the plan sponsor has a fiduciary
21 responsibility to consider the appropriateness
22 of that fee because it is ultimately being

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1 born by all investors in that fund, including
2 the plan sponsor's participants.
3 With respect to bundled versus
4 unbundled service delivery and fee disclosure,
5 we strongly support the Department's
6 conclusion that bundled service providers need
7 not artificially unbundle services and fees if
8 the services are not delivered in an unbundled
9 package and fees are not charged separately
10 for each service.
11 Bundled service offerings are
12 popular in the marketplace today because they
13 offer an effective one-stop approach to
14 delivering the ever expanding breadth of
15 services it takes to provide a top-notch
16 retirement savings package. This approach
17 enables the plan sponsor to partner with a
18 single central service provider whose core
19 investments, service quality and fees can be
20 monitored without hiring teams of consultants
21 or other experts to oversee multiple
22 providers. This can be especially important

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1 to smaller employers with more limited
2 resources.
3 Examples of the types of service
4 Vanguard is capable of offering in our bundled
5 service offerings include:
6 The ability for participants to
7 have 24 by 7 account and transaction access
8 through the web and toll free telephone lines;
9 Regular participant account
10 statements and comprehensive investing
11 education and advice programs;
12 Extensive compliance testing
13 services such as nondiscrimination testing and
14 excess contribution monitoring;
15 Plan loan and hardship withdrawal
16 tracking and payment processing;
17 After tax and Roth contribution
18 tracking and tax reporting.
19 To the extent a bundled price is
20 charged, we feel a requirement to separate out
21 components of the bundled fee would result in
22 an artificial and irrelevant allocation of

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1 fees. If, however, some of the services are
2 delivered separately with a separate charge
3 associated in an unbundled or quasi-unbundled
4 approach our view is that it is appropriate to
5 require disclosure of that component price
6 since it represents a reliable number that is
7 separately negotiated and charged to the plan
8 sponsor.
9 You'll notice in our sample all-in
10 fee report that we do provide specific
11 disclosure for service fees that are billed
12 separately.
13 We agree that plan sponsors need
14 to have a comprehensive list of the services
15 that are included in the bundled offer in
16 order to compare that package's all-in fee
17 with other bundled offers or the aggregate
18 fees associated with a group of unbundled
19 services offered in a more a la carte fashion.
20 To make the comparison manageable, we
21 recommend that the Department's final rule
22 mandate broad descriptions of services

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1 provided to the plan, such as investment
2 management, record keeping, participant
3 education, web and phone services, brokerage,
4 et cetera rather than a long list of each
5 individual service component provided to the
6 plan. The latter approach could overwhelm
7 fiduciaries and would not be meaningful since
8 plan sponsors do not purchase services on such
9 a granular basis.
10 Ultimately, this guidance should
11 be an incremental approach to plan sponsor
12 disclosure. The issuance of comprehensive
13 benchmarking data in the future derived from
14 the additional plan expense disclosure on the
15 Form 5500 Schedule C holds the potential to
16 provide plan sponsors with a meaningful
17 comparison of the fees associated with their
18 plan as compared to plans of similar size,
19 type and complexity. If these final
20 regulations provide uniform, consistent
21 summary information regardless of the service
22 provider or type of investment, then plan

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1 sponsors will have the data they need to
2 benchmark their plans against a national
3 standard. To this end simplicity and
4 uniformity will serve the purpose of fiduciary
5 prudence.
6 I appreciate the opportunity to
7 present Vanguard's views today. And I'm
8 pleased to take any questions you might have.
9 CHAIR CAMPBELL: Thank you. We'll
10 start down here.
11 PANEL MEMBER PIACENTINI: I guess
12 I'd like to start with the same question that
13 I finished with with the last witness. And it
14 goes to this question of how record keeping
15 expenses are defrayed relative to other
16 expenses in the presence or absence of revenue
17 sharing.
18 MS. FALLON-WALSH: Yes.
19 PANEL MEMBER PIACENTINI: If I
20 understand correctly, Vanguard itself as a
21 business practice generally does not pay
22 revenue sharing to record keepers.

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1 MS. FALLON-WALSH: We don't.
2 PANEL MEMBER PIACENTINI: Okay.
3 But when you act as a record keeper, you might
4 receive revenue sharing?
5 MS. FALLON-WALSH: Yes.
6 PANEL MEMBER PIACENTINI: So I
7 guess my question then is in a case where your
8 fund is offered on a different platform versus
9 on Vanguard's own platform, do the plans that
10 come in through those two channels invest in
11 the same fund class share classes? And if so,
12 does that then imply that because they'd be
13 paying a similar expense ratio that they'd be
14 paying record keeping separately at Vanguard?
15 How does that work? How does the economics
16 of that break out?
17 MS. FALLON-WALSH: All right.
18 Some funds offer additional share classes and
19 some funds do not. So when a fund is offered
20 on our record keeping platform, it might most
21 often be in investor shares. And we might use
22 the Index 500 as an example.

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1 So there are institutional share
2 classes of that fund, and that might be what
3 is offered on a competitor's or another third
4 party administrator's platform. So that would
5 be a separate.
6 When you think of the investor
7 share class, that's a share class that is
8 shared between our retail shareholders, you
9 know often, as well as our plan participants.
10 And that's part of what points to the
11 challenges in trying to differentiate what is
12 record keeping versus what isn't because there
13 are different costs associated with those two
14 service models.
15 PANEL MEMBER PIACENTINI: Thank
16 you.
17 And then I guess I'd also like to
18 ask the other question I asked the previous
19 witness. In terms of the dynamics of the
20 market, of how different investment options
21 end up on different platforms and ultimately
22 on different plan menus.

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1 MS. FALLON-WALSH: Yes.
2 PANEL MEMBER PIACENTINI: You
3 know, I think I understand that some fund
4 vendors use revenue sharing as one tool to try
5 to get their fund offered on more platforms.
6 And you don't do that. Can you talk to me a
7 little bit about that dynamic and what's
8 behind your strategy versus competitors and
9 how you view that?
10 MS. FALLON-WALSH: Yes. Well,
11 Vanguard is different. I mean, I'm not sure,
12 you might be somewhat familiar with the
13 company. But we are a mutual fund firm that
14 operates at cost. And so there's no profit of
15 Vanguard. What otherwise would be profit is
16 returned to the shareholders in the form of
17 lower expense ratios.
18 We don't pay for distribution. So
19 where our funds appear on other people's
20 platform it's because the plan sponsor wants
21 them there. And that they would have to cover
22 their costs of record keeping through other

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1 means.

2 Other fund companies might be on

3 our platform. We're not soliciting them to be

4 on our platform. In fact, we're most closely

5 philosophically aligned with plan sponsors

6 that put a high premium on low cost, if you'll

7 let me mix those two phrases. So they would

8 start off with a depreciation for low cost

9 funds on behalf of their participants, but

10 they might want to complement the Vanguard

11 lineup with other particularly active fund

12 mandates.

13 Some of those funds would offer

14 revenue sharing. We would use that revenue

15 share to defray some of the costs of record

16 keeping. Those are clearly disclosed and have

17 been, I think for a decade, to plan sponsors

18 in the all-in fee report. And when you look

19 at that, you'll see it gives the total expense

20 ratio of the fund and then what portion of

21 that is returned to Vanguard to defray record

22 keeping expenses.

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1 I mean, if outside funds are half
2 of the assets or 30 percent of the assets in a
3 plan, there are times when what they're paying
4 for investment management on a tiny percentage
5 or 30 percent of the assets in the plan is
6 greater than what Vanguard is receiving for
7 both investment management and record keeping
8 on all of the assets in the plan.
9 PANEL MEMBER PIACENTINI: One last
10 question.
11 MS. FALLON-WALSH: Yes.
12 PANEL MEMBER PIACENTINI: And I
13 will look with interest at the sample all-in
14 fee report that you talk about.
15 MS. FALLON-WALSH: Yes.
16 PANEL MEMBER PIACENTINI: My
17 question immediately is does that treat as
18 part of the all-in fees the transaction costs
19 incurred by the fund brokerage and so forth?
20 And if, why not? What's the philosophy for
21 not calling that part of all-in fees?
22 MS. FALLON-WALSH: Well, I point

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1 back to the comments that Mr. Stevens made
2 earlier about the expense ratio of the fund
3 capturing the all-in fees. And then I would
4 say the transaction costs of the fund go to
5 reduce the return. So I think if you were to
6 report those, it would be double counting in a
7 way, because you would have reduced return
8 that would include things like brokerage funds
9 and that sort of thing. You've already taken
10 the return down. It's not the expense ratio,
11 right? So I'm looking at that thinking I'm
12 not sure what I would do with that and how I
13 would consider it because you've already
14 captured it in the reduce return in the fund.
15 PANEL MEMBER PIACENTINI: Thank
16 you.
17 MS. FALLON-WALSH: You're welcome.
18 PANEL MEMBER CAMPAGNA: You spoke
19 about a possible broad description of all the
20 services that could be provided vis-à-vis
21 record keeping and what the fund would offer.
22 There are those who say you should unbundle

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1 and come up with a definition for every single
2 service and disclose that and the fees
3 associated with that. What are the broad
4 definitions that you're talking about and
5 could they accommodate all the particular
6 services that really are being provided in a
7 bundle?
8 MS. FALLON-WALSH: I think the
9 broad descriptions could accommodate all the
10 services that are included in the bundle.
11 Things like record keeping services,
12 education, participant services, compliance
13 testing if that's part of the bundle. I think
14 it's not difficult to come up with a broad
15 description.
16 We don't have the granular cost
17 accounting that would be associated with
18 trying to ascribe a price to each of those and
19 to what end.
20 So I think, though, as far as the
21 broad descriptions of the services included,
22 that's very straightforward. And we do that

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1 on a regular basis.
2 PANEL MEMBER CAMPAGNA: You're a
3 proponent of the use of the prospectus, but
4 there are those who have said prospectus
5 really doesn't disclose who is receiving
6 revenue sharing. So I take it your position
7 is that the record keeper or the point of
8 contact with the plan would be responsible for
9 their own disclosures regarding that; their
10 receipt of revenue sharing?
11 MS. FALLON-WALSH: If I understand
12 you correctly, if what you're asking me is how
13 would a plan sponsor know that the service
14 provider Vanguard is receiving record keeping,
15 we disclose that as part of our all-in fee
16 report. And so we say here's the gross
17 expense ratio on a fund, here is what Vanguard
18 is receiving to defray the cost of record
19 keeping. So we do disclose that.
20 PANEL MEMBER CAMPAGNA: Now if
21 you're record keeping it for a non-affiliated
22 fund, how would you describe your obligations

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1 with respect to the information that the non-
2 affiliated fund has with respect to fees of
3 that fund?
4 MS. FALLON-WALSH: I think it's
5 our obligation to take the information that
6 they provide to us. You know, we're using the
7 term "fund," so the expense ratio is readily
8 available.
9 What share class that fund might
10 represent to provide that to the plan sponsor.
11 And then to also disclose out of
12 that broad expense ratio what component of
13 that expense ratio, if any, is being paid to
14 Vanguard to defray the cost of record keeping.
15 In addition, we also disclose to the
16 participants the expense ratio of the funds
17 that are included in the plan. It's available
18 both by prospectus as well as fund fact sheets
19 that we supply to them on paper when they join
20 the plan as well as on the web.
21 PANEL MEMBER CAMPAGNA: All right.
22 Those are my questions. Thank you.

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1 MS. FALLON-WALSH: You're welcome.
2 PANEL MEMBER CANARY: Thank you.
3 I'd like to follow up a little on
4 Mr. Piacentini's questions focused on expense
5 ratios.
6 MS. FALLON-WALSH: Yes.
7 PANEL MEMBER CANARY: I was
8 intrigued by your statement that Vanguard
9 currently has an expense ratio base disclosure
10 for separate accounts and common/collective
11 trusts.
12 MS. FALLON-WALSH: These are for
13 Vanguard separate accounts and collective
14 trusts, for those that we administer. Excuse
15 me. For those that we investment manage.
16 PANEL MEMBER CANARY: I
17 understand.
18 So can you talk a little bit about
19 how you end up developing that expense ratio
20 for those different sorts of products? And
21 part of that is, if I understand it correctly,
22 in the mutual fund area there are certain

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1 expenses that are included in the expense
2 ratio and others that are not. For example,
3 brokerage?
4 MS. FALLON-WALSH: Yes.
5 PANEL MEMBER CANARY: So how did
6 you go about defining what was going to be
7 included in the expense ratio when you were
8 talking about an insurance product or a bank
9 investment fund?
10 MS. FALLON-WALSH: Bank investment
11 fund, I'm not familiar with those.
12 PANEL MEMBER CANARY: Okay.
13 MS. FALLON-WALSH: And in our own,
14 I'm not the expert in terms of how we go about
15 collecting that information. But we do
16 provide an expense ratio type disclosure. And
17 we would be happy to provide to the Department
18 detail on how we do that, if that would be
19 helpful to you.
20 PANEL MEMBER CANARY: Yes. I think
21 that would be helpful.
22 MS. FALLON-WALSH: Okay.

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1 PANEL MEMBER CANARY: Then just
2 back to the mutual fund area. So can you talk
3 a little bit about what the expenses are that
4 are included in the expense ratio versus not?
5 And my focus is, is there in your view
6 something that ties the expense that's
7 included in the expense ratio to a reason why
8 the investor should be told about that, i.e.,
9 that they are getting an indirect service as
10 part of that expense and that's why it's
11 included as opposed to, for example, the
12 brokerage expense which isn't is somehow a
13 different type of expense?
14 MS. FALLON-WALSH: Obviously in
15 developing the expense ratio we're following
16 the rules of the SEC, which I think are pretty
17 clearly laid out.
18 I can't think of any expenses that
19 are not included in the expense ratio that
20 would be relevant to a plan sponsor or a
21 participant that wouldn't be captured in a
22 reduced return of the fund, right? I think

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1 that the plan sponsor has an obligation to
2 look at the expenses of the fund and then how
3 a fund is performing. If you have a very high
4 expense ratio fund with low returns, it's not
5 tracking to its benchmark, it's not
6 competitive, that's where if those expenses
7 were outsized compared to their peers.
8 The other thing that comes up
9 that's unique to the mutual fund world is that
10 we do have mutual fund boards and they do
11 provide oversight of the funds as well. And
12 it's their job to look through and make sure
13 that the things that are being charged to the
14 funds are in the best interest of the funds
15 and the funds' shareholders. So it's an
16 additional level and layer of oversight that
17 other investment vehicles wouldn't provide.
18 PANEL MEMBER CANARY: Okay. Then
19 one last question. I know this may be not
20 really the greatest question for Vanguard
21 because you don't do much revenue sharing
22 payment.

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1 MS. FALLON-WALSH: We don't do
2 any.
3 PANEL MEMBER CANARY: Okay. Don't
4 do any. So based on that understanding, I
5 think you said that you supported the
6 Department's proposal in the component where
7 the recipient of revenue sharing payment would
8 be required to disclose that to the plan
9 fiduciary.
10 MS. FALLON-WALSH: Yes.
11 PANEL MEMBER CANARY: In
12 distinguishing between revenue sharing
13 payments and then, I guess, expense sharing
14 among affiliated groups, do you see a
15 difference there? And let me try to clarify
16 that a little bit.
17 So if I'm an independent party and
18 I'm getting a revenue sharing payment from an
19 investment provider, you say well that should
20 be disclosed to the fiduciary. Let's assume
21 that I'm an affiliate of the investment
22 provider and it's part of the bundled expense?

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

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1 service provider and all the discussion of
2 what the services are and kind of more
3 specifically how they'll be provided and how
4 they'll be judged for performance and so
5 forth.
6 So going to your testimony about
7 the broad service description, is your concern
8 trying to attach a price to each part of a
9 more granulated service? Because I'm assuming
10 in at least some of your contracts that you
11 enter into with plans that you probably do
12 specify in great detail exactly how services
13 will be provided. Could you discuss that a
14 little bit?
15 MS. FALLON-WALSH: When we are
16 negotiating with plan sponsors, when we are
17 bringing in new business, for example, there
18 is usually a pretty detailed RFP process that
19 goes on. But you know, I look at that and you
20 think that can get quite granular. I wouldn't
21 want to have that be part of official
22 reporting. Because the plan sponsor's needs

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1 change and ways of doing business that -- you
2 know, think about negotiating with someone ten
3 years ago and the web wouldn't have even been
4 conceived in terms of how business would be
5 provided. So I think those documents would
6 become stale pretty quickly.
7 So the broad service description
8 but the underlying components of it as
9 efficiencies are realized.
10 You know, think back and it would
11 have said we'll send payments by check, and
12 then it went to wire, then it went to ACH, and
13 all that sort of thing, leveraging the web for
14 increased efficiencies, how reports get
15 transmitted back and forth, whether Social
16 Security numbers are going to get used,
17 whether or not -- you know, things like one
18 step automatic enrollment programs, automatic
19 escalation programs. If you get extremely
20 granular that isn't a living document, whereas
21 the service model continues to evolve and grow
22 in partnership with the plan sponsor. And

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1 that is better served under a broader
2 umbrella.
3 CHAIR CAMPBELL: So in other
4 words, the practice in the industry in your
5 view is that the plan -- not the plan
6 documents per se, but sort of all the
7 documents that relate to the relationship you
8 have with the plan aren't always reflective of
9 what actual practice is occurring and that
10 there is a disconnect at times in terms of
11 keeping those current and fresh as you go
12 through that would make it burdensome to be
13 more specific?
14 MS. FALLON-WALSH: I think it
15 would be burdensome to be more specific. So
16 when we talk about we provide keeping services
17 or we provide participant education, what the
18 education program looks like in 2007 could be
19 different from the education program in 2008
20 because the plan sponsor may have a different
21 focus and a different need.
22 In 2007 we're focusing on new

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1 funds that are being added to the lineup and
2 we want to support that program in this way.
3 In 2008 we may be focusing on trying to
4 increase savings.
5 So we would say participant
6 education is there without saying it is that
7 granular, that it's X number of meetings and
8 that it's this many pieces of mail and that
9 sort of thing.
10 CHAIR CAMPBELL: Okay.
11 PANEL MEMBER DWYER: You stated
12 that when Vanguard record keeps for an
13 unaffiliated fund it may receive revenue
14 sharing and that it voluntarily discloses that
15 revenue sharing. Are you required to disclose
16 that by the SEC or by anybody else?
17 MS. FALLON-WALSH: It would be the
18 Department of Labor, I believe. I mean, we
19 have always done it. I have never lived in a
20 world where we didn't.
21 PANEL MEMBER DWYER: Would that be
22 available in any SEC disclosure and would it

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1 appear in the expense ratio?

2 MS. FALLON-WALSH: Of the other

3 party's fund.

4 PANEL MEMBER DWYER: Yes.

5 MS. FALLON-WALSH: It wouldn't be

6 something that we would be reporting because

7 we don't do it, right? So since we're not the

8 revenue sharer, we wouldn't be disclosing

9 anything like that.

10 Now the other fund companies,

11 there are 12b-1 rules and all that sort of

12 thing, and those payments have to be disclosed

13 in their prospectus. Not that X company

14 receives it, but that they do pay it.

15 PANEL MEMBER DWYER: And to whom?

16 MS. FALLON-WALSH: Not the to

17 whom. The to whom would be a broad category,

18 right? For distribution we pay X, but it

19 wouldn't list all the recipients.

20 PANEL MEMBER DWYER: It wouldn't

21 list the parties.

22 MS. FALLON-WALSH: Yes.

1 PANEL MEMBER DWYER: Okay. The
2 second question I have it deals with breaking
3 up the components of the bundle, which you say
4 would be very difficult to do because it's not
5 how the business model works.
6 MS. FALLON-WALSH: Yes.
7 PANEL MEMBER DWYER: But what
8 about at least segregating the administrative
9 costs from investment management? What would
10 be involved in that? Why would that be so
11 hard to do?
12 MS. FALLON-WALSH: First of all,
13 you know the speaker just prior to me talked
14 about a shared economic model. And ours is a
15 shared economic model across the retail part
16 of Vanguard and the institutional part of
17 Vanguard. And we accumulate the cost of the
18 complex and we set an expense ratio that nets
19 to zero. We could not break out in a way that
20 I feel would be either accurate or actionable
21 the record keeping component of that separate
22 from all of the other costs.

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1 PANEL MEMBER DWYER: All right.
2 Thank you.
3 MS. FALLON-WALSH: You're welcome.
4 PANEL MEMBER ZARENKO: I'm just
5 wondering, the all-in fee report, what else do
6 you typically disclose along with this to your
7 plan clients, or does it just depend on what
8 else they ask for?
9 MS. FALLON-WALSH: Yes.
10 PANEL MEMBER ZARENKO: I mean you
11 can pass through a prospectus?
12 MS. FALLON-WALSH: Right.
13 PANEL MEMBER ZARENKO: Please just
14 explain to me how that typically works.
15 MS. FALLON-WALSH: We annually
16 provide the all-in fee report. It's often
17 part of an Investment Committee meeting
18 reviewed with the fiduciaries of the plan. We
19 would talk about the services and activities
20 that happen with the plan over the course of
21 the past year, any special events that might
22 have come up.

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1 We would try to provide context
2 for the fees, you know, in terms of the
3 Vanguard funds. And in regards to the
4 Vanguard funds, you know through broad
5 communications often as well as meetings we're
6 talking about what trends have occurred in,
7 for example the expense ratio of the Vanguard
8 funds.
9 I was pulling some statistics in
10 anticipation of this meeting and looking at
11 something, just the expense ratio for example
12 on a couple of our funds. The Index 500 and
13 the Total Stock Market Index Fund.
14 In 1995 the Index 500 fund had an
15 expense ratio of 20 basis points and Total
16 Stock Market 25 basis points. In 2008 today
17 they're both at 15 basis points. So one has
18 dropped by 25 percent and one by 40 percent.
19 So we look at those trends over time with our
20 plan sponsors as well.
21 We would talk about any explicit
22 fees that get charged. If there's a per

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1 participant fee within the plan. We talk
2 about fees that are charged on an as-used
3 basis, things like loan fees, QDRO
4 calculations, something like that.
5 PANEL MEMBER ZARENKO: Some
6 commenters are asking that the Department
7 provide more specific formatting or
8 consolidation requirements, I think trying to
9 get at something more like this --
10 MS. FALLON-WALSH: Yes.
11 PANEL MEMBER ZARENKO: -- with the
12 argument being that's much more useful to a
13 plan fiduciary. But on the other side people
14 saying, you know, it would be impossible for
15 us to come up with a one-size-fits-all
16 consolidated disclosure format.
17 MS. FALLON-WALSH: Yes.
18 PANEL MEMBER ZARENKO: Because
19 there's so many different services and so many
20 different ways that these are charged.
21 MS. FALLON-WALSH: Right.
22 PANEL MEMBER ZARENKO: Any views

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1 on these?

2 MS. FALLON-WALSH: I think it is

3 hard to come up with a one-size-fits-all. So

4 I would -- my remarks are well received, I

5 hear cheering in the halls.

6 But I would say that I think a

7 one-size-fits-all perhaps could be difficult.

8 We find this works particularly well for us,

9 and I would suggest would work well for others

10 that are using mutual funds as the basis for

11 the expenses that are charged.

12 PANEL MEMBER ZARENKO: So this is

13 more just an example of how you disclose than

14 --

15 MS. FALLON-WALSH: Yes. Right.

16 PANEL MEMBER ZARENKO: -- any

17 recommendation of formatting requirements on

18 our part?

19 MS. FALLON-WALSH: I think our

20 plan sponsors find it clear. It's easy to

21 use. It's useful information and it's not

22 overwhelming. And I think that's particularly

1 important for smaller plan sponsors.

2 PANEL MEMBER ZARENKO: And on

3 smaller plan sponsors, are there any

4 generalizations or differences that you think

5 would be helpful for us to know about in

6 dealing with large plan clients and small plan

7 clients? There's been a lot of distinctions

8 drawn yesterday about the difference between

9 the two. I'd just enjoy hearing your

10 comments.

11 MS. FALLON-WALSH: I would say

12 that the larger plan sponsors generally have

13 more breadth and depth in terms of the

14 expertise and support that they can bring to

15 the table. Smaller plans probably rely more

16 on us to provide our expertise. So that would

17 be one difference that I would offer.

18 PANEL MEMBER ZARENKO: Any reasons

19 you can think of why the small plan market

20 should be excluded from our requirements?

21 MS. FALLON-WALSH: No.

22 PANEL MEMBER ZARENKO: Thank you.

1 PANEL MEMBER WILLIAMS: Okay. In
2 the interest of time, just to reiterate you
3 say that Vanguard receives revenue sharing and
4 that it discloses this and it supports
5 disclosure. Does it ever have any problems
6 receiving the information that it would need
7 to provide that disclosure?
8 MS. FALLON-WALSH: Since most of
9 the -- since the revenue sharing that we
10 receive comes through mutual funds, it's
11 readily available. Now, if it were collective
12 trusts or separately managed trusts and things
13 like that that were administered by outside
14 parties, I think it could be quite difficult
15 to get to the underlying expense ratio
16 equivalent type of number. I think that is
17 where it could become more challenging.
18 PANEL MEMBER WILLIAMS: Okay.
19 Thank you.
20 MS. FALLON-WALSH: You're welcome.
21 CHAIR CAMPBELL: All right. Thank
22 you very much.

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1 MS. FALLON-WALSH: You're very
2 welcome.
3 And next we'll have Mr. Mollahan
4 with the American Bankers Association, or I
5 should say representing the American Bankers
6 Association with JP Morgan Chase.
7 MR. MOLLAHAN: How are we on time.
8 CHAIR CAMPBELL: Well we will
9 certainly make sure everyone has the time they
10 need.
11 MR. MOLLAHAN: Okay. Good.
12 In the interest of that time, let
13 me get right to some comments. I've submitted
14 testimony on behalf of the ABA that provides
15 additional insights and perspective.
16 Unlike many of the people who have
17 spoken prior to myself, both yesterday and
18 today, I represent a broader based view, I
19 believe, that incorporates all employee
20 benefit plans that include defined benefit,
21 defined contribution and all forms of health
22 and welfare plans. So hopefully, that

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1 perspective will be valuable to the group
2 today.
3 Okay. First of all, my name is Ed
4 Mollahan. I'm a Managing Director at JP
5 Morgan Chase. I'm also the Chairman of the
6 American Bankers Association Committee on
7 Retirement and Employee Benefits.
8 The ABA brings together banks of
9 all sizes and charter into one association.
10 Many of these institutions provide trust or
11 custody services for institutional clients
12 including employee benefit plans as well as
13 services to individuals holding retirement
14 assets and individual retirement accounts. As
15 of 2006, banks and savings associations held
16 more than 22 trillion in fiduciary assets for
17 both personal, institutional customers in 20
18 million accounts. As a result, the
19 Department's proposed regulation is of great
20 important to the banking industry.
21 The ABA appreciates the
22 opportunity to testify before the Department

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1 of Labor today on the issue of disclosure of
2 compensation of plan sponsors for plan
3 services and commends the efforts of the
4 Department to try to strike the right balance
5 between disclosure that a plan sponsor needs
6 to make an informed decision and disclosure
7 that includes extraneous information.
8 Okay. So my testimony today is
9 highlighted by three key points. Collective
10 funds, like mutual funds, are not plan service
11 providers as we see it. The conflict of
12 interest disclosure provision is overly broad
13 and unworkable on many fronts. And I'll
14 provide some specific comments to that.
15 And finally, more time would be
16 required for banks to come into compliance
17 with regulation once that regulation is
18 finalized and adopted.
19 Okay. First relative to
20 collective funds. Like mutual funds, they're
21 important investment vehicles made available
22 to plan sponsors and participants alike.

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1 There's no secret that collective funds
2 provide plans and plan participants with
3 extraordinarily cost effective vehicles in
4 which to invest retirement assets.
5 The Federal Government's own
6 Thrift Savings Plan is heavily invested in
7 collective funds. According to recent FDIC
8 data there are 1.6 trillion assets held in
9 collective funds today. JP Morgan Chase offers
10 a number of collective funds holding tens of
11 billions of dollars in assets alone. These
12 funds are made available to the many plans
13 that we service. That number is in excess of
14 1,000 retirement plans.
15 The proposed regulation would
16 appear to require the plan service provider to
17 disclose information about compensation earned
18 by persons that are not handling the plan's
19 assets or providing services directly to the
20 plan. This would appear to include some
21 advisors and other persons who provide
22 services to the fund. It is our understanding

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1 that service providers to mutual funds would
2 be exempt under ERISA from providing that
3 disclosure. We support this treatment of
4 mutual funds but believe that the regulations
5 should make clear that service providers to
6 collective funds are to be treated in the same
7 fashion.
8 As with mutual fund, service
9 providers to plan asset pool investment
10 vehicles would contract only with the
11 collective investment fund and will not know
12 the identity of the investors in the fund.
13 And it would also be impossible for service
14 providers to a collective fund to determine if
15 they or one of their affiliates had any
16 relationship with any particular sponsor
17 invested in that fund, much less maintain such
18 information on an ongoing basis.
19 Just as with mutual funds,
20 collective funds utilize services provided by
21 many providers that may or may not be
22 affiliated with the collective fund trustees,

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1 including but not limited to custodians, asset
2 managers, securities lending agents,
3 evaluation service providers, fund
4 accountants, auditors, legal counsel, et
5 cetera.
6 Moreover, and finally, we question
7 the need for this level of disclosure. The
8 disclosure to plan sponsors of compensation
9 paid by the collective fund to third parties
10 that are not affiliated with the investment
11 manager, such as securities or real estate
12 brokers, appraisers, pricing services,
13 accountants, auditors and printers, lawyers,
14 et cetera should not be required.
15 Regarding conflicts of interest.
16 The conflicts of interest provision is
17 extraordinarily broad and requires too much
18 unnecessary disclosure. The proposal would
19 require the service provider to disclose
20 whether the service provider or any affiliate
21 has material, financial, referral or other
22 relationship with money managers, brokers,

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1 another client of the service provider,
2 another service provider of the plan or any
3 entity that could create a conflict of
4 interest for the service provider in providing
5 those services.
6 In effect, the proposal nearly
7 shifts some of the burden placed on plan
8 sponsors from a fiduciary standpoint onto the
9 service provider to identify on a plan-by-plan
10 basis all of the service providers for each
11 plan client and then determine whether they
12 "could" pose a conflict of interest. On its
13 face it seems unreasonable and extremely
14 burdensome to require service providers to
15 perform a detailed inventory and analysis of
16 all of the relationships that could
17 potentially give rise to conflict of interest
18 and then create a customized disclosure for
19 each plan client listing all of these
20 potential conflicts. And I would highlight
21 the word "potential."
22 JP Morgan and its affiliates

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1 provide trust custody investment management
2 and securities lending services to plans in
3 addition to a number of other services. We
4 also provide underwriting services to issuers
5 of securities and other investment banking
6 services, transition management, securities
7 brokerage and trading, foreign exchange and
8 the like.
9 We also provide a great deal of
10 services to unaffiliated mutual funds
11 including custody fund accounting related
12 services that also include shareholder record
13 keeping and transfer responsibilities.
14 Under the proposal it would appear
15 that JP Morgan -- if JP Morgan Chase was to
16 serve as a directed trustee of a plan that was
17 directed by a named fiduciary or investment
18 manager to buy a security underwritten by the
19 JP Morgan Chase Securities, Inc., that
20 transaction under the proposal could be deemed
21 a disclosable event, regardless of whether the
22 security is purchased directly from JP Morgan

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1 Chase Securities, Inc. or from another
2 unaffiliated member of the underwriting
3 syndicate.
4 In addition, the Department is
5 aware the banking industry for many years has
6 been in a period of consolidation. Mergers
7 between institutions increase the potential
8 for newly affiliated companies, and that they
9 will have existing relationships with plans.
10 For example, my own firm is
11 compiled of JP Morgan Chase, Bank One,
12 Chemical, First Chicago, MBD, Manufacturers
13 Hanover, and this all in my career by the way.
14 So of these institutions there are a number
15 of affiliates and subsidiaries that exist, and
16 that's just with JP Morgan Chase. There are
17 plenty of other institutions with equally or
18 possibly even greater number of conflicts --
19 not conflicts, but interconnecting
20 relationships which are nearly impossible and
21 definitely a costly standard to achieve in
22 today's complex financial world.

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1 Finally, the proposal fails to
2 recognize that even if there is an actual
3 conflict of interest between the plan and
4 party of interest, the party in interest may
5 have been granted a prohibited transaction
6 class exemption with its own required
7 disclosures. Many conflict situations could
8 be covered, perhaps, by various prohibited
9 transaction exemptions that service providers
10 have sought and have been granted over the
11 years.
12 The effective date -- this is my
13 favorite. Ninety days is, in our opinion,
14 insufficient time for creating the disclosures
15 regime mandated under the proposal in its
16 current form. The extensive information that
17 would be required to be captured under the
18 final regulation will require time for bankers
19 to review and understand the final regulation
20 and develop new or update current systems to
21 track that particular information and report
22 it in a format that's useable.

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1 Specifically, the extensive
2 conflict of interest disclosures mandated
3 under this proposal will require the
4 development of an entire system to capture the
5 many relationships between numerous service
6 providers.
7 There are a number of other points
8 that I would like to touch on, but I would
9 like to open it to questions given the
10 significant difference, perhaps, in terms of
11 my position here of testifying today and some
12 of those who have testified before me.
13 CHAIR CAMPBELL: All right. Thank
14 you very much. Let's start down here.
15 PANEL MEMBER WILLIAMS: Thank you.
16 Now the collective funds that
17 you're talking about, hold plan assets,
18 correct? So when you say that a servicer to a
19 collective fund is not a party interest to an
20 investing plan --
21 MR. MOLLAHAN: Right.
22 PANEL MEMBER WILLIAMS: -- are you

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1 thinking of a situation where the collective
2 fund is holding plan assets of that plan?
3 MR. MOLLAHAN: The collective fund
4 is holding plan assets. What we're saying is
5 that the contractor and auditor, by way of
6 example, to that fund is not being contracted
7 by the plans. It's contracting with the fund
8 itself.
9 PANEL MEMBER WILLIAMS: So the
10 fact that this is a service provider for plan
11 assets of a plan avoids the need for
12 408(b)(2), is that --
13 MR. MOLLAHAN: Well, what we're
14 saying is that the collective investment fund
15 in our estimation is not different than a
16 mutual fund.
17 PANEL MEMBER WILLIAMS: Even
18 though it holds plan assets?
19 MR. MOLLAHAN: Yes.
20 PANEL MEMBER WILLIAMS: So --
21 MR. MOLLAHAN: It should be
22 treated similarly for that reason.

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1 PANEL MEMBER WILLIAMS: Okay. So
2 in your view you don't have a prohibited
3 transaction when the collective fund engages
4 anyone for a service or for a transaction?
5 What am I missing?
6 MR. MOLLAHAN: What we're saying
7 is that the collective fund, right, will
8 obtain the services for accounting, legal,
9 regulatory review, preparation of documents to
10 the OCC by way of example, and the like. And
11 that those service providers may be providers
12 of other services to participants in the
13 collective fund.
14 PANEL MEMBER WILLIAMS: Then I
15 think you said that you can't identify all of
16 the people that are providing services to a
17 collective fund or to the people that are
18 acting as subadvisors or subservicers?
19 MR. MOLLAHAN: No. We will not be
20 able to identify all of the inter-
21 relationships that they may have, right, with
22 plans who have chosen collective funds.

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1 PANEL MEMBER WILLIAMS: Okay. But
2 you are required to meet conditions that are
3 in the existing class exemptions where that
4 would be required?
5 MR. MOLLAHAN: Perhaps. I mean I
6 am not the collective fund expert nor the
7 class exemption expert on that topic. But I'd
8 be happy to come back, Fil, and answer that
9 question more succinctly.
10 PANEL MEMBER WILLIAMS: Okay.
11 PANEL MEMBER ZARENKO: Our
12 definition of compensation, most commenters
13 are saying it's too broad, especially when
14 we're talking about indirect compensation and
15 that there has to be some limit in our rule
16 about how far down the line the concept of
17 indirect compensation goes.
18 MR. MOLLAHAN: Yes.
19 PANEL MEMBER ZARENKO: But of
20 course any time that we try to draw a line, it
21 always gets very fuzzy as to what falls on one
22 side or the other.

1 MR. MOLLAHAN: Right.
2 PANEL MEMBER ZARENKO: And we also
3 want to try to avoid drawing any line that
4 would cause people to just change their
5 compensation practices or structures to ensure
6 that they're on one side of that line or the
7 other.
8 MR. MOLLAHAN: Right.
9 PANEL MEMBER ZARENKO: And you
10 talk about limiting it to compensation that's
11 related to the plan.
12 MR. MOLLAHAN: Yes.
13 PANEL MEMBER ZARENKO: And that
14 seems to me to be exactly one of those kinds
15 of the hard lines to draw. Can you just
16 expand a bit on how as a regulatory matter we
17 would define what it means to be related to
18 the plan to avoid those problems?
19 MR. MOLLAHAN: I'm not sure that I
20 have a unique or specific definition that I
21 can share. I can certainly take a look at
22 that. However, we are for full disclosure of

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1 the expense aspects, whether it's in our
2 defined contribution practice, or defined
3 benefit practice or health and welfare, right.
4 They're operating independently but often
5 unite across the board relative to common
6 customers.
7 While it would be preferred, I
8 think, to have a bright line sort of test, I'm
9 not sure it's that simplistically drawn, when
10 you look across types of plans, size of plans
11 and the underlying nature whether it's DB
12 ranked as those services are somewhat
13 different, as you might imagine, than DC
14 versus health and welfare. So perhaps I can
15 take that away as well and come back to you
16 with some thoughts more specifically that we
17 can come up with.
18 PANEL MEMBER ZARENKO: Okay. The
19 other thing I want to touch on is the
20 requirement in the rule that you or a service
21 provider identify itself as an ERISA
22 fiduciary. And I know you recommend that we

1 eliminate that requirement in your comment
2 letter.
3 The delegation of fiduciary
4 responsibility under ERISA is a big deal.
5 MR. MOLLAHAN: Yes.
6 PANEL MEMBER ZARENKO: And so I
7 understand that that's a functional test and
8 it's not always crystal clear. But yet it
9 seems to me like very important information
10 for a plan fiduciary to know up front, at
11 least whether they think they're delegating
12 fiduciary responsibility or not.
13 MR. MOLLAHAN: Right.
14 PANEL MEMBER ZARENKO: So it's one
15 thing to say we need to have a rule that would
16 accommodate mistakes in identifying oneself as
17 a fiduciary or otherwise.
18 MR. MOLLAHAN: Yes.
19 PANEL MEMBER ZARENKO: It's
20 another thing to say we don't think we should
21 even have to go there. Could you just expand
22 on why you recommend eliminating that

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1 requirement?

2 MR. MOLLAHAN: I'm sorry. Let me

3 perhaps ask you to repeat the question.

4 Because I want to make sure I answer that

5 correctly.

6 PANEL MEMBER ZARENKO: And I guess

7 the bottom line in your comment you request

8 that we remove the requirement that a service

9 provider identify whether or not it's an ERISA

10 fiduciary.

11 MR. MOLLAHAN: Right.

12 PANEL MEMBER ZARENKO: Other

13 commenters don't necessarily say you should

14 remove that requirement. They say you just

15 need to find a way to accommodate the fact

16 that people might slip up despite their best

17 intentions because it is a difficult standard

18 that depends on what happens in practice.

19 MR. MOLLAHAN: Yes.

20 PANEL MEMBER ZARENKO: And it's

21 hard to always say with certainty at the

22 beginning I will or won't. But to the extent

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1 the delegation of fiduciary function to a
2 service provider is very important --
3 MR. MOLLAHAN: Yes.
4 PANEL MEMBER ZARENKO: --
5 understanding that there be mistakes, I'm just
6 wondering why you recommend eliminating the
7 requirement entirely rather than trying to
8 accommodate the fact that it's a difficult
9 line to draw?
10 MR. MOLLAHAN: Well, I think
11 there's two reasons or two components, right.
12 One of them is we're not providing services
13 uniquely and solely to the 401(k) or defined
14 contribution arena. Okay.
15 Secondly, I think that the
16 requirement can be -- certain requirements can
17 be delegated and certainly are passed
18 contractually but we think others, you know
19 steadfastly remain the responsibility of the
20 respective parties, the named fiduciary versus
21 a trustee versus an asset manager, et cetera.
22 And we think that's a little clearer than it

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1 would appear to be from the requirement.
2 PANEL MEMBER ZARENKO: Just could
3 you comment on something, from a service
4 provider perspective, although again I know
5 it's hard to say with certainty up front
6 whether fiduciary functions are going to be
7 performed.
8 MR. MOLLAHAN: Yes.
9 PANEL MEMBER ZARENKO: But again,
10 apart from a plan sponsor wanting to know that
11 information, wouldn't a service -- given that
12 a bunch of other requirements and restrictions
13 flow from being an ERISA fiduciary --
14 MR. MOLLAHAN: Right.
15 PANEL MEMBER ZARENKO: -- wouldn't
16 a service provider want to do its best to know
17 if it is or isn't providing fiduciary
18 services?
19 MR. MOLLAHAN: Well I think from
20 our standpoint, we're frequently the trustee.
21 We're always acting in a fiduciary capacity.
22 PANEL MEMBER ZARENKO: Yes.

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1 MR. MOLLAHAN: And that would be
2 the case with most of the constituents within
3 the ABA.
4 And to the extent that we were
5 performing fiduciary responsibilities, we are
6 I think disclosed and open specifically by
7 contract and otherwise to the services and
8 responsibilities that we take, whether they're
9 fiduciary or purely administrative in their
10 nature. And so to that extent, we think
11 that's quite clear and has been for some time.
12 PANEL MEMBER ZARENKO: Okay.
13 Thank you.
14 PANEL MEMBER DWYER: I have no
15 questions.
16 CHAIR CAMPBELL: Well, actually I
17 wanted to follow up on that. Because I was
18 also somewhat perplexed by that comment about
19 wanting to not state whether you're a
20 fiduciary or not, given as you just said it
21 seems to me well the standard is based on what
22 actually occurs. When you're entering into a

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1 service contract you're sort of deciding what
2 types of services to provide, which ought to
3 give you an indication as to whether you
4 intend for those to be, as you say, trustee
5 services where there's a fiduciary
6 relationship.
7 MR. MOLLAHAN: Yes.
8 CHAIR CAMPBELL: So it's not clear
9 to me why it's so difficult to state at the
10 outset of the contract this is the type of
11 services we think we're providing and we think
12 that makes us a fiduciary for ERISA purposes
13 or otherwise.
14 MR. MOLLAHAN: I suppose maybe to
15 try to get back to Kristen's question and to
16 maybe answer that, there are a plethora of
17 other services that we provide that are not
18 fiduciary and purely administrative in their
19 nature.
20 For example, we may be a record
21 keeper, right, in one instance but not the
22 trustee. We could be a custodian and a record

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1 keeper and providing asset management
2 services. And/or there are just plain
3 administrative services that we may supply in
4 support of a plan's operation where the
5 administrative nature of those services would
6 not be defined by any stretch of the
7 imagination as fiduciary in their nature. And
8 I get that straight from counsel. And each of
9 those contracts clearly stipulates whether or
10 not we're performing in a fiduciary fashion,
11 but not all contracts.
12 CHAIR CAMPBELL: I'm sorry. I
13 guess I didn't quite understand what you
14 meant. Each of those contracts states it but
15 not all contracts?
16 MR. MOLLAHAN: To the extent we're
17 only providing an administrative service,
18 right?
19 CHAIR CAMPBELL: Then those
20 contracts are silent as to whether you're a
21 fiduciary or not, or they say you're not?
22 MR. MOLLAHAN: They typically say

1 we're not if it's a purely administrative
2 undertaking and support of the sponsor or
3 elements of services that they require to
4 carry out their responsibilities and their
5 obligations.
6 CHAIR CAMPBELL: And I don't mean
7 to belabor this but I guess I'm still confused
8 then. Aren't you already complying with the
9 proposal then?
10 MR. MOLLAHAN: From a contractual
11 standpoint, whether or not we're a fiduciary?
12 CHAIR CAMPBELL: I mean, your
13 contracts state whether you are or not
14 already?
15 MR. MOLLAHAN: Right.
16 CHAIR CAMPBELL: Okay. So again,
17 I just am confused as to why then it's a
18 problem to state that affirmatively under the
19 proposed regulations?
20 MR. MOLLAHAN: I'll confirm with
21 counsel. I mean it was their opinion that we
22 were clear enough already. That we did not

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1 need to take any additional clarifying acts,
2 if you will. But contractually where we're a
3 trustee, we're a trustee and we clearly state
4 that.
5 CHAIR CAMPBELL: Okay.
6 MR. MOLLAHAN: It's a contracted
7 service.
8 CHAIR CAMPBELL: Thank you.
9 PANEL MEMBER CANARY: Okay. Let
10 me just follow up. Because I may have heard an
11 element to your answer which at least I
12 understood to suggest the following is: That
13 if you're dealing with a multiple service
14 arrangement that the issue for you is trying
15 to confirm where you're a fiduciary and where
16 you're not and making that sort of disclosure
17 may be complicated if you end up with a range
18 of services. So currently under your
19 contracts, where you get into whether you're a
20 fiduciary or not, are you suggesting that's
21 the problem, is that now when you are a
22 fiduciary you say you're a fiduciary, but if

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1 you're providing multiple services the concern
2 is going through and trying to identify in
3 your contract as to each service whether
4 you're a fiduciary?
5 MR. MOLLAHAN: That is certainly
6 an element of it.
7 PANEL MEMBER CANARY: Okay. I
8 guess we've had some testimony suggesting that
9 one thing that might be good, and I think
10 you're a good person to ask this question, is
11 having other providers mirror their
12 disclosures to what are now in the mutual fund
13 industry disclosure requirements. Do you have
14 any thoughts about that coming from the bank
15 collective fund perspective?
16 MR. MOLLAHAN: I do. I think that
17 expense ratios, any expense can be stated
18 fundamentally in a ratio. Performance of
19 funds, returns of investments whether they're
20 mutual funds, collective funds or separate
21 accounts that are established for defined
22 benefit, defined contribution or health and

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1 welfare plans can be stated and stipulated in
2 a similar fashion, right. So by way of
3 example, it's been very common practice in the
4 performance and investment analytics arena,
5 which is a service that we provide to our
6 clients, to state returns both in gross and
7 net of fee terms and calculate expense ratios
8 where a client's preference is to see it
9 reflected in that fashion.
10 PANEL MEMBER CANARY: Okay. So
11 when you do that, how do you define what's in
12 the expense ratio and what's out? I guess I'm
13 focused again on this expense ratio question,
14 as I understand it not all expenses, at least
15 from one perspective, are included in
16 calculation of the expense ratio.
17 MR. MOLLAHAN: Right.
18 PANEL MEMBER CANARY: Can you talk
19 about that and why that is?
20 MR. MOLLAHAN: Depending on the
21 level of requirement, for example in a defined
22 -- I'll try to use a defined benefit plan by

1 way of example. In the defined benefit plan
2 the investment manager, right, is employing
3 his services making asset selection, et
4 cetera. They also select the brokers that
5 they choose to execute trading with.
6 We do track for 5500 purposes the
7 reportable transaction events, right. So we
8 do have the brokerage expense and we are able
9 to incorporate those expenses as part of the
10 expense ratio.
11 There may be other situations
12 where certain expenses are not known or not
13 clear by way of example, but they would be
14 picked up in the performance aspect. Foreign
15 exchange trading, right, which is a spread
16 product just like a lot of fixed income
17 trading, right, is often spread based. And so
18 it gets incorporated in the investment return
19 of the fund.
20 PANEL MEMBER CANARY: As opposed
21 to being in the expense ratio?
22 MR. MOLLAHAN: Right, as an

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1 identified expense. Right.

2 PANEL MEMBER CANARY: Right.

3 MR. MOLLAHAN: Two point two basis

4 points for a particular purchase of currency

5 to settle a trade.

6 PANEL MEMBER CANARY: Okay. And I

7 want to follow up on Fil Williams' question a

8 little bit. Because I think in the collective

9 investment fund area they're plan assets,

10 there are parties that are clearly fiduciaries

11 managing those plan assets for ERISA purposes.

12 MR. MOLLAHAN: Yes.

13 PANEL MEMBER CANARY: And I think

14 that the conclusion would be well if they're

15 fiduciaries under ERISA, then does not reflect

16 that they're providing some sort of a service

17 to the plan in connection with that fiduciary

18 status, even though it may be similar to the

19 investment manager or investment advisor to

20 the mutual fund. And if I'm understanding you

21 correctly, it isn't so much the legal status

22 that you're getting at as opposed to the

1 operational equivalence or treatment that
2 you're looking for?
3 MR. MOLLAHAN: That's correct.
4 It's purely from an operational standpoint.
5 PANEL MEMBER CANARY: Okay. Thank
6 you.
7 PANEL MEMBER CAMPAGNA: You spoke
8 in terms of our conflicts of interest
9 provisions being too broad because of all the
10 relationships that a bank trustee may have
11 through mergers, acquisitions, et cetera. But
12 do you believe that there could be a problem
13 in the conflicts area regarding certain
14 service providers, brokers, pension
15 consultants, those kinds of things that could
16 lead to the need for such a provision? And
17 how could we narrow it to fit that?
18 MR. MOLLAHAN: I'll try to answer
19 that not from a personal opinion standpoint.
20 I certainly think a monitoring
21 process makes sense. How far and how wide
22 that monitoring process goes I think is the

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1 subject of our comments, right?

2 There are certain studies that

3 have been done, there's research that's been

4 done related to conflicts and where they tend

5 to range. I think there's been a number of

6 changes since a lot of the '05 studies have

7 been done, for example, in the consultant

8 arena, right, where oftentimes consultants are

9 contracted on behalf of employee benefit plans

10 now as fiduciaries where prior to that, that

11 was not always the case. I don't want to say

12 that that's the unique example, nor am I

13 picking on the consultant industry, but I'm

14 simply pointing out that at some point the

15 level of look through for conflicts becomes

16 unmanageable from a knowledge standpoint and

17 requires an interpretive component that's not

18 measurable nor easily reportable.

19 PANEL MEMBER CAMPAGNA: So you're

20 talking about, perhaps, limiting it at the

21 point of contact with the plan?

22 MR. MOLLAHAN: Yes. Much the same

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1 as I believe one of the prior speakers did,
2 yes.
3 PANEL MEMBER CAMPAGNA: Okay.
4 Now I know that you're not the class exemption
5 expert. You said as much. I hope this doesn't
6 catch you off guard.
7 MR. MOLLAHAN: I would say not.
8 PANEL MEMBER CAMPAGNA: But just
9 describe a couple of the class exemptions, and
10 it refers to your comment later, too.
11 MR. MOLLAHAN: Yes.
12 PANEL MEMBER CAMPAGNA: Because
13 you did mention these in your comment letter.
14 MR. MOLLAHAN: Yes, that there are
15 problems, yes.
16 PANEL MEMBER CAMPAGNA: That
17 basically class exemptions should be left as
18 is apart from the regulations. But there are
19 two in mind that I have; one in 1975 for
20 brokerage --
21 MR. MOLLAHAN: Yes.
22 PANEL MEMBER CAMPAGNA: -- where

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1 there's not a lot of disclosure regarding this
2 indirect compensation that a broker may
3 receive in connection with the provision of
4 brokerage service.
5 In '84 we did a class exemption
6 for -- you know affecting the sale of an
7 insurance contract. And again, it's only
8 about the commissions. It's not about
9 indirect compensation that the agent may be
10 receiving which could, perhaps, reflect some
11 kind of interest that the agent might have in
12 steering the plan to that particular contract.
13 Do you see a need in any of those
14 cases for new information to come forward?
15 MR. MOLLAHAN: Well, and I believe
16 it was Vanguard had a rather well documented
17 process around disclosure of its expenses and
18 related impacts to their client base. We
19 fully applaud and support disclosure and
20 disclosure to the extent those interests are
21 known and understood and could be quantified
22 in a way that makes an important and

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1 meaningful decision process effective for the
2 plan fiduciary.
3 PANEL MEMBER CAMPAGNA: Okay.
4 MR. MOLLAHAN: And the only other
5 comment I would add to that is that it's not
6 clear to me whether or not knowing that
7 information would be beneficial to a
8 participant who tends to look for some sort of
9 expense ratio or the net result impact from
10 its performance return.
11 PANEL MEMBER CAMPAGNA: I'm just
12 talking about the plan fiduciary in context,
13 say, with a broker.
14 MR. MOLLAHAN: Right.
15 PANEL MEMBER CAMPAGNA: An
16 insurance broker, selling him a contract.
17 MR. MOLLAHAN: Yes.
18 PANEL MEMBER CAMPAGNA: Is there a
19 need for more information than just
20 commissions --
21 MR. MOLLAHAN: Right.
22 PANEL MEMBER CAMPAGNA: --

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1 associated with that sale? Do they need to
2 know that there may be some additional
3 payments coming from the insurance company in
4 association with that?
5 MR. MOLLAHAN: It would seem that
6 the plan fiduciary has a responsibility to
7 know that.
8 PANEL MEMBER CAMPAGNA: Okay.
9 Thanks.
10 PANEL MEMBER PIACENTINI: Just one
11 narrow follow up on a question that Joe Canary
12 asked.
13 MR. MOLLAHAN: Yes.
14 PANEL MEMBER PIACENTINI: And this
15 has to do with whether something like an
16 expense ratio could be reported for a bank
17 collective fund.
18 MR. MOLLAHAN: Yes.
19 PANEL MEMBER PIACENTINI: I think
20 I heard you say that probably that could be
21 done in the context of performance analysis.
22 And as I heard that, and I thought does that

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1 mean that this could be done retrospectively
2 only or could it also be done prospectively;
3 that you could generate an expense ratio that
4 would let people know in advance what they
5 would pay to the same degree that it does now
6 in the case of a mutual fund?
7 MR. MOLLAHAN: It could be done
8 either way. I mean, the calculation is not
9 extraordinarily burdensome, you know, from the
10 mathematical perspective or how you would
11 present or state how you summarize your fees.
12 Many times we break down our fees
13 individually at the dollar level and they can
14 be rolled into an expense ratio. There are
15 many clients who ask for it to be stated in
16 that way even if you disclose the individual
17 numbers to them.
18 PANEL MEMBER PIACENTINI: Now just
19 one narrow follow up. As I understand in the
20 case of a mutual fund that number is
21 consistent? The expense ratio is the same for
22 all holders of a particular share class.

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1 Would that be the same in a bank collective
2 fund or does it vary by client for any reason,
3 is it negotiated separately or how would that
4 work?
5 MR. MOLLAHAN: To my knowledge it
6 is not a different level of fee structure
7 based on the client or type of client, et
8 cetera. I can verify that for the counsel or
9 Committee as well.
10 PANEL MEMBER PIACENTINI: Thank
11 you.
12 MR. MOLLAHAN: Okay.
13 CHAIR CAMPBELL: All right. Thank
14 you very much. We appreciate it.
15 MR. MOLLAHAN: Thank you.
16 CHAIR CAMPBELL: And our last
17 witness before lunch, no pressure, is Mr. Ryan
18 with the Securities Industry and Financial
19 Markets Association. And I do mean that, no
20 pressure. Take all the time that we've
21 allotted for each witness, please.
22 MR. RYAN: Okay. Well, good

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1 morning on this happy April Fool's Day.
2 My name is Bill Ryan. And on
3 behalf of SIFMA, I appreciate the opportunity
4 to testify for you today.
5 We have obviously submitted
6 written comments. And we'll try in the
7 interest of time and not having people throw
8 things at me while I'm speaking, we'll try to
9 condense our comments to some discrete points
10 and then leave it open to questions for the
11 Department.
12 We're basically concerned about
13 four aspects of the regulations. Number one,
14 we respectfully submit and agree with the ICI,
15 Vanguard and other parties that enhanced
16 disclosure requirements for fees should be
17 issued and addressed by the issuance of new
18 guidance. We, however, believe that the
19 appropriate vehicle for this guidance is
20 actually 404, not 408(b)(2). We don't believe
21 that the prohibited transaction rules for
22 service provider contracts necessarily gets at

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1 what we think you and others have focused on,
2 which is the fiduciary's obligation of the
3 plan to actually obtain the information. And
4 we understand the issues they may have with
5 respect to trying to get that from
6 nonresponsive service providers, and we'll be
7 happy to deal with that in questions.
8 But as we understand it, the
9 Department's primary focus here is the receipt
10 of payments from third parties, such as mutual
11 funds, advisors, transfer agents and the like
12 by pension consultants, brokers, advisors and
13 record keepers and that the plan fiduciary
14 should be better aware of. And we're
15 definitely prepared to work with the
16 Department to ensure that these payments are
17 disclosed. But we think that these disclosure
18 obligations, generally speaking, should be
19 addressed first in the 401(k) context, in the
20 mutual fund areas where people have seen this
21 problem and then more gradually expanded to
22 the defined benefit and health universe. As

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1 it reads right now, the same standards and the
2 same disclosure requirements apply to all
3 different types of plans and all different
4 types of service providers.
5 Our view is that trying to treat
6 all of these arrangements the same and forcing
7 the disclosure requirement through the excise
8 tax provisions, which basically to the point
9 that was raised earlier by Vanguard, puts a
10 premium on granularity, puts a premium on
11 excessive disclosure because no one wants to
12 miss a particular type of service that one
13 might be providing if they think they have a
14 15 percent excise tax to pay for it. And what
15 we're worried about, and we think our clients
16 are worried about, is that forcing it into
17 this framework will result in expensive,
18 voluminous and candidly excessive disclosure.
19 Our second point is that in
20 achieving the objective of enhanced disclosure
21 the Department in our view should not mandate
22 specific types of disclosure required of every

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1 type of service provider to any type of plan
2 regardless of the types of service providers
3 or candidly, the types of plans.
4 SIFMA urges the Department to
5 recognize that, as others have said, one size
6 does not fit all.
7 Third, in its efforts to expand
8 disclosure to plan fiduciaries, SIFMA is
9 concerned that the Department, and this has
10 been the talk of other conversations this
11 morning and yesterday, has inadvertently
12 overextended its reach through the use of
13 408(b)(2) as the vehicle for the changes.
14 For example, it's been discussed
15 in the mutual fund context brokerage
16 commissions and advisory fees paid from assets
17 of a nonplan asset vehicle are not subject to
18 the prohibited transaction requirements. They
19 are not subject to an excise tax regime.
20 At a minimum we think that any
21 final regulation should distinguish between
22 compensation paid by funds and their

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1 affiliates for distribution, record keeping
2 and similar services in connection with the
3 particular plan, on the one hand, and separate
4 that from commissions paid for the purchase of
5 the underlying portfolio securities that are
6 held by the mutual funds themselves.
7 Finally, and again I think I'm
8 preaching to the choir here, SIFMA believes
9 that the effective date of the final rule
10 needs to be at a minimum coordinated with the
11 effective date of the Form 5500 disclosure.
12 So we would propose currently that that would
13 be July 2010, roughly an 18 month phase-in
14 from whenever the Department finalizes these
15 rules.
16 We think that trying to look at
17 these as a package, as we believe the
18 Department has, and looking at the disclosure
19 obligations for 5500, the disclosure
20 obligations for service providers and the like
21 should be looked at in a coherent form.
22 Now, to touch on some of the

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1 points in a little more detail, SIFMA again
2 strongly supports the goal of ensuring that
3 plan fiduciaries have the information they
4 need. But we continue to believe that the
5 fiduciary requirements of 404 are more
6 amenable to a flexible approach to disclosure
7 than is advanced in the one in the proposed
8 regulation.
9 We think it's appropriate to
10 follow the regimen of the current framework
11 which allows a fiduciary, a plan fiduciary to
12 decide how much disclosure is appropriate
13 under the circumstances for their type of
14 plan, for their type of service provider
15 relationship and how to obtain that
16 efficiently, shouldn't be discarded in the
17 absolutely legitimate effort to raise
18 consciousness of plan fiduciaries regarding
19 the information that may be relevant to their
20 decisions.
21 Now in dealing with the
22 contracting part of the regulation, we have a

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1 couple of points that we've made in greater
2 detail, but I want to summarize them briefly.
3 First, we urge the Department to
4 continue its view not to require signed
5 agreements for every service provider. We
6 think the cost and the delay of doing this
7 both from the plan's perspective and candidly
8 and more selfishly from our perspective is
9 prohibitive. And we're not entirely clear
10 with our experience on obtaining signed
11 contracts that that process will either be
12 expeditious or necessarily in the best
13 interest of plans or participants.
14 We urge also that the Department
15 continue its view to think that in terms of
16 looking at the documentation itself that we
17 incorporate other documents that are simply
18 published and other rules that are applicable
19 to many of our firms. Especially in the
20 securities brokerage area many of the rules on
21 disclosure are mandated already by FINRA, by
22 the SEC, by state security requirements as

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1 well as the Department of Labor. And what
2 we're concerned about and what our members are
3 concerned about is actually imposing a new set
4 of these requirements onto an existing
5 brokerage framework where disclosure with
6 respect to compensation is often times on a
7 transactional basis after the fact. Our entire
8 structure has been dealed with giving very
9 detailed disclosure on a transaction-by-
10 transaction basis through the Confirm system
11 rather than trying to come up front with an
12 estimate of what some of these brokerage
13 commissions or expenses could be.
14 We've urged the Department to
15 consider a safe harbor for disclosure under
16 the regulations such that any disclosure that
17 meets the requirements of the securities laws,
18 for example, will be deemed to meet the
19 disclosure requirements of 408(b)(2). And we
20 urge the Department to also consider a rule
21 similar to that of the Insurance Company
22 General Account Rule in 2550.401c-1 which

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1 allows noncompliance of these requirements to
2 be cured in a reasonable period of time
3 without imposing an excise tax regime.
4 We think the regulations should
5 provide that if a service is provided has not
6 been fully disclosed, it's full disclosure in
7 a reasonable period after discovery should
8 cure the harm.
9 We also think, and I touched on
10 this point earlier, that a written
11 comprehensive disclosure document in advance
12 of all plan service provider relationships is
13 not going to be required or honestly workable
14 for a number of different reasons.
15 First the services, as others have
16 noted, may evolve over time. It is very
17 possible that you may have brokerage services,
18 you may have custodial services, you may use
19 mutual funds, ETFs, managed accounts and the
20 like all within the same context of a plan
21 relationship and all within the context of a
22 brokerage relationship in the retail side. On

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1 the institutional side where a lot of our
2 members also transact business on behalf of
3 pooled funds and large plans, plans like the
4 General Motors plan and the like, we have
5 different requirements and different services
6 that they may require with respect to
7 securities lending, principle trading,
8 transition management and the like, all of
9 which evolve over time, all of which are
10 usually in the institutional context at least,
11 directed by an independent plan fiduciary, in
12 many cases a QPAM, or someone of equivalent
13 stature, and all of which we think are
14 adequately protecting the interests of plan
15 participants and beneficiaries who may be
16 invested in those vehicles.
17 We also believe that all of the
18 relationships themselves with respect to the
19 service providers aren't candidly going to be
20 known at the time that any particular contract
21 is entered into. The representative from the
22 American Banking Association noted his own

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1 corporate structure which, candidly, I would
2 have to say on behalf of Morgan Stanley's, our
3 corporate structure is equally convoluted and
4 equally historic. But more to the point, most
5 of the service providers that you would be
6 dealing with, especially on an institutional
7 basis evolve. They hire affiliates. They
8 hire different types of transactional
9 activities. And I will say that conflicts
10 disclosure when you do it in an advisory
11 vehicle through the Investment Advisors Act
12 recognizes that in many cases the disclosure
13 has to be fairly general with respect to these
14 relationships, especially with respect to
15 conflicts.
16 So the level of granularity and
17 the particularity may not be achievable, in
18 part because times change, the service
19 providers themselves change and the services
20 that the plans require may change as well.
21 And one point I think that we
22 would like to make in particular with respect

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1 to the conflicts of disclosure, we think for
2 our members, and we're trying to deal with
3 this from an institutional as well as a retail
4 basis, we think the provision for explicit,
5 detailed, candidly onerous, conflicts
6 disclosure is misplaced outside of the
7 fiduciary context.
8 Where someone is an investment
9 advisor under the Advisors Act, where they
10 have taken on an ERISA fiduciary role or the
11 like, there are documentations and procedures
12 that you should be concerned about with
13 respect to conflicts disclosure, and there are
14 issues that we all have to deal with as
15 financial institutions in making sure that
16 occurs. But if you're dealing with a service
17 provider to, let's say, a bank collective
18 trust or a pooled vehicle that is a plan asset
19 vehicle and you have a contract with that fund
20 to provide mailing services or printing
21 statements and the like, candidly and no
22 disparagement to FedEx or the like, I doubt

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1 that any plan investor in a bank collective
2 trust is going to be worried about FedEx being
3 used as the service provider of choice in
4 mailing.
5 So our point is that the level of
6 specificity really should depend on the types
7 of services that are actually being engaged
8 in.
9 We also think that if the
10 industry, and again we're speaking primarily
11 of the brokerage industry here, is required to
12 document in advance every possible service or
13 fee that a broker may be asked to perform for
14 all potential conflicts, from our own
15 experience the disclosure will be so
16 voluminous, especially given the fact that we
17 are concerned about missing a specific
18 conflict, a specific service that we may
19 provide or the like, that we think any value
20 in this disclosure will be lost in the
21 overwhelming nature of it.
22 So believe me, I think it's safe

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1 to say that every ERISA lawyer who is worrying
2 about this and concerned about this focuses
3 their attention on the excise tax aspect of
4 this. And I can tell you from my own
5 experience, more will be recommended rather
6 than less.
7 We also, and this was a point that
8 was raised earlier, strongly urge the
9 Department to leave other exemptive relief
10 unaffected by any new changes to 408(b)(2).
11 We think it's entirely appropriate for any of
12 the original and applicable prohibited
13 transactions to apply in their current form.
14 And we think the Department carefully
15 considered many of these issues in the
16 issuance of these types of exemptions, both on
17 the retail side and actually addressing retail
18 transactional issues as well as the
19 institutional asset management and verbal
20 transactions such as QPAM and the like.
21 And finally, and again, once again
22 we just do believe that when the Department

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1 settles on a final proposal on the type of
2 disclosure that's warranted, we believe an
3 extended period of time to actually implement
4 this is appropriate.
5 And I thank you for your
6 attention. I hope no one's throwing too many
7 things at me at this point. And I'm open to
8 any questions you may have.
9 CHAIR CAMPBELL: All right. Thank
10 you.
11 Well let's start down on this end.
12 PANEL MEMBER PIACENTINI: I don't
13 have anything.
14 PANEL MEMBER CAMPAGNA: You
15 mentioned that a 404 approach --
16 MR. RYAN: Yes.
17 PANEL MEMBER CAMPAGNA: A prudence
18 approach by the plan fiduciary.
19 MR. RYAN: Yes.
20 PANEL MEMBER CAMPAGNA: Others
21 have been before us and they have said that
22 there are problems with nonresponsive service

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1 providers.
2 MR. RYAN: Yes.
3 PANEL MEMBER CAMPAGNA: And that
4 small plans have a hard time negotiating in
5 this marketplace.
6 MR. RYAN: Yes.
7 PANEL MEMBER CAMPAGNA: Given the
8 issues that we've heard, how would the 404
9 approach work given --
10 MR. RYAN: Well, let me focus
11 primarily on the retail side of this because I
12 think this does not tend to occur on the
13 institutional side as much.
14 If I'm talking about the small
15 plan universe where you have less than 100
16 participants, I think part of the issue that
17 you're going to have here is that regardless
18 of what goes on, the plan sponsor, the plan
19 fiduciary has a responsibility to know this
20 information.
21 I can tell you that our various
22 members in their retail programs may provide

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1 fairly voluminous discussions and disclosures
2 already with respect to the types of conflicts
3 or the types of fees. But what we think is
4 most important here is that the Department
5 through the 404 process tries to remind plan
6 sponsors and plan fiduciaries that sponsoring
7 a plan honestly is serious work. That they
8 have responsibilities to do this. That they
9 really need to use their best judgment on the
10 types of providers. And that candidly, advice
11 from the Department would be required on this,
12 perhaps. But candidly if they're not provided
13 the information that they think they need with
14 respect to the engagement or the services,
15 they shouldn't engage the service provider.
16 Rather than trying to penalize them after the
17 fact, simply don't engage with them or
18 terminate the relationship. It's always been
19 part of 408(b)(2) that plans should be able to
20 get out without penalty. So we would suggest
21 the Department in part of this process simply
22 remind plan fiduciaries that that would be

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1 appropriate..

2 PANEL MEMBER CAMPAGNA: Okay. You

3 also mentioned the conflicts provision. And I

4 think what I heard you say is it should be

5 limited to fiduciaries.

6 MR. RYAN: Fiduciaries.

7 PANEL MEMBER CAMPAGNA: Okay. And

8 my question is do you think that there are

9 possible service providers who may not be

10 fiduciaries but are still in a position of

11 influence over plan or plan fiduciaries.

12 MR. RYAN: Well, I think as the

13 Department has said in various advisory

14 opinions, and I know this goes to the point of

15 recommendations versus investment advice, it's

16 entirely possible that people have influence

17 without necessarily having fiduciary ERISA

18 defined investment advice with respect to the

19 purchase of securities and other property.

20 Do I think it's appropriate that

21 there may be some disclosure? Absolutely.

22 Do I think that most service

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1 providers represented by SIFMA do provide
2 baseline disclosures, certainly if they're
3 dual registrants with respect to the types of
4 conflicts that may arise? Absolutely. But
5 the types of conflict disclosure that may be
6 provided here is fairly general. It is not
7 going to be plan-by-plan specific. It can't
8 be by its very nature of it. And it will be
9 difficult on the small plan context for many
10 of the members to try to drill them with each
11 particular, for example on the retail side,
12 broker to figure out does he or she have
13 sufficient influence to warrant a specific
14 disclosure or not.
15 We think that there may be ways to
16 approach this in terms of the general
17 conflicts area, to remind plan sponsors for
18 example that most service providers are there,
19 in fact, to make a profit. And that they do
20 have financial relationships with other
21 parties that may be unaffiliated or unrelated
22 to the plans.

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1 PANEL MEMBER CAMPAGNA: Is the
2 problem you see that the conflicts provision
3 could be interpreted to go beyond the point of
4 contact, the service provider point of contact
5 with the plan, or you do not see it even in
6 that context?
7 MR. RYAN: Well, I'm not exactly
8 sure I'm following you. But I do believe the
9 relationships can evolve over time, especially
10 on the retail side.
11 PANEL MEMBER CAMPAGNA: Yes.
12 MR. RYAN: The conflicts can
13 evolve as well as the parties involved in
14 there. This is not to say that we think that
15 the Department has not already addressed fee
16 disclosure issues with respect to Form 5500.
17 We do believe that that is, in fact, already
18 addressed. We're just not sure that the
19 specific nature of a conflict disclosure adds
20 that much value in this case.
21 PANEL MEMBER CAMPAGNA: Okay. You
22 also mentioned you're in favor of the

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1 incorporation by reference of other documents.
2 MR. RYAN: Yes.
3 PANEL MEMBER CAMPAGNA: We
4 actually have that in our reg. And I'm just
5 trying to understand the differences that you
6 see or what we could add?
7 MR. RYAN: Well, I mean I think
8 part of the issue that we have, and I think
9 others have addressed here, part of this does
10 depend on the type of plan that we're
11 offering. And let's leave aside the health
12 and welfare types of plans for the time being.
13 To the degree that we actually
14 have information for mutual funds and
15 similarly type of registered products, I think
16 most of that disclosure can be incorporated by
17 reference. It does require, candidly, people
18 to be as dedicated as the counsel from
19 Fidelity to point to pages where perhaps they
20 can find it. But they can find it.
21 So we can list various types of
22 disclosure. We know that our members and we

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1 know that the mutual fund industry generally
2 has issued various types of bills of rights
3 describing fee arrangements, revenue sharing
4 whether or not it's coming out of the fund or
5 not. It's clearly being disclosed in the fund
6 documents, if it is in fact being paid by the
7 fund. If it's being paid by the advisor,
8 there's usually point of sale contact with
9 respect to the service provider or broker that
10 actually would disclose that nature.
11 PANEL MEMBER CAMPAGNA: Last
12 question, same question I asked Mr. Mollahan,
13 previously.
14 MR. RYAN: Yes.
15 PANEL MEMBER CAMPAGNA: About the
16 class exemptions, and I pointed out two
17 involving execution of brokerage and sales of
18 insurance contracts --
19 MR. RYAN: Yes.
20 PANEL MEMBER CAMPAGNA: -- where
21 the only things being disclosed now are as
22 basic commissions. And what we're talking

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1 about in our regulations, perhaps, is a little
2 bit more regarding indirect compensation or
3 conflicts associated with this.
4 MR. RYAN: Yes.
5 PANEL MEMBER CAMPAGNA: Do you see
6 --
7 MR. RYAN: I actually do believe
8 that in many cases 75-1 and 84-24 would take
9 into account some of these issues.
10 If I recall correctly the
11 Department's enforcement positions on
12 insurance contracts over the late 1990s
13 articulated that posture. So I'm not entirely
14 sure that candidly you need this.
15 PANEL MEMBER CAMPAGNA: All right.
16 Thank you.
17 PANEL MEMBER CANARY: A couple of
18 people have talked about the difference
19 between the broker and the broker's activity
20 when you are sort of buying and selling shares
21 in a portfolio that's managed by either the
22 mutual fund investment advisor or another

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1 institutional fund versus the role of the
2 broker more as a point of contact --
3 MR. RYAN: Yes.
4 PANEL MEMBER CANARY: -- where the
5 plan may be going through the broker and using
6 the broker as a provider as a platform, more
7 or less. Can you talk a little bit about
8 those different roles?
9 MR. RYAN: Sure.
10 PANEL MEMBER CANARY: And how you
11 think our regulations should deal with those
12 different roles?
13 MR. RYAN: Well, I think the
14 former, which is the institutional -- what I
15 would classify as the institutional trading
16 platform. The broker dealer serves as the
17 institutional broker for the underlying assets
18 of a mutual fund, a bank collective trust and
19 the like. In many cases those transactions
20 are directed by the fund advisor, a fund
21 manager, an independent fiduciary, not
22 necessarily an ERISA fiduciary, but a

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1 fiduciary either under the Advisors Act, the
2 Company Act or perhaps ERISA.
3 What usually happens in those
4 cases we are talking about large scale
5 trading. We are talking about a selection of
6 brokers that these funds and accounts use.
7 And in many cases on the institutional side
8 there are no contracts because there are
9 relationships that the particular funds may
10 have that could use any one of a number of
11 institutional brokers based on their
12 responsibilities for best execution. So in
13 terms of the disclosure requirements, Number
14 1, in that space you may not have written
15 contracts.
16 Number 2, you clearly have
17 independent experienced investment
18 professionals as well as the broker dealer who
19 has to satisfy the requirement of best
20 execution.
21 So I would look at that as not an
22 areas candidly, that needs to be the

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1 Department's focus with respect to -- nor
2 would I recommend or I believe SIFMA would
3 recommend sweeping into brokerage that one
4 size fit all.
5 Now on what I call the retail
6 side, which is an individual broker who's
7 affiliated with a broker dealer or that broker
8 dealer itself may have relationships with a
9 plan, these are usually personal
10 relationships. There may be assets that are
11 custodied on the balance sheet of the broker
12 dealer, they may be held away at various
13 vendors like Vanguard, Fidelity and the like.
14 In those kind of relationships I can
15 guarantee there are contracts. I mean, there
16 are contracts clearly with respect to the
17 accounts that are opened on our members'
18 platforms. There are also contracts that are
19 opened at the various provider networks.
20 Now I think it's safe to say that
21 in those cases you may want to focus in, and
22 those tend to be the retail focus that you

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1 were trying to address in terms of disclosure.
2 Those contracts are there. We have the issues
3 that we will have with respect to amending
4 them and trying to supplement disclosures to
5 the degree that the Department thinks it's
6 appropriate. But it's a different framework.
7 And actually that's a framework that's closer
8 in spirit to what I believe the Department is
9 addressing in the regulation.
10 PANEL MEMBER CANARY: Okay. So in
11 that environment --
12 MR. RYAN: Yes.
13 PANEL MEMBER CANARY: -- in terms
14 of the broker in that circumstance then
15 receiving payments from parties other than the
16 plan --
17 MR. RYAN: Yes.
18 PANEL MEMBER CANARY: -- can you
19 talk a little bit about things like
20 nonmonetary forms of compensation that may be
21 received in that environment and your thoughts
22 about the regulation's treatment of the

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1 nonmonetary disclosure of the receipt of
2 nonmonetary compensation?
3 MR. RYAN: Well, I think it's safe
4 to say that I can't give you an exhaustive
5 list. But when I think of nonmonetary
6 compensation, I tend to think about, among
7 other things, training seminars rather than
8 I'm worried about gift and entertainment
9 expense that the broker may be receiving.
10 Most broker dealers in that
11 context, candidly, are worried and the
12 Department's helped that worry by focusing in
13 on the LM-10 Project in keeping track of the
14 expenses that they in fact incur in
15 entertaining and that could be gifts,
16 entertainment. That's also a question of
17 training facilities or training seminars.
18 So the degree that you could be
19 receiving those, most broker dealers,
20 financial providers are given access to
21 training seminars to let the platform
22 providers teach you about what types of

1 offerings they have. Those things do occur in
2 the ordinary course. They can be generally
3 described. They can't be described necessarily
4 specifically up front as how many of those go,
5 or I believe as the Vanguard representative
6 indicated, the contents of each one of those
7 programs may change.
8 I think you can have generalized
9 disclosure about the existence of those
10 arrangements, which I think the Department
11 wants to encourage rather than discourage
12 because they're primarily vehicles for people
13 to learn more about how to properly invest.
14 So that would be my take on it.
15 PANEL MEMBER CANARY: All right.
16 Thank you.
17 MR. RYAN: Thank you.
18 CHAIR CAMPBELL: Mr. Ryan, I guess
19 we had heard from a number of folks testifying
20 that small plan in particular can have
21 difficulty getting the information that they
22 feel they need from their service providers.

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1 And I'm wondering if that's consistent with
2 what you've observed in your professional
3 experience?
4 MR. RYAN: Well, again, on a
5 retail focus my own world is that I support
6 Morgan Stanley's institutional retail and
7 money management business.
8 I can tell you with all candor
9 that no small plan at Morgan Stanley seems to
10 have any trouble finding my phone number. So
11 in terms of the access issues, I think there
12 are very real issues that clients have
13 probably grappled with, which the Department
14 has grappled with on how I would, for example,
15 calculate float, how I would calculate
16 indirect compensation of the type that,
17 candidly, none of our systems really capture,
18 at least currently.
19 It is not my experience, I don't
20 believe it's the experience of the majority of
21 the members where they have not provided
22 information upon request. I will tell you the

1 requests don't always come in a timely basis.
2 They are usually required to be provided
3 yesterday. But I do think that the small plan
4 community in particular has been, as one
5 speaker said earlier, very sensitized to the
6 whole nature of fees, disclosure, commissions,
7 expenses and the like. So I don't think they
8 are not getting -- they're not getting heard.
9 They are clearly getting heard. There may be
10 some things that we can't give them any
11 specific details on, but they tend to be the
12 issues like float where we can only tell them
13 about the specifics, where we've disclosed it,
14 at least the existence of it up front but
15 can't give them a specific dollar amount.
16 CHAIR CAMPBELL: Okay. But we'd,
17 as I said, received testimony to that effect
18 that in particular small plans, and this has
19 been a recurring issue that we've heard over a
20 number of years. Indeed, it's one of the
21 factors that I think led us to this proposed
22 regulation.

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1 MR. RYAN: And I think
2 realistically that the Department's efforts
3 and the SEC's efforts with respect to various
4 sweeps with pension consultants and the like,
5 candidly, have had some benefit in terms of
6 sensitizing everyone with respect to the
7 importance of responding to those kinds of
8 requests.
9 CHAIR CAMPBELL: Well, I
10 appreciate that. And I notice in your
11 comments that you suggest though that we carve
12 out from this regulation small plans to ensure
13 that they aren't subject to these disclosure
14 requirements -- service providers, rather, to
15 those plans and the plans themselves aren't
16 subject to it. And I'm curious why that is.
17 MR. RYAN: Well, I think part of
18 it is honestly logistical. To the degree that
19 we have to go down the road, you can have a
20 lot of small things. But if you are requiring
21 a recontracting of these types of
22 arrangements, I can tell you from personal

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1 experience those do not tend to be
2 negotiations that are done quickly. They are
3 protracted. Part of it is an explanation
4 again of the services and the model and the
5 cost and the like. But I think our view tended
6 to be that in that market what we were most --
7 we are obviously concerned about providing the
8 right level of disclosure to the plans. What
9 we're most concerned about, though, is
10 inundating them. I will tell you a recurring
11 theme that we keep getting on all of our
12 marking material at Morgan Stanley is we're
13 sending you too much. We're sending you too
14 much disclosure. Why are you sending the
15 prospectuses? I will tell them it's because
16 the Department of Labor says so. But why are
17 you providing all this paperwork? Why am I
18 looking at multiple versions of the contract?
19 Why am I basically going down the road of
20 actually seeing these documents?
21 I think part of this is just based
22 on the retail side of the practical experience

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1 of how we deal with some of our small plan
2 clients. It takes a lot of them, candidly, to
3 actually negotiate much of this stuff.
4 And honestly, some of it is a
5 question of force feeding to some degree the
6 disclosures we provide.
7 CHAIR CAMPBELL: Well then do you
8 think that lends itself to suggest, as some
9 other commenters have, that there should be a
10 summary document where either one document or
11 executive summary that points to other
12 documents so that there's one place where all
13 this information is?
14 MR. RYAN: I think it's a noble
15 goal. I'm not entirely sure how one would do
16 it given the types of services.
17 I will also tell you I think --
18 you know, I would like to paint myself as
19 sponsoring a noble industry. And I think it
20 is. But I would say that also a practical
21 issue that we have with small plans is that we
22 don't necessarily want to be responsible for

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1 compliance issues with 408(b)(2) in failing to
2 get contracts signed and finally negotiated.
3 I mean, the excise tax does concern us from
4 that perspective.
5 CHAIR CAMPBELL: Okay.
6 PANEL MEMBER ZARENKO: Can I jump
7 in with a follow up question.
8 CHAIR CAMPBELL: Of course, do.
9 PANEL MEMBER ZARENKO: So you had
10 started out by recommending that we should
11 have done this as a 404 matter, not a
12 408(b)(2)?
13 MR. RYAN: Yes.
14 PANEL MEMBER ZARENKO: So if we
15 went that route, would you no longer have this
16 concern or even requirements under 404 should
17 have some kind of a carve out for small plans?
18 MR. RYAN: Well, I think it's less
19 pressing. I think telling -- if the
20 Department, for example, and I'm not
21 recommending this, believe me, but if the
22 Department was trying to come up with a one

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1 stop shop to give small plan clients a sample
2 contract that's one thing, and that's
3 something that they could do as illustrative
4 guidance under 404 not mandating, as you said
5 in the past, that it's the only way to
6 proceed. But to look at different aspects of
7 the service provider relationship and then see
8 does that make sense under your context? Do
9 you understand these basic issues?
10 That's really our focus on this
11 from a 404 perspective. We think a lot of
12 this is, candidly, employer education and plan
13 education.
14 PANEL MEMBER ZARENKO: Thank you.
15 PANEL MEMBER DWYER: Let me just
16 follow up on a question asked by Mr. Canary
17 about the brokers.
18 MR. RYAN: Sure. Yes.
19 PANEL MEMBER DWYER: You said
20 there were brokers in these two regimes, the
21 institutional broker and the retail broker. In
22 your written comment you state that it would

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1 be extremely cumbersome to have contracts --
2 for investment managers to enter into
3 contracts with the brokers. Is that comment
4 limited to the institutional regime?
5 MR. RYAN: Institutional.
6 Institutional.
7 PANEL MEMBER DWYER:
8 Institutional. Why is that so difficult?
9 MR. RYAN: Well, it's not a
10 question of difficulty, it's simply
11 interfering with market practice, number one.
12 And number two we are not the exclusive broker
13 with respect to any mutual fund or any pooled
14 vehicle. They choose among a dozen different
15 broker dealers on any given day with respect
16 to trading activities. These are phone calls
17 that are engaged in, and the truth is you can
18 open under the securities laws a securities
19 brokerage account, again not an advisory
20 account, a brokerage account simply without a
21 written contract.
22 We're just saying that in the

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1 context of the reduced costs that have been
2 passed on, which others have talked about in
3 terms of the institutional market and the
4 institutional funds, adding a requirement that
5 you suddenly have to have a contract where
6 you've never had to have one on the
7 institutional side, doesn't seem to me to help
8 anyone.
9 In terms of the institutional
10 trading activity we think the plans are
11 already well protected by the parties that are
12 engaging in the brokerage transactions.
13 They're receiving the confirms, they
14 understand the nature of the brokerage
15 relationship as principal versus agency, they
16 understand the full range of compensation
17 that's being disclosed. The manager may have
18 an obligation to report that as part of the
19 expense ratio, et cetera in a mutual fund.
20 But we're not sure that this necessarily adds
21 anything to the context of those types of
22 trading activities.

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1 PANEL MEMBER DWYER: But as a
2 practical matter could it be done?
3 MR. RYAN: As --
4 PANEL MEMBER DWYER: What would be
5 involved in that?
6 MR. RYAN: Recontracting every
7 institutional trading relationship in the
8 middle of, let's just say, a relatively
9 unsettled financial trading situation? It
10 would take months. You are talking to the one
11 person who would be reviewing most of them. I
12 can honestly tell you I am not looking forward
13 to spending the next year and a half trying to
14 do that.
15 PANEL MEMBER DWYER: Okay. A
16 second question. You talk about the
17 regulations should distinguish the fund's
18 payments of distribution and record keeping --
19 MR. RYAN: Yes.
20 PANEL MEMBER DWYER: -- in
21 connection with the plan's purchase of mutual
22 fund shares and commissions for the underlying

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1 portfolio securities of the fund.

2 MR. RYAN: Right.

3 PANEL MEMBER DWYER: Can you

4 explain more about that and --

5 MR. RYAN: Sure.

6 PANEL MEMBER DWYER: -- and why

7 that distinction would be important to a

8 plan--

9 MR. RYAN: Sure

10 PANEL MEMBER DWYER: -- in

11 determining reasonableness of the fees?

12 MR. RYAN: Well, I actually think

13 others have already articulated these points

14 rather elegantly.

15 What we're referring to, again, is

16 the breakdown between the institutional and

17 the retail distribution arms. What I was

18 referring to in the portfolio trading activity

19 was in fact the trading of the underlying

20 securities held by the mutual fund themselves.

21 Now I know we've had different

22 discussions about expense ratios and the like.

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1 But when we compute an expense ratio in a
2 mutual fund context, that tends to be
3 something that's know in advance. It's usually
4 the investment management fee, record keeping
5 fee. Think of it as the administrative start
6 up costs and maintenance costs with respect to
7 a mutual fund, generally.
8 When you're talking about the
9 portfolio trading activity, you're talking
10 about transaction-by-transaction cost that
11 basically incurs when you invest in
12 securities, when you use Morgan Stanley,
13 Goldman Sachs or any other institutional
14 broker dealer. Those costs are not known up
15 front. Those are trading costs that are known
16 at the time of the transaction. So you simply
17 can't disclose them up front. At the best you
18 can do with respect to those is, as others
19 have noted, include those in the performance
20 evaluation with respect to the fund on a
21 quarterly or annual basis.
22 So that's really the distinction.

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1 When we're talking portfolio theory, we're
2 really talking about the trades the mutual
3 fund managers are doing through the
4 institutional trading arms and those types of
5 costs, which are really found generally, I
6 believe, in the portfolio return.
7 PANEL MEMBER DWYER: Thank you.
8 CHAIR CAMPBELL: Any other
9 questions?
10 PANEL MEMBER WILLIAMS: Just one
11 minor point. You know, banks are often
12 affiliated with broker dealers. And we had
13 done some advisory opinions a while back about
14 discount brokerage and those advisory opinions
15 analyzed it in terms of 408(b)(2) and the
16 avoidance of fiduciary self-dealing.
17 MR. RYAN: Yes.
18 PANEL MEMBER WILLIAMS: Say where
19 you have a directed trustee and you have an
20 affiliate that would be used as a broker
21 pursuant to the direction of the an
22 independent fiduciary.

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1 MR. RYAN: Yes.
2 PANEL MEMBER WILLIAMS: In those
3 instances are you saying there's no written
4 contracts with the affiliated broker?
5 MR. RYAN: No, I think there is
6 what I would think of as the retail side. It's
7 a discount brokerage. These tend to be retail
8 operations where you actually would have a
9 contractual relationship.
10 PANEL MEMBER WILLIAMS: Okay. So
11 in the institutional side where the investment
12 manager will be affiliated with the broker
13 dealer would there be contracts with the
14 affiliate?
15 MR. RYAN: The affiliate would
16 have a contract if for no other reason to make
17 sure that the account is coded as an agency
18 only trading account. Because the one thing
19 you want to avoid if you have an affiliated
20 investment manager is trading through an
21 affiliated broker dealer on anything other
22 than an 86-128 basis.

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1 PANEL MEMBER WILLIAMS: Okay. So
2 that's really 86-128?
3 MR. RYAN: Right.
4 PANEL MEMBER WILLIAMS: And that's
5 why you're saying don't mess with that?
6 That's separate?
7 MR. RYAN: Yes. That's exactly
8 right.
9 PANEL MEMBER WILLIAMS: Thank you.
10 CHAIR CAMPBELL: All right. And
11 with that we have concluded.
12 I think we're right now about half
13 an hour behind. So I think what we'll do is
14 halve that. Let's come back at 1:15, that
15 will give you all a few moments to become
16 acquainted with our cafeteria, unless you can
17 quickly find other options. And we'll see you
18 at 1:15.
19 Thank you.
20 (Whereupon, the above-entitled
21 matter went off the record at 12:30 p.m. and
22 resumed at 1:20 p.m.)

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1 PANEL MEMBER CAMPAGNA: I think
2 we'll begin. Okay. Mr. Campbell is probably
3 tied up; I wouldn't be surprised. So let us
4 begin with the Council of Insurance Agents and
5 Brokers.
6 MR. FINDLAY: Ready for me? Okay.
7 Thanks very much. My name is Cam
8 Findlay. I'm currently the Executive Vice
9 President and General Counsel of Aon, which is
10 the world's largest insurance broker and one
11 of the world's largest employee benefits
12 consulting firms.
13 I served as the Deputy Secretary
14 of this Department from 2001 to 2003, so I
15 know a little bit, not much, about the work of
16 EBSA. And I just would say that it is great to
17 be back for the first time in an official
18 capacity back in the building, because I have
19 great affection for the place and the people
20 here.
21 I'm appearing today on behalf of
22 the Council of Insurance Agents and Brokers.

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1 And I wanted to expand and clarify the
2 substance of the Council's written comments on
3 proposed regs.
4 I want to emphasize, also, that my
5 testimony is submitted on behalf of the entire
6 Council and not just on behalf of Aon, because
7 as I'll discuss at various points, Aon has
8 introduced some business reforms which go
9 beyond what some other members of the industry
10 have done.
11 The CIAB is the association that
12 represents the nation's largest insurance
13 brokerage firms and insurance agencies. And
14 we specialize in a wide range of insurance
15 products and risk management services for
16 business, industry, government and the public.
17 Council members conduct business
18 in 3,000 locations, employ 120,000 people and
19 place 80 percent of all U.S. insurance
20 products and services protecting business,
21 industry, government and public at large.
22 We also place the majority of U.S.

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1 employee benefit insurance products.
2 We want to start by saying that we
3 strongly support the efforts of the Department
4 to increase transparency and disclosure.
5 Indeed, our group has been supporting such
6 efforts since 1998, when we adopted a formal
7 policy position in favor of greater
8 transparency. And in 2004 we again publicly
9 took steps to enhance transparency and
10 disclosure in the insurance industry, working
11 with the NAIC NCOIL, which is the National
12 Conference of Insurance Legislators to develop
13 model state laws on transparency.
14 As I'll discuss ins greater
15 detail, Council members are absolutely
16 committed to disclosure of their compensation
17 and routinely do disclose information on how
18 they're compensated, either voluntarily or
19 certainly when requested of them by their
20 clients.
21 We do differ with the proposed
22 rule somewhat, but we do so not because we

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1 want to keep our compensation secret, but
2 rather because we do not believe that the
3 Department's rules need to overlay on existing
4 requirements and practices, creating a new and
5 burdensome federal regime that seems to us to
6 have been designed for different industry
7 providers of 401(k) plan services, and
8 seemingly devised for fiduciaries, which
9 insurance brokers and agents are not.
10 As I'll discuss in greater detail
11 in a moment, the considerations that might
12 lead the Department to impose strict
13 disclosure requirements on 401(k) providers
14 simply don't apply very well to insurance
15 brokers given our role. For instance, 401(k)
16 providers manage and service large pools of
17 assets for beneficiaries. We insurance
18 brokers do not.
19 Moreover, insurance brokers are
20 not typically thought to be fiduciaries to
21 plan beneficiaries or even to plan purchasers,
22 but the Department's proposed rules would seem

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1 to treat brokers as equivalent to fiduciaries.
2 For these reasons, while we certainly support
3 efforts toward greater transparency and
4 disclosure in our industry, we don't believe
5 that the proposed rules would be a positive
6 step in such a case.
7 Let me first tell you a little bit
8 about our industry and how we operate. Our
9 primary business is the placement of insurance
10 products with welfare benefit plans and
11 others. The products include, amongst others,
12 life, health, disability and long-term care
13 insurance. And in connection with the
14 insurance products that Council members place,
15 they may also provide a variety of
16 administrative services to the purchaser,
17 including assisting plan sponsors with plan
18 design, applications for coverage, claim forms
19 and claim resolution.
20 The relationship among a purchaser
21 of insurance products, which we sometimes call
22 the client, the broker placing the insurance,

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1 and the carrier issuing the policy is governed
2 principally by the contractual relationship
3 entered into between the purchaser and the
4 broker or agent, and then of course by the
5 terms of the insurance policy itself.
6 There's a well developed body of
7 state law and in some states, statutory law,
8 providing that the legal relationships between
9 the plans that purchase insurance products,
10 the broker that places the coverage and the
11 carriers that provide the coverage are
12 contractual matters.
13 Council members receive
14 compensation in these arrangements in a
15 variety of forms, and it's very difficult to
16 generalize how Council members receive
17 compensation.
18 Some receive commissions from
19 carriers; some receive fees from the plans
20 themselves; some receive a combination of
21 those two; some, though not Aon and other
22 large brokers, accept contingent payments from

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1 the carrier when business originated by the
2 broker passes certain thresholds; and then
3 some brokers, though again not Aon, accept
4 discretionary travel or gifts from the
5 carrier.
6 And the variety in the forms of
7 compensation is exacerbated by the fact that,
8 as I alluded to, really a very large segment
9 of the industry, including the four largest
10 brokers, Aon, Marsh, Willis and Gallagher, do
11 not accept contingent commissions at all or
12 similar forms of compensation.
13 As noted above, state insurance
14 laws govern whether and to what extent brokers
15 or agents must disclose the types and amounts
16 of compensation they receive. Under the laws
17 of most states, brokers and agents are
18 required to at most disclose the type of
19 compensation they receive in advance.
20 However, brokers are generally not required to
21 disclose in advance the amounts of
22 compensation they're going to receive, in part

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1 because the actual amounts of compensation
2 cannot be known until after placement of the
3 insurance, because commission rates and the
4 forms of compensation vary by carrier and
5 program and because it's never clear what the
6 uptake will be for particular aspects of a
7 program.
8 Welfare plan benefits programs
9 vary in terms of carriers, products, price and
10 usage. A single welfare plan could offer its
11 participants multiple products for multiple
12 insurers in several categories of coverage:
13 medical, dental, life and so on. The
14 commission earned by the broker will vary with
15 the carrier and the premium paid on the
16 particular policy. The premium, in turn, will
17 vary with the take-up rates by plan
18 participants because brokers can't determine
19 in advance how all these factors will play
20 out, they really can't provide upon placement
21 more than general disclosure about the
22 commissions they receive.

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1 Let me just say a word about
2 contingent compensation. As I discussed a
3 second ago, some brokers and agents, though
4 not Aon, Marsh, Willis or Gallagher, accept
5 contingent compensation such as contingent
6 commissions, overrides, bonuses or gifts. The
7 level of such compensation is explicitly
8 contingent upon factors such as volume, client
9 retention and premium income levels. The
10 extent to which these factors affect the
11 actual level of compensation is not knowable
12 at the outset of an engagement.
13 Additionally, some contingent
14 commission is based on a broker's overall
15 relationship with a carrier and not the
16 premiums with respect to any particular plan.
17 So it's not practicable for the broker to
18 determine with any precision the extent to
19 which contingent compensation arises from
20 insurance placed for any particular plan.
21 The existing disclosure regime is,
22 as I said, essentially a matter of state law

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1 and contract. Insurance agents and brokers,
2 as you know, I'm sure, are already subject to
3 extensive state regulation including
4 disclosure requirements. And that sets them
5 apart from some of the other service providers
6 that you're addressing in the rule.
7 State law regulates the placement
8 activities of insurance agents and brokers and
9 most states require compensation disclosures
10 when a broker is providing both placement and
11 non-placement services.
12 In addition the largest four
13 brokers, as I've mentioned, have adopted
14 business reforms under which they disclose to
15 their clients prior to binding an insurance
16 policy the types and levels of commissions and
17 fees which they and affiliates will be paid
18 under various scenarios.
19 Next, supplementing the state law
20 regulation, most carriers contractually
21 require brokers to make significant
22 disclosures to policy holders and potential

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1 policy holders, and we give you some examples
2 of that in our written testimony.
3 Further, obviously under Form 5500
4 and related opinion letters, the Department
5 requires comprehensive disclosure regarding
6 commissions and fees earned by insurance
7 agents and brokers in particular, in contrast
8 to other service providers.
9 And finally, where agents or
10 brokers or their affiliates act as fiduciaries
11 under prohibited transaction class exemption
12 84-24, they of course must comply with the
13 exemption's comprehensive fee and conflict of
14 interest disclosure requirements.
15 Let me now just talk a little bit
16 about why we think that the proposed
17 regulations really don't apply particularly
18 well to our industry.
19 The Department's primary concern
20 under the proposed regulations appears to be
21 with participant-directed defined contribution
22 plans, in particular, with undisclosed,

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1 indirect compensation paid in connection with
2 those plans.
3 The Council certainly understands
4 the Department's concerns and certainly
5 supports the desire to enhance transparency in
6 connection with those plans. However, in our
7 view the Department appears to have cast its
8 net too broadly by promulgating one-size-fits-
9 all rules that also sweep in the placement of
10 insurance products and other welfare plans
11 with such 401(k)-type defined contribution
12 plans.
13 We're not aware, and at this point
14 of any public record that indicates that the
15 Department's concerns relating to such 401(k)
16 plans are equally applicable to insurance
17 placements. In fact, I think it's fair to say
18 we think that the two types of products are
19 completely different, both in their essential
20 nature and in the existence of state
21 regulation.
22 As we see it, 401(k) plans and

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1 insurance programs have different purchasers,
2 different beneficiary concerns, different
3 duties of the service provider and different
4 regulatory schemes.
5 Service providers for defined
6 contribution plans often manage assets for
7 plan beneficiaries, whereas insurance agents
8 and brokers do not.
9 Moreover as previously explained,
10 under state law and the contractual
11 requirements of insurance carriers, disclosure
12 concerning fees and relationships to the
13 extent feasible is already the standard in our
14 industry.
15 Further, in the 401(k) context
16 services are performed on literally a daily
17 basis that affect the purchasers and plan
18 beneficiaries. In contrast, brokers are
19 typically just selling a product on an annual
20 basis with little day-to-day involvement
21 beyond that. Therefore, we're uncertain that
22 the sorts of rules that you proposed would

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1 apply very well beyond the 401(k) scenario to
2 insurance brokers.
3 We submit that the Department's
4 efforts to bring transparency to service
5 provider compensation and potential conflicts
6 of interest in the context of section
7 408(b)(2) should not affect the conditions for
8 relief under other existing class exemptions.
9 In crafting those exemptions the Department
10 carefully considered the industries and
11 transactions at issue and the attendant risks.
12 In many cases, but not all, the Department
13 addressed those risks by predicating a relief
14 on comprehensive disclosures regarding fees
15 and other issues. We would respectfully submit
16 that in the absence of any evidence that prior
17 exemptions have not adequately protected
18 plans, the Department need not revisit them.
19 However, to the extent the Department believes
20 that it should, we submit that the Department
21 should do so on an exemption-by-exemption
22 basis.

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1 And, of the existing class
2 exemptions, is the one that's most relevant
3 here is 84-24. As you know, this permits
4 brokers and agents to place insurance products
5 with plans when they're fiduciaries or
6 affiliated with fiduciaries, notwithstanding
7 the self-dealing prohibitions. The exemption
8 has unique, carefully crafted conditions
9 intended to protect the plans involved,
10 including comprehensive disclosure and consent
11 conditions.
12 And we've set out in our testimony
13 the various types of information which is
14 required to be disclosed and the sorts of
15 consents that are required.
16 And we think that that exemption
17 actually highlights one of our major points,
18 which is that, when an entity is a fiduciary
19 there should be strict responsibilities placed
20 on that entity. So for instance, the
21 purchaser of our services is often going to be
22 a fiduciary, and we would understand why the

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1 purchaser should have certain requirements.
2 As I mentioned before, insurance
3 brokers are typically not fiduciaries. They're
4 a provider of service to fiduciaries, and we
5 think that different requirements ought to be
6 imposed on service providers.
7 I see that my red light is going
8 off, so I'm happy to address any questions
9 that you have.
10 CHAIR CAMPBELL: Great. And I
11 apologize. I had missed the very first part of
12 your remarks there. But hopefully -- I think I
13 caught the gist of what you were saying and
14 certainly want to welcome you back to the
15 Department as our former Deputy Secretary just
16 a few years ago.
17 Going to your question about some
18 of the differences that might be there in
19 welfare plans, one of the reasons that I think
20 came out a lot in the testimony yesterday is
21 the question of, from the fiduciary's
22 perspective, who, after all, is contracting

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1 for services across a variety of different
2 regulated products, some regulated by the SEC,
3 some by the OCC, some by state insurance
4 commissioners, from the perspective of the
5 fiduciary is there a distinction in the
6 different decision making process and the type
7 of information they need? Because the focus
8 of the regulation was looking at what is it
9 that a fiduciary needs to carry out his or her
10 duty, what information do they have to have?
11 And obviously we have to adjust that to suit
12 the law and the regulatory structure. But are
13 there distinctions you think in welfare plans
14 that would make a fiduciary approach that
15 decision process in a different way in the
16 welfare context versus, say, a defined
17 contribution plan context?
18 MR. FINDLAY: I think there are a
19 couple important differences. One, as I
20 mentioned, an insurance broker is typically
21 assisting the client with purchasing a
22 product, and it's not actively involved in

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1 managing these vast amounts of assets that
2 would be involved in a 401(k) plan. So I think
3 that's one difference.
4 I think a second difference is the
5 difference in the sort of fall-back regulatory
6 and disclosure regime that exists absent DOL
7 putting itself into this situation. And in our
8 world, as I mentioned, there are all sorts of
9 reasons why there's good disclosure out there.
10 And then I think the other reason
11 I'd say is that it's the nature of the sorts
12 of compensation issues which are lurking in
13 the background. When you're talking about
14 401(k) plans, and I'm far from an expert on
15 those, as I understand it, it's hard to get
16 behind the kinds of information that might be
17 provided, like the cost and basis points or
18 something like that.
19 In our situation if you know the
20 commission rate which is, in our case,
21 provided to the client, then that's really all
22 you need to know. You know what your gross

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1 premium is going to be. That's the most
2 important thing to a purchaser. If what you're
3 concerned about is how is the broker making
4 money, we do disclosures first of all in our
5 letters of engagement. I believe that's
6 industry standard practice. As I say, many
7 carriers require us to disclose the commission
8 that we receive and any compensation. And
9 then, for the vast majority of the industry,
10 we are already providing very extensive
11 disclosure in the pre-bidding process where we
12 will say in each way that we get compensated.
13 So I think that the biggest
14 difference is that they're just fundamentally
15 different kinds of products that are being
16 purchased. Essentially the asset management
17 versus insurance purchase. And the second
18 thing I would say is that you ought to take
19 account of what is in existence if you don't
20 engage the DOL in this process.
21 And in our view there are a lot of
22 strong protections in place already in our

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1 industry.

2 CHAIR CAMPBELL: Okay. Why don't

3 we start over here with Allison.

4 PANEL MEMBER WIELOBOB: You said

5 that something that we've heard earlier,

6 yesterday primarily, from health and welfare

7 service providers, that they don't think the

8 regulations should apply to them. However,

9 Congress decided that welfare plans should be

10 covered by the same fiduciary protections --

11 at ERISA's most basic level, the same

12 protections that retirement plans get.

13 I mean, if not this type of

14 regime, you're telling us that it's sort of

15 apples and oranges with your industry. What

16 types of disclosures -- what would work

17 better?

18 In your written comments you've

19 asked us to reserve with respect to welfare

20 benefit plans, so --

21 MR. FINDLAY: Well, I think that

22 you're absolutely right that the statute

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1 doesn't distinguish between the fiduciary
2 responsibilities as the two types of plans,
3 but as I mentioned before we're not a
4 fiduciary. So what we're really saying is: is
5 the information available to the purchaser of
6 these plans, who is the fiduciary, from folks
7 like us? And so I think it is appropriate to
8 take into account the existing regulations
9 under state law, the existing practices in the
10 industry and decide, do we need to do anything
11 different as the Department of Labor in our
12 rules to make sure that that information is
13 available to the purchaser?
14 Ultimately it is the purchaser's
15 responsibility to exercise its fiduciary
16 duties, to protect its plan beneficiaries. It
17 ought to ask the questions anyway, whether or
18 not you require us to provide information, it
19 ought to be asking us for that. And our
20 members routinely have provided information in
21 response to questions, and in many contexts,
22 as I've mentioned, we actually are required to

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1 provide it already.

2 So I think that, while the

3 underlying responsibility of the fiduciary is

4 the same, the background information as to

5 what the availability of the information to

6 that fiduciary is, is different.

7 PANEL MEMBER WIELOBOB: Okay.

8 Another question. Well, you're subject to

9 state regulation, I get that with the

10 insurance industry. And we actually, you

11 know, in other areas of this reg, we

12 incorporate by reference information provided

13 to other agencies.

14 With that in mind, I'd like to

15 hear a little bit from you about exactly what

16 kind of information are we talking about.

17 What would that get to plan fiduciary in a

18 meaningful way? How does it reach them?

19 MR. FINDLAY: Absent the

20 Department?

21 PANEL MEMBER WIELOBOB: Absent,

22 yes, aside from the federal regime. What do

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1 state insurance commissions -- in effect, is
2 it easy for them to access, it is
3 understandable for the plan fiduciaries?
4 MR. FINDLAY: I think it's a lot
5 less complicated than for 401(k) plans.
6 Although there are various ways in which the
7 tens of thousands of brokers and agents in the
8 country get compensated. It's kind of easy to
9 summarize.
10 You know, typically we get paid on
11 either a commission basis or a fee basis. For
12 large clients, they don't want the brokers to
13 be getting commissions so they'll often
14 negotiate a fee with us. For smaller brokers
15 and smaller clients, it's quite common that
16 they get paid in commissions.
17 Now there's this third category
18 that I mentioned, which is contingent
19 commissions. As a result of state actions the
20 big four brokers have all decided we no longer
21 take them. So you're really just talking about
22 smaller brokers in that area. And smaller

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1 brokers are the ones that typically would
2 really be affected in terms of burden if these
3 rules were to go into effect.
4 We're not a small broker. We're
5 actually the largest one in the world, so I
6 can't really talk in a sort of practical,
7 down-to-earth way as to what the burdens would
8 be for them. But I can say that we've had to
9 build IT systems and very extensive processes
10 in order to get that kind information to our
11 clients. And I would imagine for a small
12 broker -- and the smallest ones in my
13 association are about $5 million in revenue --
14 that would be a huge burden for them if they
15 were to have to put this in place.
16 Of course if a client asks, it's
17 the practice of every broker I know of to
18 basically say: Here's what the commission is
19 going to be. Yes, we get paid contingents and
20 so forth. Even absent the sort of new
21 requirements that we had, we always did that.
22 PANEL MEMBER WIELOBOB: Speaking

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1 of contingent commissions, how is that
2 regarded by brokers, if you can imagine? I
3 mean, what portion of compensation is that, if
4 it's a part of a broker's/agent's
5 compensation, is it something that this is the
6 contingent, which is that's based on the
7 totality of the relationship with the carrier?
8 MR. FINDLAY: Yes, and it tends to
9 be very, very small.
10 PANEL MEMBER WIELOBOB: Okay.
11 MR. FINDLAY: In fact I think
12 differences amongst contingent commission
13 arrangements with carriers would be dwarfed by
14 differences in commission rates between
15 various carriers. There's not a kind of
16 standard commission in, really, even any line
17 of insurance in the industry. It tends to be a
18 negotiation between the carrier and the
19 broker.
20 PANEL MEMBER WIELOBOB: Okay. I
21 just have one more question. It's about your
22 position on 84-24 and juxtaposed or in

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1 combination with the 5500 and these
2 disclosures to other entities you feel is
3 adequate for a plan fiduciary.
4 I guess, you know, the information
5 provided in the 5500 is really retrospective.
6 Perhaps the arrangements don't change very
7 much in compensation formulas, what have you,
8 it remains relatively static. But information
9 provided to state insurance commissions, is
10 that prospective, retrospective? What's the
11 nature?
12 MR. FINDLAY: Well, you know,
13 we're not a carrier, so I'm not an expert on
14 what carriers have to file. The carriers
15 generally have to file with state insurance
16 commissions how they compensate brokers. I
17 don't think, honestly though, it's to the sort
18 of level detail that you would be requiring if
19 I'm reading the rule correctly.
20 And I guess, as I alluded to
21 before, we think 84-24 appropriately strikes
22 the balance. Because it recognizes that, when

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1 a broker or if a broker ever acts as a
2 fiduciary, you ought to impose on the
3 fiduciary the same sort of responsibilities
4 you do on the purchasers of the plan who are
5 fiduciaries. But when we don't act as a
6 fiduciary, I think a different disclosure
7 regime is appropriate. And that's why we think
8 84-24 really appropriately struck the balance.
9 The fiduciary can still ask us
10 anything they want, and if they don't like the
11 answer, of course, they can hire a different
12 broker. So there are market pressures here
13 also that cause us to be transparent.
14 PANEL MEMBER WIELOBOB: Well,
15 that's actually -- my last point is, you know,
16 one of the things in your written testimony is
17 that you say amongst this whole sort of
18 disclosure or background for you all, is
19 carriers require disclosure from the brokers.
20 What type of information of that? Because
21 while that might be an important component
22 part of getting information out, it's a little

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1 different from a federal agency entrusting --
2 MR. FINDLAY: Sure.
3 PANEL MEMBER WIELOBOB: -- the
4 private entities to provide that information.
5 MR. FINDLAY: It's a point we
6 wanted to make to kind of -- you know, what
7 exactly is broke here that needs to be fixed?
8 That there seems to be a lot of information
9 out there out for the fiduciaries who are the
10 ones required to get it, digest it and act on
11 it. And so when you have a background of a
12 fair amount of information out there, you know
13 we would say that we don't need to have the
14 DOL take on this new role and impose burdens
15 on smaller brokers in particular, who would
16 really be hurt very significantly by this in
17 terms of the cost burden, the day-to-day
18 hassle of putting together all the systems and
19 forms and so forth.
20 PANEL MEMBER WIELOBOB: Thank you.
21
22 MR. FINDLAY: Thank you.

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1 PANEL MEMBER WILLIAMS: Okay. I
2 have a quick clarification. The selling
3 agent, I think you said, was just doing this
4 sort of on an episodic basis and there wasn't
5 really an ongoing service relationship that
6 would create a service provider status?
7 MR. FINDLAY: It's not to the same
8 extent as a 401(k) plan. There is sort of
9 episodic involvement. For instance, sometimes
10 a broker will assist with pursuing a claim.
11 But quite often insurance products are bought
12 and then no claim comes in for a long time,
13 certainly in the property or casualty areas.
14 In this area we don't get as
15 involved in pursuing claims on behalf of
16 beneficiaries, although I think some benefits
17 providers will provide that service. But it's
18 not the kind of constant, minute-to-minute,
19 day-to-day relationship that you have in the
20 401(k) context.
21 PANEL MEMBER WILLIAMS: Okay.
22 When that does happen, you're taking on the

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1 role as a consultant; is that how you trigger
2 the 84-24 status with being a fiduciary?
3 MR. FINDLAY: I think we largely
4 think that we're not fiduciaries. And we
5 typically make that quite clear to our clients
6 that we're not fiduciaries. Under state law,
7 we're typically not considered fiduciaries.
8 I was going to say, except in rare
9 circumstances, but I can't even think of a
10 circumstance where state law imposes a
11 fiduciary duty on us. And even during the
12 midst of the Spitzer investigations, it was
13 never asserted that we had a fiduciary
14 obligation to our client. It was that we owed
15 a duty to our duty, but it didn't rise to the
16 high level of fiduciary duty.
17 PANEL MEMBER WILLIAMS: Okay. So
18 what exactly goes on when they are acting as
19 fiduciary and they're using the 84-24?
20 MR. FINDLAY: I think it would
21 only happen if we affirmatively agreed with a
22 client insurant to do that, that we were going

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1 to be a fiduciary in some particular instance.
2 But the general backdrop of law is that
3 insurance brokers are not fiduciaries.
4 PANEL MEMBER WILLIAMS: Okay.
5 Thank you.
6 PANEL MEMBER DWYER: I do
7 understand that your company doesn't take
8 contingent commissions, but I did want to ask
9 about it. You say that they're not known at
10 the time contracting, but what level of
11 specificity is known about them? And you
12 might not know the exact amount, but what
13 would the broker know about the contingent
14 commission at the time of contracting?
15 MR. FINDLAY: Again, we don't take
16 them so I might not be the best person to talk
17 about this. And I was greeted upon by arrival
18 at Aon with a subpoena from Mr. Spitzer and we
19 haven't taken them since I've been there. So
20 I'm not the expert on contingents.
21 But I think that in most cases the
22 broker would know the sort of general

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1 arrangement, but these contingents tended to
2 be on an entire book of business between a
3 broker and a carrier. They often even wouldn't
4 be known to the people except at top
5 management to avoid a sort of conflict of
6 interest situation in a broker.
7 And so in a sense, one could say
8 that the sort of disclosure required would
9 actually get information to the people in a
10 position to act on a conflict when it
11 typically isn't there now.
12 But to answer your question
13 directly, Ms. Dwyer, you would usually know at
14 the time of placement that you had a
15 contingent commission -- the company would
16 know it had a contingent commission
17 arrangement in place and kind of what its
18 broad outlines were -- that for a certain
19 amount of business you get a certain --
20 PANEL MEMBER DWYER: Okay. So
21 every $100,000 worth of business you get
22 $10,000?

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1 MR. FINDLAY: Yes, or --
2 PANEL MEMBER DWYER: They would
3 know that?
4 MR. FINDLAY: Or if you had a
5 particular level of volume that they get an
6 extra half percentage of premium across the
7 entire book of business.
8 PANEL MEMBER DWYER: I see. Okay.
9 And the second question is; the
10 brokers have four categories of fees, as I
11 understand. There are fees, commissions, gifts
12 and contingencies. Those are the four
13 classifications. Are all four of those
14 required to be disclosed under state law?
15 MR. FINDLAY: Well, we are dealing
16 with 51 or 54 state laws or state and
17 territorial laws. So it is very difficult to
18 generalize.
19 In most states, maybe all states,
20 but certainly the predominance of states, if
21 you take both fee and commission, then you
22 have to disclose the commission.

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1 I think your commission-only state
2 law usually does not impose a requirement of
3 disclosing the commission, just because in
4 that circumstance I think it goes back to the
5 days when brokers were considered really to be
6 kind of agents of the carrier so it wasn't
7 information to be disclosed to the client.
8 State law is very unclear as to who brokers
9 and agents work for, quite often. And,
10 indeed, some states have been moving towards
11 just a producer license because it's too
12 complicated to decide whether you're a broker
13 or an agent. Agents typically are thought to
14 work for the carriers; brokers work for the
15 clients, is kind of the line we would draw.
16 PANEL MEMBER DWYER: And what
17 about contingent commissions and gifts?
18 MR. FINDLAY: I think contingent
19 commissions would be considered commissions,
20 so they would fall under the same rules that
21 commissions would.
22 PANEL MEMBER DWYER: Yes.

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1 MR. FINDLAY: But if you're not a
2 fee client, there is typically not a state
3 requirement. Though I think that certainly
4 the practice even pre-2003 that carriers would
5 disclose the fact that they received
6 contingent commissions. They typically would
7 not, and those that take them now, still do
8 not disclose kind of the variety of all the
9 types of arrangements they have in place with
10 different carriers. They would basically make
11 a general disclosure that we also take in
12 contingent from carriers and here's basically
13 what they look like.
14 PANEL MEMBER DWYER: And as a
15 matter of industry practice, in the contract
16 between the broker and, for instance, the
17 purchasing plan the fees would be included,
18 obviously.
19 MR. FINDLAY: Fees they know,
20 obviously.
21 PANEL MEMBER DWYER: And
22 commission rates would be in that contract as

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1 well?

2 MR. FINDLAY: It's usually in the

3 initial contract it would say that we're paid,

4 but we also will receive commissions from

5 carriers and we won't say because they

6 wouldn't know what the commission rate is

7 going to be. Because until you go out to the

8 markets, the markets are all very different in

9 terms of the commissions they pay, you

10 couldn't really say. At most you could say

11 that we would get a commission of up to 20

12 percent or something.

13 PANEL MEMBER DWYER: Yes.

14 MR. FINDLAY: And it really is

15 contractual in the sense that the client is

16 free to say, I want you only on fee; I don't

17 want you to accept commissions. And that's not

18 an uncommon feature in a contract. Or they can

19 say, your fee is going to be X hundred

20 thousand dollars, but if you receive any

21 commissions we want them to be credited

22 against the fee.

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1 PANEL MEMBER DWYER: And that
2 would all be in the contract?
3 MR. FINDLAY: And that would be in
4 the contract.
5 PANEL MEMBER DWYER: All right.
6 Thank you.
7 MR. FINDLAY: Thanks.
8 PANEL MEMBER CANARY: Just let me
9 follow up a little bit on Adrienne's line
10 here. In talking about the contingent
11 commissions and the non-monetary comp,
12 especially when we're working under Schedule A
13 that you referenced, issues came up about
14 having that information in advance for the
15 plan fiduciaries so the plan fiduciary would
16 say, when I'm getting recommendations from a
17 broker as to which product to pick, if there
18 are such contingent compensation or potential
19 incentives in there, that that would be
20 information that might be relevant for the
21 fiduciary to know up front. And I guess one of
22 your comments suggested that maybe that

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1 information isn't down at the sales force
2 line. Can you talk a little bit more about
3 that? And two, assuming that it does get down
4 to the sales force line, what is in the
5 current structure that you think gets that
6 kind of information to the fiduciary?
7 MR. FINDLAY: Well, again, I
8 always have to preface it by saying we're out
9 of the business of contingents.
10 PANEL MEMBER CANARY: I appreciate
11 that.
12 MR. FINDLAY: But I think that I
13 would come back to the point that the
14 fiduciary is in a position and actually may be
15 under a fiduciary obligation to talk to its
16 broker and say - Okay, I'd like to know, when
17 you have brought back this list of four
18 carriers, do you have an arrangement in place
19 with this carrier or that carrier, and that's
20 an appropriate time to ask that question.
21 Because then the broker will know what markets
22 it's gone out to, what the compensation scheme

1 is in relation to that market.
2 I think the difficulty with the
3 proposed rules, I think it seems to suggest
4 that it ought to be a duty of the non-
5 fiduciary and it ought to be at a stage where
6 we really don't know the information.
7 And then, Mr. Canary, on your
8 question about who knows within a broker; at
9 least in our case when we took them, it was
10 that the contingent arrangements were
11 negotiated at a high level and, while there
12 wasn't a strict Chinese wall, it was not
13 something that it was thought to be relevant
14 to the placement decisions of a line broker.
15 So our line brokers typically didn't know the
16 arrangements themselves.
17 Now if a particular client said, I
18 want you to find out, they would be able to
19 find out and relay it.
20 And that was, ironically, put in
21 place to avoid the sorts of conflicts of
22 interest that I think your rule is addressing.

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1 And for the brokers who are still accepting
2 contingents, I believe that they -- at least
3 in the case of the big brokers that still do,
4 have put in place protections to avoid the
5 conflict of interest. In a very small broker,
6 it's very difficult, frankly, because there
7 might be four people in an office or
8 something. And therefore, it would be hard to
9 set up a Chinese wall of that sort.
10 PANEL MEMBER CANARY: Two
11 questions. One sort of to follow up on that.
12 I think that the people -- from SIFMA, had
13 maybe a similar strain, suggesting that really
14 the obligation should be on the plan fiduciary
15 to ask the right question. And in a small
16 employer marketplace, I mean, if you're
17 dealing with a large employer there may be a
18 sophistication and support group there that
19 they can figure out what the right question
20 is, and have the ability to ask it without
21 some help. But in a small employer
22 marketplace, do you think it's realistic to

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1 assume that the small employer who is making
2 this insurance purchase is going to be able to
3 ask that question and then pursue it to get
4 useful information to make a decision without
5 some structure that would help empower them to
6 do that?
7 MR. FINDLAY: Yes, I actually do.
8 I think that this is not that complicated an
9 area. As Ms. Dwyer said, there's not that
10 many different forms of compensation. So I
11 think that a small employer ought to be able
12 to ask the same questions.
13 And indeed, as was pointed out
14 earlier, the fiduciary obligation is the same
15 for a small purchaser as a large purchaser.
16 So we would argue that they really are the
17 ones in the best position to protect their
18 beneficiary's interest.
19 PANEL MEMBER CANARY: And then
20 switching to Ms. Dwyer's last question.
21 MR. FINDLAY: Sure.
22 PANEL MEMBER CANARY: I think in

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1 some of the comments, the fact that the
2 employer may be paying for the insurance
3 policy, especially in this marketplace and
4 there may not be plan assets involved or if
5 there are plan assets, they're going to be
6 employee contributions that are withheld and
7 commingled with the general assets you use to
8 pay for the contract. Do you think that
9 complicates the application of this reg to
10 that marketplace? And that may be an overly,
11 sort of, hypothetically legal question, so I
12 apologize.
13 MR. FINDLAY: Yes. I haven't
14 really had time to think about that one. So
15 maybe we'll come to you in writing on that
16 question.
17 PANEL MEMBER CANARY: Okay.
18 MR. FINDLAY: But it's just
19 difficult to respond.
20 PANEL MEMBER CANARY: I appreciate
21 it. Thank you.
22 PANEL MEMBER CAMPAGNA: Not to

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1 belabor 84-24, but our regulation is aimed at
2 the receipt of indirect compensation and
3 conflicts. Just, you know, maybe one more
4 time, I guess, why do you think 84-24
5 addresses indirect compensation and conflicts
6 of interest?
7 MR. FINDLAY: Well, what I would
8 say is that it appropriately doesn't address
9 compensation of brokers and agents when they
10 don't act as fiduciaries. And I think that's
11 the general scheme under ERISA, which is that
12 it governs the actions of fiduciaries and it
13 doesn't impose -- it principally governs the
14 activities of fiduciaries and doesn't impose
15 the strict duties of disclosure and conflict
16 of interest and so forth on non-fiduciaries.
17 And we're typically, almost always non-
18 fiduciaries. And so we think that the duty
19 ought to be on the fiduciary and not on the
20 various types of providers, certainly not in
21 the insurance industry that interact with
22 fiduciaries.

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1 We can see that there might be a
2 special exception made for the sort of 401(k)
3 plans that were identified in the rule, but we
4 don't think that concept overlays very well
5 onto our industry.
6 PANEL MEMBER CAMPAGNA: Well, what
7 is the relationship and how does it work when
8 insurance contracts are sold to plans? Do they
9 ask you questions, do plan sponsors ask
10 questions about appropriate plans, appropriate
11 contracts --
12 MR. FINDLAY: Yes.
13 PANEL MEMBER CAMPAGNA: -- the
14 parameters are given you of what they're
15 interested in?
16 MR. FINDLAY: Yes, typically.
17 PANEL MEMBER CAMPAGNA: And you
18 kind of lay out things?
19 MR. FINDLAY: Absolutely. And it
20 obviously varies quite a bit with the
21 thousands of people who are brokers and the
22 hundreds of thousands of clients, but

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1 typically we would be competing with some
2 other brokers for the brokerage business of a
3 client. The client would ask us all sorts of
4 questions from who else do you work for to how
5 are you compensated. And then we would end up
6 signing a contract that governs in a fairly
7 detailed way the kind of compensation we do
8 and can receive.
9 We would then sit down with a
10 client, understand their needs, help shape
11 their needs. Tell them, you know you don't
12 really have very good coverage for this type
13 of risk or this type of employee class or so
14 forth. We would then go out to several
15 markets. Usually we would agree with the
16 client what markets we would approach or talk
17 about what markets we would approach. We would
18 go out to the markets and then we'd come back
19 and say, I've got four quotes for you.
20 There's Aetna, CIGNA, et cetera, et cetera.
21 We think that the coverage is good here, but
22 the cost is higher. We think that the coverage

1 is not as good here but the cost is lower, and
2 they're good at claims and that sort of thing.
3 And we essentially help the client pick its
4 carrier.
5 If the client asks us, even prior
6 to our business reforms, if the client were to
7 ask us, wait a second. You seem to be pushing
8 CIGNA awfully hard, do you have some special
9 arrangement with CIGNA? We would say, here
10 are our arrangements with CIGNA. Here's what
11 our commission rate is, and so forth.
12 So it really is a very iterative
13 process, even with the smallest clients. We
14 would go out and get several quotes and
15 present them to the client.
16 PANEL MEMBER CAMPAGNA: Okay.
17 Thank you.
18 PANEL MEMBER BUTIKOFER: You've
19 mentioned that there's already the state
20 regulation in place, but how uniform are the
21 regulations across the different states? I
22 could imagine a situation where there could be

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1 a large variation and the disclosures could be
2 quite high in some states and not in others.
3 But how uniform is it?
4 MR. FINDLAY: I think it's
5 relatively uniform. As I said, it's almost
6 always, perhaps always the case that if we
7 take fee and commission, we have to disclose
8 the commission. It's almost always the case
9 that you typically don't have to disclose the
10 commission under state law when you're just
11 acting on commission. But it certainly is the
12 practice between the contractual arrangements
13 we have with our clients, the contractual
14 arrangements with carriers, the market
15 pressures and us wanting to be good custodians
16 of our clients' decisions to do disclosure of
17 that sort.
18 So I don't think that you would be
19 entering an area where there's no disclosure
20 going on. But you would be entering an area
21 where, for the first time, you'd be putting a
22 new federal disclosure regime in place where

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1 the states and market practices have been
2 pretty good.
3 PANEL MEMBER BUTIKOFER: The other
4 question I have is, if the regulation were to
5 go in place as is, you've already mentioned
6 that the largest carriers or brokers don't
7 have a problem with contingency fees, the
8 smaller brokers would, and that you've already
9 built up an IT system which the smaller
10 brokers would have to implement and could be
11 quite burdensome. Is there anything else that
12 would be unique to the brokerage industry that
13 could impact the cost of implementation?
14 MR. FINDLAY: Well, I think you
15 touched upon it, which is that there are four
16 brokers that are larger than maybe half a
17 million dollars a year in revenues. Don't
18 check me on that, but I think that's right.
19 And the vast number of brokers and -- most of
20 whom are not represented by our Council -- are
21 small mom-and-pop types that might be a
22 handful of employees and a million of dollars

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1 in revenue or something.

2 In our organization, to be a

3 member of the Council you've got to have $5

4 million in revenue, but that's not really a

5 particularly large outfit, typically.

6 So I think that what would

7 distinguish us from 401(k) providers or other

8 service providers is that the vast majority of

9 our providers are fairly small outfits that

10 would find it very burdensome to have a new

11 one-size-fits-all kind of very strict

12 disclosure regime placed upon them.

13 PANEL MEMBER BUTIKOFER: But would

14 that burden be just an initial -- complying

15 with the regulations, finding out what it is,

16 or would it be a continuing compliance cost?

17 MR. FINDLAY: I think it would be

18 continuing compliance. Obviously you've got to

19 build the system and the processes and put

20 them in place, but then, every discussion with

21 every client regardless of whether they need a

22 particular type of information, you would be

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1 having to gather that information for them,
2 and it's not easy.
3 And one of the things that we
4 found is that when we go back with a lot of
5 this information to customers, they look at it
6 and they say, you know, I'm being asked to
7 sign something. When I'm being asked to sign
8 something, it's probably not good for me.
9 It's somehow giving up my legal rights. And
10 so there's quite often a lot of back and forth
11 with the client where they say, I ain't
12 signing nothing. I'm going to take this to my
13 lawyer, and I want to have my lawyer look at
14 it.
15 And so it introduces a lot of
16 friction into the relationship. So it is a
17 very much an ongoing, day-to-day burden of
18 taking away from time that they could be out
19 advocating for their clients, instead they're
20 kind of doing paperwork.
21 PANEL MEMBER BUTIKOFER: All
22 right. Thank you.

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1 CHAIR CAMPBELL: Thank you very
2 much. We appreciate the time.
3 MR. FINDLAY: Thank you.
4 CHAIR CAMPBELL: And our next
5 witnesses will be Mr. Saxon and Ms. Eller.
6 MR. SAXON: Good afternoon. My
7 name is Steve Saxon. I'm a principal at Groom
8 Law Group in Washington. With me is Jennifer
9 Eller, who is also a principal at Groom. We're
10 testifying today on behalf of a number of
11 financial institutions and administrative
12 service providers. The companies we represent
13 today offer a variety of services to plans
14 subject to ERISA, including administrative
15 services, record keeping, consulting and
16 advisory services. A number of them also
17 offer investment and insurance products.
18 We appreciate the opportunity to
19 comment on the proposed amendments to the
20 408(b)(2) regulations. Our comment letter
21 identified a number of significant issues and
22 concerns with the proposal. Many of the

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1 witnesses at the hearing have raised similar
2 concerns, and instead of restating the
3 problems with the proposal, today we want to
4 share with you some thoughts we have on how to
5 craft a more workable solution.
6 What we're doing is suggesting to
7 the Department that you consider six revisions
8 to the current proposal. If made, these
9 changes would offer a dramatic improvement
10 over the proposal. Without these changes, the
11 proposal is virtually unworkable and could be
12 vulnerable to challenge in federal court. So
13 I'm going to run down those six suggested
14 revisions.
15 First, limit the scope of the
16 regulation to providers of services to plans.
17 In order for any regulation interpreting ERISA
18 section 408(b)(2) to work, the application of
19 the regulation must be limited to the service
20 transactions between a plan and a party of
21 interest. Otherwise, there's simply no
22 transaction for which section 408(b)(2)'s

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1 exemptive relief is required.
2 Under the Department's proposed
3 plan asset regulation, an entity managing an
4 investment vehicle that does not hold plan
5 assets is not indirectly providing services to
6 a plan invested in the vehicle, thus it is
7 inappropriate for the Department to
8 characterize a plan's investment in such a
9 vehicle as involving any services to the plan
10 that require a relief under section 408(b)(2).
11 For this reason we asked the Department to
12 recognize some limits of 408(b)(2) and not
13 require disclosures from entities to providing
14 services to a plan.
15 We also asked that prior DOL
16 guidance to service providers be respected.
17 Such entities should not be deemed parties in
18 interest for purposes of the final regulation.
19 Second, hold plan service
20 providers to a reasonable-efforts standard.
21 The final regulations should provide that a
22 services arrangement will not be unreasonable

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1 if a plan service provider makes reasonable
2 efforts to comply with the disclosure
3 requirements, and when it becomes aware of a
4 deficiency in its disclosure, uses reasonable
5 efforts to correct the deficiency.
6 The proposal requires a service
7 provider to certify that it has disclosed the
8 required information to the best of the
9 service provider's knowledge. This is a trap
10 for not only the unweary, but the diligent.
11 The required disclosures are complex. Service
12 providers will endeavor to provide all the
13 required information, but there will
14 inevitably be oversights and errors. In
15 addition, different providers will interpret
16 the rules in different ways.
17 A service provider who has used
18 reasonable efforts in complying with these
19 requirements should not be subject to
20 potential excise tax liability or being
21 reported to the Department merely because of a
22 mistake or interpretive error.

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1 Third, recognize the limits of a
2 service provider's ability to collect
3 information regarding payments made in
4 connection with plan investment options.
5 If a bundled service arrangement
6 simply allows the plan to access a universe of
7 investment alternatives or investment
8 platforms, the management of the investments
9 should not be considered a service provided as
10 part of the bundle. Plan service providers
11 frequently offer access electronically to
12 investment options, but do not have anything
13 to do with the management of those investment
14 options or payments made from the options.
15 Quite simply, this is not information that the
16 access provider should be expected to know.
17 If the Department intends to
18 require service providers, such as 401(k)
19 record keepers, who offer access to plan
20 investment options to make disclosures with
21 respect to perhaps hundreds or thousands of
22 investment alternatives, it must be sensitive

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1 to the limitations inherent in these
2 relationships.
3 For instance, one option would be
4 for the final regulation to require that plan
5 service providers offering access to
6 investment alternatives to disclose any
7 information about the fees and compensation
8 paid from the investment alternative that is
9 contained in the investments disclosure
10 documents and available to the access
11 provider. Alternatively, the Department could
12 identify the types of information it expects
13 the access providers will request from the
14 investment providers or platform providers and
15 will require that the access provider disclose
16 the responses to these information requests to
17 plan fiduciaries. As noted above, to the
18 extent a service provider makes reasonable
19 efforts to obtain information and cannot, the
20 service provider's contract with the plan
21 should not fail to be deemed a reasonable
22 arrangement.

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1 The Department should allow for
2 flexibility in determining when allocation of
3 compensation within a bundle is necessary,
4 especially where requiring disclosure of the
5 allocation of compensation could result in a
6 competitive disadvantage or release of
7 proprietary information.
8 For instance, where an investment
9 manager in accordance with the terms of its
10 investment management agreement hires a
11 subadvisor, the manager should be required to
12 disclose only the aggregate compensation for
13 which the management services are made. If
14 the Department does not agree with this
15 comment, it is imperative that the Department
16 provide clear and specific examples of the
17 disclosure requirements and the scope of their
18 application. Otherwise, there is a very
19 significant risk that differences in
20 interpretation will result in a competitive
21 disadvantage for compliance-oriented
22 companies.

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1 That last sentence that I read was
2 highlighted by all of our clients.
3 Fourth, require yearly updates of
4 information from plan service providers. The
5 proposed regulation requires providers to
6 update their disclosures within 30 days of the
7 service providers learning of any material
8 change in the information. Plan fiduciaries
9 and service providers may have different views
10 as to what constitutes a material change.
11 Furthermore, to the extent disclosures
12 regarding a bundled arrangement must be made
13 by a single service provider, a 30-day rule is
14 simply not enough time for the elements of the
15 bundle to give notice of the change to the
16 provider and for the bundle provider to be
17 give notice to the plan.
18 In any case, plan fiduciaries may
19 be inundated with notices of piecemeal changes
20 to their service contracts. Instead the
21 Department should require updates on a yearly
22 basis, or upon reasonable requests of a plan

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1 fiduciary.

2 Fifth, mandate specific

3 disclosures but not contract terms. The final

4 regulation should not mandate the inclusion of

5 specific disclosures, statements or

6 representations in the services contract

7 itself. A significant issue with this

8 requirement is that it could be read to mean

9 that every plan services agreement is

10 immediately ineligible for the final section

11 408(b)(2) exemption, even if every disclosure

12 has been given merely because the contract

13 terms themselves do not require the disclosure

14 to be provided.

15 If the services contract has to

16 include specific terms, a separate writing

17 should be acceptable. It is not always

18 possible or practical to amend a services

19 contract. Under state law, an insurance

20 company's contracts must be approved by the

21 state insurance commissioner before they can

22 be issued to the public. If the contracts are

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1 materially modified, they must be resubmitted
2 for approval. It's not clear whether some or
3 all of the insurance contracts such as group
4 variable annuity issued to cover plans will
5 need re-approval. A state consideration of
6 contracts can be a lengthy process.
7 Similarly, certain types of plans
8 have been pre-approved by Internal Revenue
9 Service. Some such plans include separate
10 trust agreements that have been approved by
11 the service-provider, while for others the
12 trust agreements are included in the plan
13 itself. Such agreements cannot be revised
14 without being resubmitted to the service under
15 the IRS review cycle for pre-approved plans,
16 submissions can only be made in specified
17 years, and even if allowed, would be expensive
18 and time consuming.
19 Finally, in number six: provide
20 transitional relief. The proposed regulation's
21 focus is on disclosure and fiduciary
22 consideration before a contract is entered

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1 into. Given the regulation's complexity, it
2 makes sense to phase in the requirements and
3 allow existing contracts to come into
4 compliance when they are renewed or modified.
5 As indicated by over 30 comment letters
6 requesting an extension of the effective date,
7 90 days from the publication of the final reg
8 does not provide sufficient time.
9 In its economic analysis the
10 Department estimated implementation of the
11 regulation will require one work hour for most
12 service providers -- that is incredible -- and
13 24 work hours for the largest service
14 providers. This is unrealistic. But even if
15 the Department's estimates were accurate, 90
16 days would still not be enough time.
17 For example, many of our clients
18 have many thousands of contracts with employee
19 benefit plans. If you assume the regulation
20 becomes final 90 days after the final reg is
21 published and the Department, as the
22 Department projects, it takes these client 3

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1 days or 24 work hours to determine its
2 obligations in the remaining time, it will
3 need to renegotiate hundreds of contracts per
4 business day. The burdens are equally heavy
5 on small service providers.
6 Fiduciaries will also be
7 overwhelmed. A large plan may have hundreds
8 of effected service providers and the
9 fiduciaries will have to gather required
10 information and renegotiate contracts with
11 each of them within the scope of their
12 obligations under ERISA section 404 within a
13 short time frame. The effective date should
14 be at least a year after publication of the
15 final reg.
16 We appreciate the opportunity to
17 appear before you today and look forward to
18 working with the Department to find a workable
19 solution.
20 CHAIR CAMPBELL: Thank you very
21 much.
22 Let's start down here.

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1 PANEL MEMBER BUTIKOFER: The very
2 last piece of your testimony was talking about
3 the amount of time it would take to implement
4 the regulation. And you've expressed, and
5 several others have as well, that we
6 underestimated how much time it would take to
7 comply. Could you kind of walk me through the
8 process?
9 **A regulation comes out. What**
10 **happens as you receive the regulation and then**
11 **you turn around and advise your clients, can**
12 **you kind of walk me through that process? I**
13 **don't know if you're comfortable giving me**
14 **time amounts, but how involved is this process**
15 **of just communicating what's required to the**
16 **service providers?**
17 MR. SAXON: Well, in this case
18 it's even doubly more complicated. Because we
19 have the Schedule C and the Schedule A to the
20 5500 also to work into our compliance
21 protocol. But I think in this case this reg
22 was published or proposed in December. We

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1 immediately began to work through and break
2 apart the reg into its different component
3 parts. We solicited comments from tens of
4 clients. We had discussions. We sent out
5 memoranda that described how we thought the
6 regulation, what it meant particularly for
7 things like, what does the concept of a
8 bundled arrangement mean, when does it begin,
9 when does it end, who is included in it, what
10 are the requirements for a bundled provider,
11 you know, so excessive, will bundled providers
12 be able to obtain the kind of information that
13 they need in order to comply with 408(b)(2)?
14 And that process, it took a couple of months.
15 And actually we were pleased with the
16 opportunity that the hearing came up, so that
17 we would have a little bit more time to digest
18 the regulation, have conversations with other
19 folks in the industry and figure out what a
20 workable solution might be.
21 PANEL MEMBER BUTIKOFER: You said
22 that the existence of other regulations

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1 already being needed to be implemented would
2 make it more complex. Could it not also work
3 that some of the things that need changed
4 actually are duplicated across the different
5 regulations, as in, for example, we've heard
6 mentioned the IT systems that need updated or
7 whatnot?
8 MR. SAXON: Well, yes. I mean
9 obviously we'd like, from an IT perspective,
10 to make sure that what you're saying and the
11 information you're collecting as a service
12 provider, what you're collecting to provide to
13 the plan sponsors so that they can meet their
14 requirements under the 5500 is at least
15 consistent with the information that you're
16 going to provide the plan sponsor in
17 connection with their determination. But it's
18 even more complicated than that.
19 Right now, all of us are watching
20 very carefully all the litigation that's
21 growing in the 401(k) space. And a lot of what
22 happens in the federal courts, it seems to me,

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1 would have an impact on what's happening up on
2 the Hill. There are legislative proposals now
3 under consideration that would expand the
4 disclosure requirements for service providers
5 and plan sponsors.
6 So we look at all of those things.
7 We look at what's happening on the Hill, we
8 look at the litigation, we look at all the
9 possibility that shortly the Department will
10 develop regulations or amendments to 404(c)
11 that will enhance the disclosure to
12 participants. And we try to take all that into
13 account in advising the clients on what they
14 ought to be saying and what they need to do.
15 Our clients haven't objected to
16 the concept of fee transparency. There are,
17 however, technological obstacles that have to
18 be overcome and then there are legal obstacles
19 that have to be addressed. The difference
20 between Schedule C to the 5500 or the
21 408(b)(2) regs is that it's easier for the
22 Department to expand the scope of the

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1 disclosure requirements under Schedule C, it
2 seems to me, than under 408(b)(2), because
3 408(b)(2) just applies to party in interest
4 service providers, although some would argue
5 that the Department has expanded the concept
6 of who a party in interest service provider is
7 to expand the scope of the exemption.
8 PANEL MEMBER BUTIKOFER: All
9 right. Thank you.
10 PANEL MEMBER CAMPAGNA: Thanks for
11 your thoughts. I was jotting down everything.
12 I hope I got it all. And I just want to go
13 through some clarification points.
14 On your first point, service
15 providers to service providers. Do you see
16 some kind of line that has to be drawn here or
17 can you give us some idea as to that kind of
18 line? For instance if a record keeper or a
19 direct service provider subcontracts some of
20 their services, but the charge is against plan
21 assets for that sub-contract as opposed to
22 coming out of the service provider's fees,

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1 even though it's a subcontract with that
2 service provider do you see any need there to
3 draw that line or give us a little hint on
4 that?
5 MR. SAXON: I'll start.
6 One example, the example in our
7 comment letter is a simple one is where an
8 investment manager -- and let's say we're
9 talking about a collective investment trust or
10 some other vehicle that holds plan assets. So
11 you have a direct charge against the plan
12 assets to pay the investment manager. The
13 investment manager feels like they need a
14 little bit additional expertise. Out of their
15 fee --
16 PANEL MEMBER CAMPAGNA: Out of
17 their fee?
18 MR. SAXON: -- they pay the sub-
19 advisor. It seems to me that for proprietary
20 purposes they may not want to share what
21 they're paying the sub-advisor. And it seems
22 to me what the important information from the

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1 plan sponsor's perspective is, is what's this
2 investment management arrangement costing us,
3 not so much what the relationship is between
4 the primary investment manager service
5 provider and the other service provider.
6 I have to admit, Jenny may
7 disagree with me, but in the example you gave,
8 it would be a little bit unusual to see this,
9 but if you had a subcontract where you had an
10 additional charge against the assets of a plan
11 for the services provided by the
12 subcontractor, it would make sense in that
13 case for that subcontractor's compensation to
14 be disclosed.
15 PANEL MEMBER CAMPAGNA: And you
16 also talked about recognizing the limits of
17 the service provider's ability to collect
18 information. So how do you see this working,
19 say, in the situation where there's a record
20 keeper in a non-affiliated fund. What are the
21 obligations? Should there be agreements
22 between the parties regarding the information

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1 of the fund and how do you see that working in
2 your construct?
3 MS. ELLER: I think it would be
4 difficult for many record keepers that are
5 providing services to plans to put in place
6 contracts with every investment option on
7 their platform. Mostly, the reason the
8 investment option is on the platform, is
9 because they link up electronically. And so to
10 have separate agreements and then to have the
11 record keeper be responsible for sort of
12 tracking the compensation paid out of those
13 investment alternatives I think would be
14 really difficult.
15 The two suggestions that we had
16 were to, either for the record keeper to pass
17 on the information that's available to it or
18 for the record keeper to ask some questions
19 and pass on the answers that it gets.
20 I think Doug Kant made a good
21 point earlier that, if the record keeper does
22 act as a conduit, there's got to be some

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1 recognition that they can't be double-checking
2 the information that they get. Not only will
3 they not necessarily be able to get a lot of
4 information or be able to ensure that it's
5 correct. And there needs to be some allowance
6 made for that.
7 MR. SAXON: Yes. This is a big
8 deal. Your question there, it's a difficult
9 one; we've really struggled with it.
10 Where you have a one-stop-shop
11 bundled contract, if you will, where a record
12 keeper is contracting with the plan or the
13 plan sponsor on behalf of the plan, and they
14 provide administrative services, but they have
15 access to a platform, that platform may
16 include 10,000 mutual funds, many, many
17 families of mutual funds; they're not
18 contracting with those funds. They don't have
19 any legal basis for obtaining information from
20 those funds outside of the prospectus. What
21 we have said, and to the extent that the
22 record keeper gets information about the

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1 nonproprietary fund fees from the advisory
2 fees that they charge or the 12(b)(1) or
3 administrative service fees that are made
4 available to pay for services, we can pass
5 that information along.
6 What worries us is that the record
7 keeper is going to rely on this services
8 exemption for relief, the record keeper or
9 other administrative service provider. And to
10 the extent they don't get this information
11 from this other party that's not legally
12 obligated to give it to them, they're
13 potentially liable for excise tax liability.
14 That seems to me to be a fairly harsh
15 consequence.
16 And what's happened is, you know,
17 if you have worked in the retirement services
18 marketplace like we have for so long, you
19 understand that what the Department is trying
20 to do is remove from the plan sponsor and the
21 fiduciary the responsibility to collect this
22 information and put it in the hands of

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1 somebody else. The problem is, the record
2 keeper has, to an extent, less of an ability
3 to get that information than the plan sponsor
4 because they don't have a contract with the
5 nonproprietary fund.
6 PANEL MEMBER CAMPAGNA: Would you
7 have any problems with what we were referring
8 to the preamble that the bundled provider,
9 say, would make reference to the particular,
10 relevant services and where to find that
11 information in the prospectus?
12 MS. ELLER: If it's not a specific
13 page number for every fund. But some general
14 information about information on fund expense
15 ratios can generally be found in the
16 prospectus. I think that's something that
17 kind of falls in line with passing on
18 information that's available.
19 PANEL MEMBER CAMPAGNA: Okay.
20 Thank you.
21 PANEL MEMBER CANARY: I wanted to
22 follow up a little bit on what Lou was talking

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1 about. You used a couple of terms, and I
2 wasn't sure they were interchangeable. One was
3 talking about an access provider and then also
4 talking about bundled providers. Can you tell
5 me whether or not those were interchangeable
6 or if they're not, how you perceive them as
7 being different?
8 MR. SAXON: Well, they can be the
9 same. A bundled provider could be, let's keep
10 it simple, a record keeper that provides
11 record keeping, reporting, administrative
12 services but does not provide investment
13 management services itself. What the record
14 keeper would do was provide electronic link to
15 some platform so that they can access a
16 variety of mutual funds or perhaps other kinds
17 of investment vehicles electronically so that
18 they can conduct their business on a daily
19 basis. But they don't provide investment
20 advice with respect to the funds that are
21 offered.
22 Now they may provide some

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1 screening because some funds may not
2 electronically link up with them. So if a fund
3 family doesn't link up with a record keeper,
4 they can't be offered under that product. But
5 they would be a bundled provider, but what we
6 were trying to do was kind of limit the
7 definition of when the bundle ends. And the
8 bundle ends with access to the investments,
9 but because that provider doesn't have the
10 legal ability to collect information from the
11 investment provider, we didn't think it was
12 fair to saddle that bundled provider with
13 potentially harsh consequences of failure to
14 meet the terms of the reg.
15 PANEL MEMBER CANARY: Okay. I
16 think I understand trying to define where the
17 bundle ends was -- the term "access" was
18 trying to capture that in a conceptual way,
19 which follows right to the next couple of
20 questions that I wanted to pursue.
21 Let's assume that you have an
22 access bundled provider, and one notion I get

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1 pretty clearly is that the actual management
2 to that pool, that investment option that,
3 that in your perspective would not be a
4 service provider. And does that make a
5 difference whether or not that's a plan asset
6 pool versus something like a mutual fund
7 that's not holding plan assets?
8 MR. SAXON: Well, let me ask you a
9 question.
10 PANEL MEMBER CANARY: Fair enough.
11 MR. SAXON: If you had a
12 collective investment trust or you had an
13 insurance company pooled separate account, as
14 you know from the plan asset regulations, and
15 underlying the assets of those vehicles, would
16 be plan assets.
17 PANEL MEMBER CANARY: Correct. And
18 I guess I'm trying to say so I'm an access
19 provider and there's the mutual fund platform,
20 there's the collective investment fund
21 platform and there's the insurance company
22 pooled separate account platform. I'm

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1 oversimplifying it. But if I am the access
2 provider here and we go to the mutual fund
3 door and it says - okay management of that
4 would not be part of the service. The bundle
5 would end before you get there. But if I'm in
6 the bank or the insurance company platform,
7 where does the access provider stop in terms
8 of bundle? Would we also exclude the
9 management from there?
10 It's kind of trying to explore a
11 little bit the mutual fund not being a plan
12 asset vehicle versus these others being plan
13 asset vehicles and what's part of the bundle
14 and what's not. If you could talk to that a
15 little bit?
16 MS. ELLER: Well, maybe an example
17 might be helpful. Sometimes you'll have a bank
18 that provides investment management services
19 to its own bank collective funds and also
20 record keeping services to a plan. I think
21 that's more akin to a record keeper that also
22 provides investment management services in the

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1 mutual fund context.

2 If you're dealing with a bank that

3 keeps records, access direct to trustee and

4 also manages collective funds, then I think

5 there's more reason to expand the definition

6 of an bundle to include those services to the

7 plan assets vehicle.

8 Where you have an access provider

9 that has nothing to do with the entity

10 providing the management services to the plan

11 assets vehicle, then maybe you need to look at

12 the entity who is a fiduciary with respect to

13 the plan that's managing those assets for

14 their direct reporting requirements.

15 PANEL MEMBER CANARY: So the

16 assets provider may define the scope of their

17 bundle and not the circumstance based on what

18 they can or cannot control?

19 MR. SAXON: Right. Exactly. So

20 to answer to your question, it doesn't matter.

21 It doesn't matter whether the investment is a

22 mutual fund or it's a collective investment

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1 trust or an insurance company pooled separate
2 account. The bundled providers, they don't
3 have any better legal opportunity or ability
4 to obtain information from the CIT than they
5 did from the mutual fund. They don't have a
6 contract there.
7 PANEL MEMBER CANARY: I
8 understand.
9 I only have two others. But it's
10 sort of interesting when you get the lawyers
11 up here, it tends to facilitate our being able
12 to ask some of the legal questions.
13 The gentleman from the American
14 Bankers Association was, I think,
15 operationally saying he thought the bank fund
16 should be treated the same as the mutual funds
17 as an operational mater. And I think, as Fil
18 Williams was exploring a little bit is - well
19 legally is that really a comparison? You can
20 say, well no. If I'm the investment manager
21 for the bank, common collection trust or the
22 pooled separate account, I'm the fiduciary for

1 the plan, I'm in fact providing services to
2 the plan. Even if I'm doing it on this level,
3 and frankly I don't even know which plan is
4 which in the day-to-day sort of world, I can
5 obviously figure that out, but then I'd have
6 to allocate who I'm providing services to, and
7 how much I'm getting paid is allocated to
8 which plan. Are you guys challenging on this
9 service provider to service provider that that
10 party for the plan asset fund is providing
11 services to the plan? I guess that's trying
12 to get down to the bottom line.
13 MS. ELLER: I think the short
14 answer is no. I think where we are asking
15 you, the Department, to draw a line in terms
16 of who is a service provider to a plan in
17 terms of plan assets vehicles we need to live
18 by the same rule.
19 PANEL MEMBER CANARY: I only
20 have--
21 MR. SAXON: Let's answer, to make
22 sure that we're all on the same page.

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1 PANEL MEMBER CANARY: Got you.
2 MR. SAXON: A plan that
3 participates in a 81-100 collective investment
4 trust, the trustee manager of that trust is
5 obligated to provide, for 5500 purposes, the
6 financial information so that the plan
7 sponsors who participate -- the plans that
8 participate in that trust can fulfill their
9 requirements for their annual reporting. So
10 the manager of that collective investment
11 trust already has a communication that's going
12 to the Labor Department or the IRS; right?
13 PANEL MEMBER CANARY: Fair enough.
14 Which is sort of my last question, which is
15 you've pointed out that it would be desirable
16 to have the 5500 disclosures, these be
17 consistent with the disclosures required
18 408(b)(2) reg. And the 408(b)(2) reg,
19 obviously, has disclosures which are broader
20 than what is in the 5500.
21 Do you perceive, currently looking
22 at the final rule in the proposals, that are

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1 particular areas where they're not consistent?
2 And that may be a hard question to hit you
3 cold with, so if you'd prefer to think about
4 it, that would be fine.
5 MS. ELLER: We have looked,
6 actually, some of the definitions are slightly
7 different. And I think what we've had
8 conversations just internally about, does this
9 particular difference in the definition of
10 compensation, for instance, mean something
11 significant where for 5500 purposes, indirect
12 compensation is anything not paid by the plan.
13 But for 408(b)(2) purposes it's anything not
14 paid by the plan or the plan sponsor. You
15 know, we're kind of left in the situation of
16 trying to figure out whether those differences
17 are significant.
18 So I think there is some benefit
19 to a pretty parallel nature between the two.
20 On the other hand, in some ways they serve
21 different purposes. So that maybe there would
22 be reasons for them to be different.

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1 MR. SAXON: We actually thought
2 about trying to answer that question, but we
3 said nobody on the Department would go that
4 far. So we said we won't bother doing the
5 comparison, but obviously Schedule C --
6 PANEL MEMBER CANARY: You
7 obviously underestimated it.
8 I'm done. Thank you.
9 PANEL MEMBER DWYER: I'm not
10 totally clear. On the investment manager to
11 the plan assets vehicle, who is a fiduciary
12 but only by virtue of managing those assets.
13 Do you agree that that party is a service
14 provider to the plan? Yes?
15 MR. SAXON: Yes.
16 PANEL MEMBER DWYER: Okay. That's
17 all I had.
18 PANEL MEMBER WILLIAMS: Okay. I
19 would like to revisit this point about how
20 does the responsible plan fiduciary get
21 information that the record keeper doesn't
22 have access to where you were talking about

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1 this electronic link to a platform and you
2 have a lot of mutual funds, but they don't
3 have a contract with all of those funds that
4 would enable them to get at information.
5 And so I was thinking about this
6 in terms of really three concepts. One would
7 be follow the money. One would be follow the
8 information. And one would be follow the
9 contracts.
10 And so I was coming to the
11 conclusion that perhaps the legal ability to
12 collect information is based on contractual
13 rights. And then I was trying to link that up
14 with the possibility of a record keeper
15 getting compensation. And I think I come to
16 the conclusion, but you may correct me if I'm
17 wrong, because I don't know anything, that a
18 record keeper wouldn't be getting compensation
19 from funds in situations where they don't have
20 contractual obligations that would enable them
21 to have the legal ability to obtain
22 information as a conduit. Does that make

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1 sense?

2 By the way, I'm trying to focus on

3 whether the responsible plan fiduciary, do

4 they really need to get at that information if

5 there's no compensation that's possible that

6 might be flowing from a source on the platform

7 where they can't get at the information about

8 the fund to enable them to pass that along.

9 And, again, my focus here is on the practical

10 delivery of this information, because, if I

11 understand your testimony, if we do the six

12 things, we end up with a workable solution.

13 But we still have issues like this, which I'm

14 focusing on the class exemption as a way to

15 cure the remaining issues. But there could

16 still be issues, I think, for instance, if the

17 class exemption was to exempt a service

18 provider that was not able to provide

19 information because it wasn't their fault, but

20 there's still compensation flowing to them.

21 So do you have any way of addressing my

22 thoughts? If not, we'll just -- but am I on

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1 the right track or is there anything that you
2 can add to that?
3 You see my concern? We could
4 possibly get to a place where there's no
5 solution, which is that they can't get the
6 information but there's still compensation
7 that the responsible plan fiduciary would want
8 to know about, but they can't get the
9 information about that.
10 MS. ELLER: I think one of the
11 fundamental questions is whether there in fact
12 is compensation that's relevant to the
13 responsible plan fiduciary.
14 PANEL MEMBER WILLIAMS: Yes.
15 MS. ELLER: If they are getting
16 the expense ratio of the fund and they have
17 other information like the amount of turnover,
18 that shows you in some indication what's
19 coming out of the net asset value, then is
20 there really more other than the plan's own
21 service provider's direct and indirect
22 compensation that is relevant to a fiduciary's

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1 decision.

2 PANEL MEMBER WILLIAMS: Right. I

3 understood what you said. Once they have this

4 legal ability to correct the information from

5 certain funds on the platform that they're not

6 going to be able to give them any information.

7 They will not be able to be a conduit for

8 information coming from those funds. So I'm

9 back to the question of well how does the

10 responsible plan fiduciary get that

11 information if they are actually, I think as

12 you said, in a better position to get that

13 information than the record keeper would be

14 because the record keeper doesn't have the

15 legal ability to compel someone to give that

16 information. Then the responsible plan

17 fiduciary would have to get it, but they don't

18 know whether or not they need it. But it

19 could be that they do, but they have no way of

20 knowing whether there is compensation coming

21 to the record keeper from these funds.

22 So is there a way to say well

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1 because they can't get this information that
2 it's not possible for them to be getting any
3 kind of compensation from those funds?
4 MR. SAXON: We have struggled
5 mightily trying to answer your question. And
6 the solutions that we've developed so far are
7 that's as far as we've been able to take this.
8 What I said earlier is that it
9 does look like the Department is kind of -- we
10 know that the plan sponsor has obligation
11 under 404 to make a prudent decision with
12 respect to the selection of all plan service
13 providers. And we now know that it's the
14 Department's view that they need the necessary
15 information including information on fees in
16 order to make a prudent decision.
17 What's happened is is that the
18 plan sponsors haven't had the ability, if you
19 will, to collect that information, at least in
20 the eyes of the Department over time. Although
21 I would suggest to you that there have been
22 some pretty significant changes.

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1 Part of the solution, I believe
2 just looking at the example that we were
3 talking about, is in the case of the record
4 keeper if the record keeper is getting revenue
5 sharing payments, if they're getting 12-B-1
6 fees from the distributor that that now has to
7 be disclosed on Schedule C the 5500 and that
8 has to be disclosed as part of the 408(b)(2)
9 regs.
10 So their fee information about
11 that bundled provider is going to be
12 disclosed. What we're trying to be careful
13 about what we said and didn't say is that
14 bundled provider has limitations on their
15 ability to access information about what other
16 service providers might be getting paid.
17 PANEL MEMBER WILLIAMS: So they
18 will always be able to do --
19 MR. SAXON: I'm not saying -- yes.
20 Well we're not saying that that bundled
21 provider is not going to disclose to the plan
22 sponsor at least by formula or an estimate the

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1 service income that they're going to receive,
2 even if it's revenue sharing payments, right?
3 PANEL MEMBER WILLIAMS: Okay.
4 Great.
5 CHAIR CAMPBELL: All right. Thank
6 you very much.
7 And I guess Mr. Saxon will stay
8 where you are and Ms. Mazo will come up.
9 Anytime you're ready.
10 MS. MAZO: My name is Judy Mazo.
11 And I'm a Senior Vice President of The Segal
12 Company, which is an employee benefit
13 actuarial consulting and human capital firm.
14 And stringing all those terms together annoys
15 me sometimes, but it’s actually relevant to
16 the testimony.
17 And I'm here with the Steve Saxon
18 on behalf of a group of similarly dedicated
19 organizations and general employee benefit
20 consultants, consultants that do the range of
21 sort of general benefit services.
22 And our request which is

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1 elaborated in more detail not only in our
2 statement but in comments that my company
3 submitted, is pretty simple. And so I think
4 I'll just describe it briefly and then let you
5 ask questions.
6 Our suggestion is that employee
7 benefit consulting per se, which I think would
8 have to be defined negatively as consulting on
9 employee benefits other than the number of
10 things that you have listed, insurance,
11 whatever should be treated as a general
12 service in what we call category 3 of your
13 list of service providers who are subject to
14 the rules. That consulting as a general
15 concept should be a profession where the
16 services -- unless the services are in someway
17 compensated indirectly or by a third party,
18 they would be exempt from the disclosure.
19 Excuse me. Not from disclosure, but from the
20 rigors of the proposed regulation.
21 It's unusual for me to be
22 testifying on behalf of my company and not

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1 clients. So sometimes I may trip over a
2 little bit.
3 The purpose of the proposal, as
4 you all have emphasized a number of times just
5 in the time that I've been here, is to provide
6 information to fiduciaries to enable them to
7 make a responsible judgment about hiring
8 service providers. And our suggestion is that
9 where the service provider is paid exclusively
10 by either a fee or hourly charges with no
11 third party payments or contingencies or
12 gifts, et cetera, that are defined as
13 compensation in the proposal that there's
14 really no further need to lay on some of the
15 formalities of the proposed regulation. And
16 there are certain services that you have
17 specifically identified as kind of integral to
18 other more complex services and arrangements
19 that are compensated in a more complex way,
20 such insurance consulting or asset consulting
21 which you may feel, and we can understand why
22 you may feel you want to just have the extra

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1 layer of demanding disclosure even if the
2 compensation is exclusively fee based. But we
3 don't see how general benefit consulting which
4 in the retirement plan arena would be talking
5 about design issues, talking about gee is this
6 QDRO specific enough. It would be just a
7 giant range of services that are associated
8 with helping a plan sponsor maintain its
9 retirement plan, helping them maintain its
10 health and welfare plan. That there's nothing
11 terribly mysterious about the arrangements and
12 there's nothing mysterious about the
13 compensation.
14 And so our suggestion is that
15 element of consulting be classified in the
16 category where you've already classified kind
17 of part of it. I mean, you say for services
18 such as actuarial accounting, legal, et cetera
19 that they are subject to the disclosure regime
20 if there is an element of third party
21 compensation or indirect compensation. And we
22 would submit that it's kind of, again, in

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1 terms of line drawing. What is the difference
2 between actuarial services and consulting
3 services related to the maintenance of a
4 defined benefit plan? One could argue which
5 one is performed by a credentialed actuary.
6 That's an odd line to draw when in fact you
7 are consulting with the sponsor of a defined
8 benefit plan. Similar on health plans, et
9 cetera.
10 So just one other point, which is
11 gee if it's so simply why are you complaining
12 about being subject to the disclosure. And
13 that was a position that I took internally
14 when people raised it. And you've heard some
15 of the reasons already, because they apply to
16 all of the service providers. You heard Steve
17 talk about a reasonableness rule.
18 Gee, what if you left something
19 out or forgot something and didn't -- you
20 know, is that a violation?
21 And you've heard people -- I know
22 I've read interesting discussions about the

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1 conflict of interest disclosures. I was
2 particularly interested in what I saw in the
3 outline from Hewitt Associates yesterday
4 talking about with a big firm, and all of the
5 companies in our particular group are big
6 firms with a whole array of services that are
7 provided to a whole array of clients, what is
8 the conflict of interest and how often do you
9 have to update your list if you happen to
10 providing actuarial services to a bank? And
11 they're not usually on the list, but maybe
12 your asset consultant branch includes when
13 they're presenting opportunities to clients.
14 But would somebody consider that a conflict of
15 interest?
16 In my company because we work a
17 great deal with collective bargained plans,
18 among others, we have two specialized internal
19 conflict of interest groups that look at
20 taking assignments. And one is just provider
21 consulting. If we're offered an opportunity to
22 do something for a health insurance company or

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1 a record keeper or something. And those are
2 services that we help our clients choose to
3 buy, can we do it and what sort of disclosure
4 do we do with the client so that they know
5 that we're doing it.
6 And the other is more general kind
7 of conflict. If we are working with a
8 Teamsters fund and they are trying to organize
9 a hospital that the service employees are
10 trying to organize, is that a conflict of
11 interest we'd have to report to both of them?
12 The client may find that much more
13 important than the fact that we work with a
14 record keeper that's not in their jurisdiction
15 or something like that. It could be endless
16 and meaningless at the same time.
17 We're worried about the disclosure
18 up front of all of the services that are being
19 provided. Because additional services continue
20 to crop up in the course of just helping the
21 client maintain their operations. Services
22 that have to be provided, they'll be paid for

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1 later if the client's willing to do it. If
2 the client says, "Okay, you put in a lot of
3 time but I don't see any value in it and I'm
4 not going to pay you," so we're not going to
5 get paid. They weren't notified before we did,
6 but again with these flat flee or fee for
7 service arrangements the client always has to
8 agree before any kind of money changes hands
9 and goes to the service provider. Because
10 there's nothing indirect, there's no control
11 over the assets where we can be paid.
12 And I guess that's basically it.
13 And I can answer any questions that you have.
14 CHAIR CAMPBELL: We'll start down
15 here.
16 PANEL MEMBER WIELOBOB: A quick
17 one. We've heard the welfare plan folks say
18 that this shouldn't apply to them or if it
19 applies, it should apply in some different
20 form. It's inapposite to the way welfare
21 plans compensate service providers and so
22 forth.

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1 Do you have any views on that, the
2 scope of the proposal?
3 MS. MAZO: I would make a lot of
4 enemies or offend a lot of people if I were to
5 sort of opine in general.
6 I will say that a client of mine,
7 one that I do often testify in favor of, the
8 NCCNP has filed a comment supporting the
9 regulation as a general principle because they
10 appreciate the idea of having the information
11 arrayed in some way and made available.
12 We work with, among others, Taft-
13 Hartley funds which are funded. And I think
14 for a funded ERISA plan the issues are the
15 same. The compensation arrangements are
16 probably not as complicated, but I think it's
17 relevant for the client to know that you're
18 getting a commission and now much the
19 commission is.
20 PANEL MEMBER WIELOBOB: Thank you.
21 MS. MAZO: Sure.
22 PANEL MEMBER WILLIAMS: With

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1 respect to the third category of covered
2 service providers, the accountants, the
3 actuaries, the appraisers, the auditors, the
4 legal services would it be correct to assume
5 that third party compensation would be
6 unusual?
7 MS. MAZO: Yes, it would in my
8 opinion unless there's --
9 PANEL MEMBER WILLIAMS: So --
10 MS. MAZO: In the absence of
11 commissions of some kind, replacement of
12 property, whatever.
13 PANEL MEMBER WILLIAMS: So you
14 would agree then with the idea that if there
15 was indirect compensation coming to such
16 service providers, that that should be
17 disclosed?
18 MS. MAZO: Yes.
19 PANEL MEMBER WILLIAMS: Thank you.
20 MS. MAZO: I have no problem with
21 that.
22 MR. SAXON: Really, if you look at

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1 category 2, category 2 includes the term
2 "consulting" without any further definitional
3 help.
4 The third category includes
5 actuarial services, which is kind of the heart
6 and soul of benefits consulting. If you expand
7 what we're talking about under benefits
8 consulting to other kinds of administrative,
9 managerial, human resources, other things that
10 would not cause the consultant to become a
11 fiduciary, then we're kind of saying why not
12 move those guys into category 3 as well as
13 long as they're not receiving indirect
14 compensation, they're not acting as
15 fiduciaries and they don't have, as Judy said,
16 the conflict of interest issues that present
17 themselves so often on the investment side.
18 MS. MAZO: I mean, for instance,
19 communications consulting, all of these firms
20 have communications groups that draft SPDs and
21 help set up websites, and that sort of thing.
22 If we or one of them were being paid by

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1 Microsoft, or some website provider or ISP,
2 that should be disclosed. But typically that's
3 not true. We have -- I'm just thinking about
4 the special practice. You advise on helping to
5 upgrade systems or to monitor your systems
6 providers, your IT providers. As long as all
7 you're being paid is what the client is paying
8 you, then I don't see that there's a reason
9 for any special regime other than making sure
10 the client knows what they're paying you.
11 PANEL MEMBER WILLIAMS: Okay. I'd
12 like to address Mr. Saxon's point. You would
13 want a sort of language fix to address your
14 comments, is that what you're contemplating or
15 recommending?
16 MS. MAZO: Right. We're basically
17 saying that consulting as a general
18 proposition be taken out of the category 2
19 automatically subject to this rule and put
20 into the category 3 along with the legal
21 actuarial, et cetera.
22 PANEL MEMBER WILLIAMS: Okay.

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1 PANEL MEMBER DWYER: Would you be
2 opposed to moving the consulting into category
3 3 for these types of HR and communication, et
4 cetera, but leaving some category of
5 consulting in category 2? For instance,
6 investment consulting related to investments?
7 Would you have any opposition to that?
8 MS. MAZO: Not really, no. I
9 assumed that, until Steve corrected me, that
10 we have a subsidiary that does investment
11 consulting and they're registered investment
12 advisors. So I assumed that they were just
13 automatically covered under category 1 until
14 Steve pointed out no, no, no, it's only if
15 they're a fiduciary. But I mean we realize
16 that that is -- and all of our group has some
17 element that does that kind of work. And I
18 can certainly understand why you would feel
19 that it's important to put an extra underscore
20 around the disclosure for those services and
21 would not object to that.
22 MR. SAXON: Yes. We thought about

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1 asking for relief for investment consultants
2 who are not fiduciaries and who get a flat
3 dollar fee. Because those folks if they're
4 not a fiduciary, they're not in category 1.
5 If they're just getting a $100,000 a year or
6 they're getting some kind of asset-based fee
7 that's not subject to conflicts, they're
8 getting 5 bps, then -- so we would like to
9 reserve the right to follow up with you and
10 we'll send you something if we can make that -
11 - we thought about making that case.
12 MS. MAZO: Right. We did --
13 MR. SAXON: But we didn't want to
14 complicate or ask at this point.
15 MS. MAZO: Right. I was only
16 speaking for us at that point.
17 PANEL MEMBER DWYER: Thank you.
18 CHAIR CAMPBELL: Well let me
19 actually just explore that issue a little bit
20 more. In your view then, well not in your
21 view, but sort of playing the reverse
22 question, is there anyone that you would see

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1 belonging -- what's the utility of being in
2 category 2 as opposed to being someone who
3 would fall under category 3 by virtue of an
4 indirect payment?
5 MS. MAZO: I didn't understand. It
6 struck me that category 2 were the service
7 providers that you were particularly concerned
8 that fiduciaries might have difficulty
9 understanding what it is they're actually
10 doing, and thereby divining what they're
11 paying for, or they seem to be service
12 providers that are particularly involved with
13 assets in one way or another.
14 CHAIR CAMPBELL: Well, and I'm not
15 disagreeing with that. I'm asking, though, do
16 you see that as necessary unless there would
17 be activity that would actually come under
18 category 3?
19 MR. SAXON: Maybe other folks
20 did, but I think you could look at a number of
21 other service providers in category 2.
22 MS. MAZO: Right.

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1 MR. SAXON: And depending on the
2 type of compensation that they get, that I
3 think that they would not be subject -- they
4 could easily be argued that they belong in
5 category 3. And this all deals with the
6 concept of who is a fiduciary and who is not.
7 And the Department in the 5500 reg and now
8 seems to be looking at certain enumerated
9 service providers as not being -- although
10 they admit they're not fiduciaries, we call
11 them around the office as fiduciary-lites,
12 like L-I-T-E. Because they're special. But
13 my point to you would be that you could
14 eliminate category 2 as long as you were very
15 clear about the compensation that was received
16 by category 2. If they're just getting a flat
17 dollar fee and they're not a fiduciary.
18 Now, an investment consultant can
19 cross the line, obviously, when they're
20 providing recommendations. So in that case
21 they would be category 1.
22 MS. MAZO: In fact we talked -- I

1 mean before we got involved with the group did
2 talk about that.
3 We frankly wanted to get what
4 we're asking for so we made our request
5 modest. But logically the idea that someone
6 who is compensated exclusively with an up
7 front fee or a fee for service kind of
8 arrangement, the fiduciary has the information
9 so you don't need an additional elaborate
10 super structure for that.
11 CHAIR CAMPBELL: So I guess just
12 to put the question one last way, in the
13 fiduciary-lite category is there anyone you
14 would see sort of escaping the intent of the
15 regulation who would not either be in category
16 1 or category 3, if category 2 did not exist?
17 MR. SAXON: Not offhand. But I've
18 only looked at it from the standpoint of --
19 really closely from the standpoint of benefits
20 consultants and the actuarial type services
21 that they provide.
22 CHAIR CAMPBELL: Okay. Thank you.

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1 PANEL MEMBER CANARY: And I only
2 have one that's sort of related. If you look
3 at category 1, the reference to persons who
4 are fiduciaries under the Investment Advisors
5 Act, how do you think that classification
6 interrelates with the consultant in terms of
7 what you'd be potentially covering anywhere if
8 you removed the word "consultant" from
9 category 2?
10 MS. MAZO: Well, we believe that
11 whether a fiduciary or not, I mean our
12 assumption, The Segal Company, was that the
13 registered investment advisor, that that
14 status puts somebody in category 1.
15 This is really the same question
16 about would we object to asset consulting.
17 And Steve is right, I mean we would reserve on
18 that formally. But I think our broader
19 concern is with the more general consulting.
20 And frankly the more general kind of
21 consulting is the one where you run into the
22 logistical problems that concern us. Because

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1 on asset consulting you're hired for a
2 specific purpose, it may be a variety of
3 purposes, you know, to monitor, to do a
4 manager search, to review the allocation
5 philosophy, whatever it is and you do that
6 service or those services. You don't tend to
7 be called for from day-to-day by the fund
8 office or the benefits department and have the
9 kind of scope creep that you have in general
10 consulting.
11 And so I think it would probably
12 be easier from a logistical point of view to
13 meet the requirements than it is the general
14 consulting where the actual what you're going
15 to do for the client and what it's going to
16 take to do it, and how long it's going to take
17 is just so much more unpredictable.
18 PANEL MEMBER CANARY: Yes, I think
19 it would be hard to do what you're suggesting.
20 We are going to look at that though.
21 MR. SAXON: Okay.
22 PANEL MEMBER CAMPAGNA: And I only

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1 have one question, too. I guess moving down to
2 category 3 would depend on one thing in my
3 mind. Are there conflicts of interest that we
4 describe in our reg that are apart from the
5 receipt of indirect compensation? In other
6 words, if you were in category 2 you have the
7 conflict of interest disclosures and you're
8 going to have those in any event, despite
9 receiving indirect comp. So are we going to
10 miss anything in this move that we ask us to
11 make?
12 MR. SAXON: You know, in thinking
13 about it if you look at the types of service
14 providers described in category 3, you could
15 say that they have the same possibility of a
16 conflict of interest that the lawyer or the
17 accountant to the plan has because they have
18 some financial interest.
19 Without looking at the other
20 service providers in category 2 and thinking
21 about that, and in fairness to us we would
22 have to think about it, but in terms of what

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1 we were thinking about, a benefits consultant
2 is most often the actuarial or the
3 communications consulting that Judy was
4 talking about. I don't see the conflict of
5 interest there. It may be present for some of
6 the other service providers. I don't think so.
7 And I think you can equally make the case
8 that you could move somebody in category 3 up
9 if you're that worried about it. But we would
10 say that the conflict of interest issues
11 should only apply to fiduciaries to begin
12 with.
13 PANEL MEMBER CAMPAGNA: Okay.
14 MS. MAZO: Yes. I mean the
15 conflict of interest if you mean the sort of
16 co-investing or the sorts of things that are
17 talked about in the preamble as posed there is
18 likely with any service provider. Sometimes
19 you find --
20 PANEL MEMBER CAMPAGNA: But I
21 guess assuming Adrienne's fix that you move
22 investment consulting and keep that in

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1 category 2. With respect to the type of
2 consulting you're talking about you really
3 don't believe that those kind of conflicts
4 exist?
5 MR. SAXON: No.
6 MS. MAZO: Right.
7 MR. SAXON: Right.
8 PANEL MEMBER CAMPAGNA: Okay.
9 Thank you.
10 CHAIR CAMPBELL: All right. Well,
11 thank you very much.
12 We're about half hour to 36
13 minutes behind, so we're going to take a 5
14 minute break which will literally be no more
15 than 5 & 1/2 minutes, and then we'll get
16 going.
17 (Whereupon, the above-entitled
18 matter went off the record at 3:08 p.m. and
19 resumed at 3:09 p.m.)
20 CHAIR CAMPBELL: All right. Well
21 in proof that tardiness and procrastination
22 sometimes pay off, we did have one of our

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1 witnesses call and say he's unavoidably
2 detained. So we have now gained a bit of time.
3 And I think we're still in the negative, so
4 let's go ahead and get started.
5 MR. KEMPER: I'm going to try to
6 speed that up, actually.
7 Good afternoon. My name is Mark
8 Kemper. I'm the general counsel at UBS Global
9 Asset Management of the Americas. And to my
10 left is Karen Barr, general counsel of the
11 Investment Adviser Association.
12 We appreciate the opportunity to
13 appear before you today on behalf of the
14 Investment Adviser Association to address the
15 proposed regulation under 408(b)(2).
16 The Investment Adviser Association
17 is a not for profit association that
18 represents the interests of SEC registered
19 investment advisers. Founded in 1937 the
20 IAA's membership today is comprised of more
21 than 500 firms that collectively manage in
22 excess of $9 trillion for a wide variety of

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1 individual and institutional clients,
2 including retirement plans governed by ERISA.
3 The IAA applauds the Department's
4 efforts to ensure that plan fiduciaries
5 receive the information they need in order to
6 assess the reasonableness of the plan's
7 arrangements with service providers. Plan
8 fiduciaries' understanding of the fees paid by
9 the plan is especially important, because such
10 fees directly impact the investment returns
11 realized by the plan and in the defined
12 contribution plan context the actual benefits
13 received by participants.
14 As reflected in our previously
15 filed comments, investment advisers provide
16 services to both defined benefit and defined
17 contribution plans. We'll incorporate our
18 earlier comments by reference, but we'll
19 devote our time today to the role of
20 investment advisers and defined benefit plans
21 in the application of the proposed regulation
22 in this context.

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1 Now, the basic premise at the
2 beginning of the release of this new rule is
3 that there have been a lot of changes recently
4 in the way that the service providers, the
5 structure that service providers provide
6 services to employee benefit plans. And in
7 our experience we believe that's true in the
8 defined contribution area, but we haven't seen
9 those types of changes in the defined benefit
10 area at all.
11 The investment managers or
12 investment advisers to defined benefit plans,
13 it's a very traditional structure that plans
14 themselves hire the trustees to provide the
15 custodial record keeping functions. They hire
16 the investment manager pursuant to a written
17 contract to provide the investment management
18 fees. The contract's going to have full
19 disclosure on the investment guidelines as
20 well as on the management fees that we're
21 going to be paid.
22 Prior to engaging the investment

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1 adviser, we're typically subject to pretty
2 extensive due diligence by defined benefit
3 plan fiduciaries and/or their consultants.
4 They tend to come into our offices on multiple
5 times. We've given them disclosure on our
6 investment processes and various other aspects
7 about the way our firm operates.
8 After the relationship is started,
9 we provide regular reporting, at least on a
10 monthly basis we provide transaction reports.
11 We provide performance reports. We provide
12 performance attribution. We provide proxy
13 reports, soft dollar reports to the ones that
14 ask for those types of reports.
15 So we have regular communication.
16 And we have regular meetings, at least
17 annually, with all of our clients to go over
18 all of these issues.
19 So while we agree that certain
20 additional disclosures are merited even in the
21 defined benefit area, we believe it would be
22 beneficial for the rule to be amended to

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1 distinguish between the types of disclosures
2 that need to be given in the defined
3 contribution area versus the types of
4 disclosures that should be given in a defined
5 benefit type of management arrangement.
6 Now, a primary example of what I'm
7 talking about are the transaction costs. When
8 you look at all the distribution type costs
9 and the revenue sharings that are present in
10 these newer type arrangements for defined
11 contribution plans, those clearly merit
12 further disclosure. And I think that's sort
13 of the whole intent to your rule here. But
14 those types of costs and fees generally are
15 not present in the way you manage defined
16 benefit plans.
17 Now, when I first read the rule I
18 assumed on transaction costs that I only
19 needed to disclose the transaction costs for
20 my defined benefit clients to the extent it
21 involved some sort of a conflict. So I needed
22 to disclose when I cause a client to pay a

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1 commission to my affiliated broker dealer, I
2 need to disclose when I'm getting something in
3 return like a soft dollar benefit.
4 In discussing the rule with my
5 colleagues further, though, they pointed out
6 where my interpretation may have been wrong.
7 And I think that deals a little bit in the way
8 that the relationship between the adviser and
9 broker dealer works.
10 As an adviser, we're an agent to
11 the plan with the authority to engage a broker
12 dealer who is also an agent to the plan to
13 execute the trade. The commission's or
14 whatever trading costs are charged in the
15 trade are going to be paid for directly out of
16 the plan assets. That structure just does not
17 meet the definition of a bundled service, so I
18 didn't see that there was any need to make
19 disclosure under the bundled service type of
20 requirements in the rule. However, if you
21 also look at the definition of a responsible
22 plan fiduciary in our position of hiring the

1 broker dealer and engaging the broker dealer
2 to do the trade, do we become the responsible
3 plan fiduciary, therefore do we have an
4 obligation to get this disclosure from the
5 broker dealer? Do we have an obligation to
6 pass it on to the client? Do we have an
7 obligation to make sure the broker dealer
8 passes the disclosures directly to the client?
9 And this all, of course, needs to be done
10 beforehand.
11 So I'm not really sure how I'm
12 going to do that in either case. And the
13 reason is, I don't know which broker dealers
14 I'm going to trade with before the
15 relationship starts. I don't know what types
16 of instruments I'm going to trade with which
17 broker dealer. So the only way I can figure
18 that I'm going to be able to comply with this
19 is I'm going to go to my broker dealer
20 approved list and I'm going to have to give a
21 disclosure from every broker dealer to every
22 new client. That's over hundreds of broker

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1 dealers on the disclosure list, even though I
2 may never actually trade this particular
3 client account with one of those broker
4 dealers.
5 And also what am I going to do as
6 things change? We trade new instruments, we
7 going to add a broker dealer, a new broker
8 dealer or change the instruments we can trade
9 through a particular broker dealer? If I have
10 to go through, and often times I need to get a
11 new broker dealer approved very quickly to get
12 a trade done, and if I have to go through a
13 full process in giving these disclosures to
14 the clients, I think I'm going to miss a lot
15 of trades that I otherwise could have done
16 because I don't think I'll be able to get the
17 disclosure process done quickly enough.
18 Now so I guess what I really think
19 is that this process of disclosure of the
20 compensation paid to broker dealers really
21 needs to be clarified in the rule quite a bit.
22 And I'd really hope that you'd adopt my

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1 earlier interpretation, which is that I should
2 only have to disclose these commissions to the
3 extent that I have a conflict of interest
4 associated with them. And the reason I think
5 that's the appropriate way to do it is because
6 we don't have any incentive to make the broker
7 dealers rich, unless it's my affiliate or I'm
8 getting something back like a soft dollar.
9 And on the other hand, we do have a lot of
10 incentives to keep those costs as low as
11 possible. You know, our performances, it
12 reduces our performance, and that's our
13 lifeblood that we sell.
14 Now the other things that we'd
15 like to say about the rule, we would like to--
16 as you know we give our Form ADV to all of our
17 clients. We believe that the Form ADV should
18 be -- it includes disclosures and conflicts
19 and compensation. We believe the Form ADV
20 should be used as a safe harbor for compliance
21 with this rule. To the extent we provide the
22 ADV it includes all the disclosures it's

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1 supposed to include that we would be deemed to
2 comply with the rule.
3 Now barring that, there was prior
4 testimony, it was about a reasonableness
5 opinion. I would agree, we would like to have
6 something like that. We think it's
7 appropriate that if an adviser or service
8 provider has acted in good faith and given all
9 the material disclosures required by the rule,
10 he shouldn't be subject to a prohibited
11 transaction excise tax just because he's
12 missed some minor amount.
13 I know in working this rule
14 through my firm I'm going to find out big
15 things that I need to disclose. But the
16 rule's very broadly drafted. I'm just as
17 confident there's going to be a lot of little
18 things on the fringes that I am not going to
19 remember, not going to figure out, I'm not
20 going to see ahead of time.
21 Also, I have to give futuristic
22 disclosures. I have to estimate how much I'm

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1 going to be trading with this and how much
2 it's going to cost. I know those estimates are
3 going to be wrong, probably more often than
4 they're right. So I think that as long as
5 I've acted in good faith and I've gotten the
6 material disclosures into whatever I've given
7 to the client, we shouldn't be subject to the
8 prohibitive transaction rules.
9 Let's see. Oh, lastly, we also
10 agree that there should be a longer transition
11 period added to the rule. We agree that the
12 amount of time it's going to take us to
13 implement this rule has been underestimated in
14 your impact analysis. And we believe that
15 we'll need a much longer time than the 90
16 days.
17 Also, we would prefer that the
18 rule doesn't say that you have to amend all of
19 your existing contracts immediately, but
20 rather that you would amend the contracts as
21 they come up for renewal as they have some
22 other material amendment required so that we

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1 aren't in the process of trying to negotiate
2 all these contracts with all of our clients at
3 the same time that they're doing this with all
4 their other service providers.
5 And at that, open for questions.
6 CHAIR CAMPBELL: Okay. We'll
7 start down here.
8 PANEL MEMBER BUTIKOFER: So turn
9 things around a little bit. Yesterday we heard
10 from some fiduciary groups talking about the
11 benefits of the proposed disclosures. And
12 they've mentioned things like more fee
13 transparency, it lowers their search time for
14 information.
15 From your side of it what do you
16 see as the big benefit to fiduciaries? I know
17 this is not your clientele necessarily. But
18 how do you see all this extra effort? Do you
19 see it as actually going to benefit the
20 fiduciaries?
21 MR. KEMPER: To benefit my clients
22 you mean, basically?

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1 PANEL MEMBER BUTIKOFER: Yes.
2 MR. KEMPER: Yes. Sure I do. I
3 think -- and again, you know I started out we
4 like the rule. We think it's good. I think
5 the disclosure in this area is necessary. What
6 my concern and only concern is is that it's a
7 little bit of a good thing is good, too much
8 of a good thing is bad. And if we have such a
9 broad rule that we're going to give so much
10 disclosure to these fiduciaries, we're going
11 to bury them. They're not going to have time.
12 They're not going to have interest to look at
13 it.
14 And so the boiler plate disclosure
15 that we're going to have to put together to
16 meet all of these broad provisions in here is
17 going to overshadow the important disclosure
18 that you're really trying to get at. And I
19 think if you do shoot a bullet rather than a
20 shotgun, get the important disclosures to
21 those fiduciaries, I think it will improve
22 their decision making.

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1 PANEL MEMBER BUTIKOFER: All
2 right. As far as the decision making, do you
3 see it as actually impact fees charged, just
4 making better choices of service providers?
5 MR. KEMPER: I think both. I
6 really do. There's downward pressures on our
7 fees, has been for quite a while in the recent
8 past, I would say. And I think a lot of the
9 transparency in the fees results in that. So
10 I would see additional transparency probably
11 putting pressures on the fees.
12 PANEL MEMBER BUTIKOFER: All
13 right. Thank you.
14 MR. KEMPER: Sure.
15 PANEL MEMBER CAMPAGNA: Previous
16 people who testified said that we shouldn't
17 extend the rule to DB plans at all, defined
18 benefit plans at all. I take it you're not
19 there. You're just saying clarify the rule and
20 get more relief in this transactional area?
21 MR. KEMPER: Absolutely. I think
22 if you specify, and you think about, again,

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1 the types of plans, the DC, DB, the health and
2 welfare. And when you try and make a rule,
3 it's going to cross all of them I think you're
4 going to have untended consequences because
5 the way they operate is just so different.
6 And you should really kind of have a different
7 regime specified for each one so that you can
8 avoid those unintended consequences on their
9 own.
10 PANEL MEMBER CAMPAGNA: Okay.
11 Thank you.
12 That's it for me.
13 PANEL MEMBER CANARY: Okay. You
14 talked about using the Form ADV as a safe
15 harbor. Have you had an opportunity to
16 compare the information that would be in the
17 Form ADV and cross walk that to what's in the
18 proposed rule to see where they're different?
19 And if you have, would that be information
20 you'd be able to share with this?
21 MR. KEMPER: I haven't sat down
22 and ticked and tied each and every one of

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1 them. But generally I think my ADV covers all
2 of the requirements of your rule.
3 The real reason I want it as a
4 safe harbor is because I'm so afraid of the
5 unknown. I don't know what I don't know, and
6 I'm not going to be able to give those
7 disclosures. And I know that there's something
8 out there. I mean, it's whenever something
9 goes wrong and you start really digging and
10 peeling the layers back, you're amazed that
11 all of a sudden you had no idea that my
12 company owned a percentage interest in this or
13 some other trust or something. Those kinds of
14 things happen. You just have no idea.
15 And so I'm not going to be able to
16 disclose those. And I know it says to the
17 best of your knowledge, but when your company
18 knows about it, you know, can I really say I
19 didn't know about it? And I've Chinese walls
20 between various entities, so maybe that would
21 protect me. But what I'm worried about is what
22 type of inquiry do I have to do to satisfy to

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1 the best of my knowledge.

2 So the safe harbor to me is really

3 a protection against all the stuff I don't

4 know about.

5 MS. BARR: And I'd like to, if you

6 don't mind, add to that.

7 We have looked at the Form ADV as

8 compared to the rule. And I think part of the

9 answer to your question depends on how far you

10 go with this rule.

11 For example, there are certain

12 items that are not ascertainable at the

13 beginning of a contract that investment

14 managers would not be able to provide actual

15 dollar amounts or even meaningful estimated

16 formulas. And so if you were permitted to use

17 the disclosures sufficient for an investor to

18 judge the reasonableness of the compensation,

19 for example, that would be consistent with

20 what is required in Form ADV.

21 If you were in the final rule to

22 go ahead and insist on making some more

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1 monetary or specific formula or estimate, that
2 may not be in Form ADV, for example. But I
3 think if you go where we're asking the
4 regulation to go, which is to say if you can't
5 ascertain the dollar amounts in any meaningful
6 way in advance, if you give enough disclosures
7 to that a reasonable fiduciary could determine
8 the reasonableness of the compensation, that
9 would be in sync with Form ADV.
10 In addition, the conflict of
11 interest disclosure, as modified with the
12 comment in our comment letter would be
13 consistent with Form ADV.
14 PANEL MEMBER CANARY: Okay. Then
15 one question with two parts. It's a soft
16 dollar disclosure. You had mentioned on
17 request, you give clients a soft dollar
18 disclosure. This one part would be in this
19 fear of the unknown or not being able to give
20 an estimate, what do you think of the idea of
21 in serving rather than an estimate, a
22 representation that certain information is

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1 available on request, such that rather than
2 trying to estimate it up front you would tell
3 the client that if they want it, they would be
4 able to get this information at, presumably a
5 time when you'd have the information to be
6 able to give it to them?
7 And then number two, can you talk
8 a little bit about how you deal with
9 proprietary versus non-proprietary soft
10 dollars when you make these soft dollar
11 disclosures available?
12 MR. KEMPER: Okay. Yes, the
13 second one I'll take second. It's the harder
14 one.
15 The on request I think is a great
16 idea. You know, we can give a general
17 disclosure to a client and, on average, you
18 know we only do soft dollars on agency equity
19 trades. And on average, about 10 to 12
20 percent of our agency equity trades are done
21 soft, and that's a pretty solid number. I can
22 tell them that. But what I can't tell them if

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1 I have a global balanced assignment that they
2 got they got a 60 percent allocation to
3 equities and out of that 60 percent allocation
4 to equities over time, you know, some of it's
5 foreign, some of it's not U.S. and at turnover
6 ratio I can't ever get there. So if I can just
7 give them, generally I do about 10 to 12
8 percent soft and that if they want to know
9 upon request what I have paid soft, I keep
10 track of everything, I do a pro rata
11 allocation to all of my clients who generate
12 my soft commission credits and I can tell them
13 in retrospect what we paid pretty closely.
14 So I think on request I think that
15 would be a great solution.
16 Proprietary, there's no way you
17 can assess a dollar figure to that. I've never
18 figured it out. You're just going to have to
19 be able to give a disclosure that this occurs
20 and it's part of what you generally pay in
21 your trading costs to service broker dealers.
22 PANEL MEMBER CANARY: So when you

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1 make the disclosure report is that kind of
2 general narrative is what you include about --
3 MR. KEMPER: Yes, that's all we
4 can ever do. And it's only the third party
5 soft we can actually track back to. Because
6 you do the third party soft, you know how much
7 you're paying Bloomberg, you know you're
8 paying it soft, you can do your pro rata
9 allocation to all your clients that generate
10 those trades and come up with a percentage of
11 that Bloomberg monthly fee or annual fee that
12 that client contributed to pay.
13 PANEL MEMBER CANARY: All right.
14 Thank you.
15 CHAIR CAMPBELL: Some of our
16 commenters expressed some concerns about
17 identifying themselves as fiduciaries either
18 under ERISA or the '40 Act. Is that something
19 you all have any concerns or thoughts about?
20 MR. KEMPER: Well, in the defined
21 benefit context, you're almost always. I
22 mean, you can always come up with an

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1 exception. But we definitely are fiduciaries.
2 We're managing ERISA plan assets. We
3 acknowledge we're a fiduciary. I mean, that's
4 part of our sales, actually, is that we
5 provide fiduciary services to you. That
6 distinguishes us from a lot of other service
7 providers.
8 If your question is relative to --
9 I'd heard discussions earlier, the manager of
10 the mutual fund is not a fiduciary to the
11 plan. I don't know if you were going there or
12 not.
13 CHAIR CAMPBELL: Well, I was
14 thinking more we heard from the bankers, they
15 still had concerns about this in part because
16 while they were often fiduciaries serving as
17 trustee and so forth, there might be other
18 services they provide that are non-fiduciary
19 services. And they had concerns about
20 distinctions between those and what they
21 disclose in connection with services. I don't
22 know if that applies to you as well.

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1 MR. KEMPER: It does to my bank as
2 a whole. To the part of the bank I work for,
3 no. All we do is provide the fiduciary
4 services. We don't provide any of the other
5 type services. The rest of the bank would. We
6 tend to have those businesses walled off for a
7 lot of reasons. And so I would give
8 disclosure on what I do. I would not ever deem
9 to give the disclosure for what our investment
10 bank or financial services groups do. I
11 wouldn't know.
12 CHAIR CAMPBELL: Okay. Thank you.
13 PANEL MEMBER DWYER: I know you
14 talked about the types of conflicts that might
15 arise in connection with the investment
16 adviser relationship with the plan. You talked
17 about commissions and soft dollars. Give us a
18 few more examples, if you can?
19 MR. KEMPER: Well, there's a lot.
20 I mean, you can go down the list of
21 prohibited transaction exemptions and kind of
22 look at there is a good place to start.

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1 I'll say when we buy an IPO or a
2 new issue of bonds, I find that a lot of times
3 my affiliated broker dealer is a member of the
4 underwriting syndicate and so that's a
5 conflict of interest. We'll buy from somebody
6 else, but there's fixed compensation within
7 the syndicate and so when I'm participating in
8 there, so you're getting a benefit or not.
9 I know, I think seventy-five one
10 is the exemption we use there.
11 Other conflicts of interest.
12 I think, you know in our industry almost
13 everything is a conflict of interest because,
14 you know, there are limited opportunities when
15 you're managing money. And, you know, even if
16 you had one client, you're going to have a
17 conflict with what the investment manager
18 wants to do with his own money, right?
19 PANEL MEMBER DWYER: Right.
20 MR. KEMPER: So you've got the
21 personal trading is another big one.
22 PANEL MEMBER DWYER: Let me ask

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1 you this: I mean, it looks like the Form ADV
2 requires disclosure of compensation of the
3 adviser's supervised persons under the SEC
4 rules. Can you think if this may require some
5 thought and even a supplemental submission to
6 us, but can you think of situations where
7 there would be a conflict of interest with the
8 plan that does not involve a supervised person
9 of the adviser?
10 MR. KEMPER: Yes, I'll have to
11 think about that.
12 PANEL MEMBER DWYER: Yes, please
13 do.
14 MR. KEMPER: Because off the top
15 of my head of think of any. I mean relative
16 to what we do, I can't think of anything.
17 And, obviously, there might be something
18 outside of what we're doing. But I think focus
19 is I can only disclose the conflicts that
20 arise by my activity, not maybe with somebody
21 else, I don't know how it's doing.
22 MS. BARR: When you're asking

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1 about a conflict that doesn't involve a
2 supervised person, do you mean a conflict that
3 is with a third party, involving a third
4 party?
5 PANEL MEMBER DWYER: A third
6 party, yes.
7 MS. BARR: Because I think there -
8 - if for example you had a referral
9 arrangement and you paid someone for a
10 referral of business, is that what you're
11 thinking of or --
12 PANEL MEMBER DWYER: Well, I'm not
13 thinking of anything in particular. I'm just
14 thinking that there may be a little bit of a
15 disconnect between the term "supervised
16 person," which is all the ADV is going to
17 cover, and then there's a larger universe of
18 parties out there with whom conflicts could
19 exist. And I think that our reg, the proposed
20 reg may actually be broader than what the ADV
21 is requesting. And so that's what I wanted to
22 know. What conflicts can you think of that

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1 would be outside the scope of the SEC's
2 definition of supervised person.
3 MR. KEMPER: I think --
4 MS. BARR: Actually -- I'm sorry
5 go ahead.
6 MR. KEMPER: Go ahead.
7 MS. BARR: The Form ADV actually
8 does cover disclosure of conflicts of interest
9 with what they call related --
10 PANEL MEMBER DWYER: Oh, I'm
11 sorry. I meant to say compensation not
12 necessary conflicts.
13 MS. BARR: Oh.
14 PANEL MEMBER DWYER: But, yes.
15 But anyway, that's something to think about.
16 MR. KEMPER: Karen's example is a
17 good one. I mean, we do have certain third
18 party solicitors, they will go out and try and
19 find clients for us. And to the extent they
20 bring a client to us, we will pay them a
21 referral fee out of our management fee, right?
22 So they're a third party unrelated to us and

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1 there's clearly a conflict of interest for
2 them to refer the client to us because we're
3 paying them to do it, right.
4 Now, there's a rule that covers
5 that that's disclosed in our ADV, and there's
6 a rule that covers it and requires what the
7 specific disclosures we have to give them.
8 PANEL MEMBER DWYER: And so that's
9 covered under the conflict of interest
10 provision of the ADV?
11 MR. KEMPER: Yes.
12 PANEL MEMBER DWYER: Not
13 necessarily the compensation provision? I see.
14 Okay.
15 And switching gears completely, I
16 had a question on contracts. You had talked
17 about when contracts come up for renewal
18 that's when they should be required to comply
19 with the regulation.
20 To what extent are evergreen
21 contracts in play in the investment adviser
22 world; contracts that just never come up for

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1 renewal?

2 MR. KEMPER: I would say in the

3 majority of our management agreements are

4 evergreen. We have certain ones that do. We

5 have terms on them, but it's the minority

6 rather than the majority.

7 Now in a renewal, often or it

8 would be less the chance of triggering an

9 amendment here for this than an amendment.

10 Because the amendments do come up frequently,

11 particularly amendments effecting the detailed

12 investment guidelines attached. Those will be

13 looked at at least annually and fairly

14 frequently we'll do amendments on those.

15 PANEL MEMBER DWYER: So what

16 thoughts do you have on how we can ensure that

17 these evergreen contracts eventually become

18 subject to the regulation?

19 MR. KEMPER: Well, you could maybe

20 put a sunset provision in and say that if you

21 renew or materially amend them but no longer

22 than X number of years or something like that

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1 would be -- so we could at least, you know as
2 we go through time we're going to catch a lot
3 of them and then we know we've got time toward
4 the end to catch the rest of them that are
5 evergreen.
6 PANEL MEMBER DWYER: Thank you.
7 MR. KEMPER: Sure.
8 PANEL MEMBER Wielobob: I have a
9 question. To clarify, the ADV -- your
10 suggestion that it could be a safe harbor, is
11 that also with respect to the conflicts of
12 interest provisions?
13 MR. KEMPER: Sure.
14 PANEL MEMBER Wielobob: Okay.
15 MR. KEMPER: Conflicts of interest
16 and compensation.
17 PANEL MEMBER Wielobob: Thank you.
18 MR. KEMPER: Sure.
19 CHAIR CAMPBELL: Great. Thank you
20 very much. We appreciate it.
21 And our next witness will be the
22 Managed Funds Association represented by Mr.

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1 Allensworth and Ms. Cho.
2 MR. ALLENSWORTH: Good afternoon,
3 My name is Benjamin Allensworth. I'm the
4 senior legal counsel of Managed Funds
5 Association. Managed Funds Association is the
6 trade association for the alternative
7 investment industry, particularly for the
8 hedge fund industry. Our members represent
9 over half of the alternative assets under
10 management, and it's approximately $2 trillion
11 in the total hedge fund assets, and our
12 members manage a little over half of that.
13 With me is Erin Cho, who is
14 counsel at the law firm of Davis Polk &
15 Wardwell.
16 We appreciate the opportunity to
17 testify today.
18 I wanted to say up front, MFA
19 supports the Department's goal of ensuring
20 that plan fiduciaries are provided adequate
21 information to enable then to fulfill their
22 fiduciary obligations under ERISA. However, we

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1 believe that several clarifications and
2 modifications to the Department's proposed
3 regulation would help focus that regulation
4 more specifically on that goal.
5 Before I get into the substance of
6 our comments, which will follow the comments
7 in our written comment letter at the end of
8 February. I think it's important to note a
9 couple of points related to hedge funds and
10 benefit plan investors.
11 Benefit plan investors in hedge
12 funds and other private investment vehicles,
13 such as hedge funds, are predominately large
14 sophisticated defined benefit plans. They're
15 not typically 401(k) or other defined
16 contribution plans.
17 Also, the typical allocation to
18 hedge funds and other alternative investments
19 is somewhere between two and 10 percent of a
20 plan's asset under management. So it's not a
21 major portion, certainly not a majority of the
22 assets.

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1 We believe these are important
2 distinctions as you're considering the
3 application and scope of the proposed
4 regulation.
5 I'd also like to say that pension
6 plans conduct extensive due diligence prior to
7 investing in an alternative investment
8 vehicle. According to one study the average
9 diligence period is seven months with an
10 additional three months for internal approval.
11 And diligence periods of 18 months or longer
12 are quite common. In fact, you could talk to
13 some of our members who will tell you that
14 they've been through diligence periods that
15 have gone up to 15 years from the initial
16 contact with the benefit plan.
17 To help assist the diligence
18 process on an industry-wide basis, MFA has
19 produced a model due diligence questionnaire
20 which we attached to our comment letter. We
21 are in the process of reaching out to pension
22 groups and particularly to pension plans to

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1 get additional comments from those plans and
2 also to encourage the use of our model due
3 diligence questionnaire.
4 Moving on to the substantive
5 comments on the proposed regulation, first I'd
6 like to talk about the scope of the proposed
7 regulation.
8 The first comment is that we as
9 service providers to non-plan asset pooled
10 investment vehicles, those would be pooled
11 investment vehicles that do not have a class
12 of equity securities owned 25 percent or more
13 by benefit plan investors should not be deemed
14 either parties in interest or fiduciaries to
15 benefit plans, and therefore should not be
16 deemed service providers to benefit plans
17 under the proposed regulation.
18 MS. CHO: To put it succinctly
19 there's an established legislative regime that
20 private funds that choose to either stay below
21 the 25 percent threshold and keep the number
22 of pension plan investors low or choose to

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1 comply with the VCOC rules or REOC rules, they
2 do so so they will not be subject to the ERISA
3 regime.
4 MR. ALLENSWORTH: That's right.
5 And actually we request that the Department
6 clarify that service providers to pooled
7 investment vehicle that do have a class of
8 equity securities, 25 percent or more owned by
9 benefit plan investors what we refer to as
10 plan asset funds, that those service providers
11 should be able to rely on other applicable
12 exceptions to or exemptions from the
13 prohibition of section 406 without necessarily
14 needing to comply with proposed regulation
15 408(b)(2).
16 MS. CHO: Sure. I mean, just to
17 give you an example to pick up on, someone
18 mentioned 86-128 earlier today. Many times a
19 QPAM, a plan asset fund, if they choose to use
20 an affiliated broker dealer they will need to
21 comply with the extensive, not onerous,
22 conditions and requirements of 86-128.

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1 MR. ALLENSWORTH: Okay. Thanks.
2 Next, we request that the
3 Department clarify or modify as appropriate
4 certain of the compensation disclosure
5 requirements continued in the proposal and
6 these would be with respect to service
7 providers to plan asset funds.
8 First we request that the
9 disclosure of compensation be permitted in any
10 of the forms listed in the proposed
11 regulation. There is some concern that the
12 proposed regulation calls for a dollar amount
13 followed by other types of disclosure. If a
14 dollar amount is not available, we would
15 request that any of those forms listed in the
16 proposal regulation be an acceptable form of
17 disclosure of compensation.
18 Next, there are two specific fact
19 patterns that our members have identified that
20 the proposed regulation would cause issues.
21 The first one would be, and this was testimony
22 that you heard previously as well, which is

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1 when a service provider such as an investment
2 adviser to a plan asset fund does not have
3 specific information available at the time the
4 contract is entered into with a benefit plan,
5 for example when using an affiliate broker
6 dealer. We would request that general
7 disclosure should be permissible at the time
8 of the contract followed by subsequent
9 disclosure of any compensation actually paid.
10 The reason for that being that at the time
11 the contract is entered into, the investment
12 adviser likely will not know, be able to
13 provide either a dollar amount or a particular
14 formula with respect to broker dealer
15 compensations. That will be determined after
16 the fact in accordance with best execution
17 obligations.
18 **A second situation arises**
19 **particularly in the context of funds of hedge**
20 **funds. And that would be a situation when a**
21 **service provider to a plan asset fund of funds**
22 **does not have the ability to determine whether**

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1 or not to use an affiliate for services that
2 would be with respect to underlying funds, so
3 the fund of funds manager that's part of a
4 large institution may very well have
5 affiliated broker dealers providing services
6 to underlying funds, but the service provider
7 to the fund of funds has no ability to make
8 that decision. And as a matter of fact, may
9 not know whether or not the underlying fund is
10 using the affiliated broker dealer. So in
11 these situations we believe that more general
12 disclosure about the potential for affiliated
13 service provider to be used by underlying
14 funds should be permissible.
15 Obviously, to the extent that any
16 service provider to a plan asset fund of funds
17 does have the ability to make that
18 determination and does know about an
19 affiliated service provider being used, then
20 the compensation arrangement should be
21 disclosed.
22 Next we have a couple of comments

1 related to the disclosure of gifts and other
2 non-cash items.
3 First, we would request that
4 disclosure of gifts or other non-cash items
5 not be required if the non-cash item is given
6 to the service provider because of an overall
7 relationship and not in connection with the
8 services being provided to the plan in this
9 fact pattern. And there does not appear to be
10 any conflict of interest that needs to be
11 disclosed.
12 Secondly, we would ask that
13 disclosure of gifts or the non-cash items in
14 amounts less than the de minimis amounts in
15 Form 5500 also not be required to be
16 disclosed.
17 Last, we would request that non-
18 cash items not be required to be required to
19 disclosed in advance, as specific amounts will
20 likely not be known, rather at the time of the
21 contract a more general disclosure should be
22 permitted with specific disclosure at a later

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1 point in time. Later point in time on any non-
2 cash items that have actually been received.
3 Last, our set of comments relate
4 to the conflicts of interest disclosure. We
5 agree with the principle that plan fiduciaries
6 should be aware of service provider material
7 conflict of interest. However, we believe the
8 language in the proposed regulation is
9 extremely broad and could be, if interpreted
10 to require a service provider to know of every
11 entity with which a plan has a relationship,
12 difficult or impossible for the service
13 provider to implement.
14 We believe that private investment
15 vehicles should be required to disclose the
16 material conflicts of interest and they
17 already do in the offering documents as well
18 as in the due diligence process with
19 investors.
20 We believe that additional
21 disclosure of conflicts of interest beyond
22 material conflicts dilutes the value of the

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1 **information being disclosed and is actually**
2 **harmful to investors rather than beneficial.**
3 **As such, we would suggest a requirement that**
4 **service providers disclose all material**
5 **conflicts of interest of which they are aware.**
6 **We believe this would adjust the Department's**
7 **goal without diluting the value of that**
8 **information.**
9 **Once again, we thank you for the**
10 **opportunity to present today, and we're happy**
11 **to answer any questions that you have.**
12 CHAIR CAMPBELL: Okay. We'll
13 start down here.
14 PANEL MEMBER WIELOBOB: No
15 questions.
16 PANEL MEMBER ZARENKO: I'd like to
17 follow up on the disclosure of compensation.
18 I mean, as you noted, we included in the
19 proposed regulation flexibility because we
20 realize this is a prospective disclosure and
21 there may not be hard dollars that are known
22 up front.

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1 I guess I start from the
2 proposition that in an ideal world we would
3 have dollars to disclose to a plan fiduciary
4 up front because that's the easiest way for a
5 plan fiduciary to comparison shop. You know
6 dollars compare to dollars pretty easily. So
7 when we put the flexibility into the reg, I
8 guess my concern was getting too generalized,
9 i.e., we said you can use formulas, you can
10 use estimates; it seems like you're asking
11 for an even more diluted manner of
12 compensation disclosure. And, you know, I
13 envision a contract saying we may receive
14 additional forms of compensation from these
15 other parties. But to a plan fiduciary how
16 helpful is that really given that they are
17 tasked when they are hiring a service provider
18 with deciding whether they think the
19 compensation to be received is going to be
20 reasonable?
21 I think, you know, when we start
22 moving away from dollars and then we start

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1 even moving away from estimates or formulas,
2 it's getting really hard for a plan fiduciary
3 to try to determine whether they think the
4 compensation is going to be reasonable. Do
5 you either of you have any thoughts on that?
6 MS. CHO: Well, I think that we
7 will provide subsequent disclosure where I
8 think it's often the case where the fund
9 starts off and later on they're in
10 negotiations with a prime broker. And I think
11 once the fees are established with the prime
12 broker, then the plan asset funds are willing
13 to make a disclosure to the investors. It's
14 just that initially they haven't hired all of
15 their service providers.
16 PANEL MEMBER ZARENKO: But
17 wouldn't they have experience based on past
18 client relationships to be able to make some
19 estimates?
20 MR. ALLENSWORTH: Well, I think
21 with respect to a prime broker, part of it is
22 going to depend on what kind of services you

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1 want. So as you're negotiating future
2 agreements you may negotiate a very different
3 agreement. You may want stock lending from
4 one, you may want -- and it may be a different
5 type of stock lending. So you may go to one
6 prime broker who is great at doing stock
7 lending on regularly available securities and
8 there's going to be a price point there.
9 You may go to another prime broker
10 who is great at locating difficult to locate
11 securities. And it may be a very different
12 price impact.
13 So an experience with one prime
14 broker is not necessarily going to carry over
15 to another one.
16 And then with respect to an
17 ordinary brokerage, again as investment
18 strategies change, as investments actually
19 made change, the price points are going to
20 change. And so a commission for a list of
21 security is going to be very difficult than
22 the charge if you're using a broker on an OTC

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1 security or if you're going to use a
2 derivative. And those price points aren't
3 going to be consistent from broker-to-broker
4 and may not be consistent over time as an
5 investment -- as a hedge fund or a fund of
6 funds, underlying fund of funds is changing
7 within its general investment strategies, is
8 changing these specific type of investments
9 that it's making.
10 So I think to the extent you try
11 to estimate what all those costs are going to
12 be going forward, that disclosure is likely to
13 be misleading. Because it really is just a
14 guess. And I think trying to put somebody in
15 a situation of providing a guess that may be
16 misleading is not particularly helpful.
17 I think it does benefit to a
18 benefit plan investors or any other investor
19 to say to the extent that we're using brokers,
20 we may use affiliates. To the extent you're
21 using affiliates, then you should say that
22 you're using affiliates. If you've used

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1 affiliates in the past providing disclosure,
2 for example, on what the past commissions or
3 the past expenses have been would be helpful.
4 So for example our due diligence
5 questionnaire, one of the questions there is
6 when you're talking about the expenses that
7 are going to get allocated to a fund, tell us
8 what those expenses what have been for the
9 last three years. We believe that type of
10 disclosure is helpful because that will allow
11 an investor to make a reasonable estimate of
12 what expenses will be like going forward or at
13 least allow them to question if future
14 expenses fall drastically outside of that
15 range.
16 PANEL MEMBER ZARENKO: Okay.
17 Thank you.
18 PANEL MEMBER DWYER: I have no
19 questions.
20 PANEL MEMBER CANARY: Some of
21 this, and this is probably an
22 oversimplification, seemed that the first

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1 premise was as a non-plan asset vehicle, that
2 you should be treated, I guess, similar to
3 what mutual funds were claiming, but not
4 really because you're primarily in the defined
5 benefit marketplace with potentially more
6 sophisticated investors. So you wouldn't have
7 the same kind of disclosure regime that would
8 be applicable in the mutual fund marketplace?
9 Is that about right?
10 MS. CHO: Well, I think there are
11 two elements. One of course is sort of, I
12 guess, obviously contrary to the history of
13 the regime that has applied to private funds.
14 They go through in the VCOC rules and REOC
15 rules definitely can be onerous to funds.
16 They go through these great lengths to avoid
17 this type of regulation or to avoid being
18 ERISA fiduciaries. So we don't even consider
19 a manager of a non-plan asset vehicle to be an
20 ERISA fiduciary. Neither does the benefit
21 plan investor who invests consider -- there's
22 no delegation of fiduciary authority between

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1 the plan investor and the manager of the fund.
2 So I think as a legal, that's sort
3 of the legal premise.
4 And I think that Ben brought up
5 some, I guess, sort of comment -- they are
6 distinctions, obviously between the industry.
7 I think revenue sharing, 12b-1 fees, it's
8 just not applicable to this industry.
9 PANEL MEMBER CANARY: Okay.
10 MR. ALLENSWORTH: And I think the
11 nature of the investors is important. I mean,
12 the security law regime differentiates between
13 mutual fund and hedge funds based on the
14 sophistication of the investor. And I think
15 that makes sense when you're talking about
16 large institutions that have the ability to
17 conduct extensive diligence and ask for the
18 information that they feel is material to
19 their investment, then it's less necessary to
20 have a regulatory regime laid on top of that.
21 And I think that's what you're talking about
22 when you're talking about hedge funds.

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1 PANEL MEMBER CANARY: Okay.
2 CHAIR CAMPBELL: Well if I can
3 interrupt for just a second.
4 I mean, to what extent do you
5 think that assumption is accurate that your
6 investments are more in the DB realm rather
7 than the DC?
8 MS. CHO: They are. They are.
9 MR. ALLENSWORTH: I can tell you
10 that for at least for the institutional
11 marketplace, so pensions, government plans,
12 unions, endowment foundations of a billion
13 dollars and up there's an SNP database which
14 tracks investments. And out of I believe 1300
15 or 1400 institutions on there, there are about
16 65 with defined contribution assets. Most of
17 those 65, the assets are going to real estate,
18 not to hedge funds. It's a very small number
19 of defined contribution plans that have
20 investments in hedge funds. Out of the few
21 that do, it's a very small percentage --
22 MS. CHO: I think they're doing it

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1 online through a brokerage window --

2 MR. ALLENSWORTH: Right.

3 MS. CHO: Also or through a

4 managed account that would mimic the strategy

5 of a hedge fund. There are issues of offering

6 a hedge fund as part of a 401(k) plan platform

7 primary because of everyone has to be either a

8 QP or an accredited investor, and there are

9 discrimination issues about it, you know. Not

10 all of the employees would be able to comply

11 with those types of requirements. And also in

12 terms of for funds that are trying to stay

13 under 100 beneficial owners, well what about

14 offering -- you know, offering it on your

15 contribution platform doesn't really work

16 because you would blow that exemption. So

17 there are like lots of reasons why the hedge

18 fund and private equity fund.

19 And then also private equity fund

20 investment are illiquid investments. And for

21 the 401(k) plan space when people need to get

22 in out of the -- you know, it just doesn't

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1 work with having them tied up in illiquid.

2 MR. ALLENSWORTH: That's right. So

3 there's a significant legal impediment to

4 getting 401(k) money into hedge funds. Again,

5 hedge funds basically fall under one of two

6 kind of general legal exemptions. One is

7 fewer than 100 investors. If the end

8 participant gets to decide where the

9 investments are going, you count that person,

10 not the plan investor. So for a hedge fund

11 that's relying on the fewer than 100

12 investors, a 401(k) plan would basically blow

13 their exemption.

14 The other one exemption for

15 3(c)(7) funds is qualified purchasers, again,

16 looking through to whoever the decision maker

17 is, means you've got to have $5 million of

18 investments if you're an individual.

19 So the limited plans that do have

20 401(k) or defined contribution, for example

21 Goldman Sachs I believe for some of their

22 senior people has a 401(k) plan that allows as

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1 one of the options investments in some Goldman
2 Sachs' hedge funds. It's a very, very small
3 universe of defined contribution money in
4 hedge funds. The overwhelming majority is
5 defined benefit.
6 CHAIR CAMPBELL: Okay. But you're
7 saying so but it does happen, predominately
8 it's happening through a managed fund itself
9 or through an open brokerage window.
10 MS. CHO: Yes.
11 CHAIR CAMPBELL: Or through just
12 an open brokerage window.
13 MR. ALLENSWORTH: That's right.
14 MS. CHO: Exactly. And then
15 they're subject to whatever the rules are of
16 that.
17 MR. ALLENSWORTH: Right.
18 CHAIR CAMPBELL: Okay. Thank you.
19 Sorry to interrupt.
20 PANEL MEMBER CANARY: That's all
21 right.
22 Then the other one was on the non-

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1 monetary comp or gift disclosure. You
2 distinguish not making disclosure where the
3 gift or the non-monetary comp is based on
4 overall relationship as opposed to any
5 connection with service that was be provided
6 to a plan.
7 MR. ALLENSWORTH: Yes.
8 PANEL MEMBER CANARY: Could you
9 talk a little bit more about that, especially
10 in the context of things that may be formula-
11 lack. Whether you end with a formula is what
12 governs whether you got this non-monetary comp
13 or gift. And, I mean for example in the
14 insurance area with our Schedule A advisory
15 opinion we were reviewing what's the sense of
16 compensation, it was not monetary but your
17 right to it or eligibility for it or the
18 amount of it may be based on business levels,
19 thresholds, breakpoints. And that plans may be
20 involved in establishing that threshold or
21 breakpoint.
22 When you're talking about overall

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1 relationship, how would you classify that kind
2 of formula in being disclosed or not
3 disclosed?
4 MS. CHO: I think we just sort of
5 thought about it differently. That there has
6 to be some causal relationship between the
7 relationship between the plan and this, I
8 guess the gift giver. I think someone brought
9 up the example of someone attending a
10 conference or a luncheon at -- I guess that's
11 sponsored by maybe a plan sponsor or an
12 affiliate. And we would hope that that type
13 of arrangement where they got some type of
14 benefit, whether non-monetary benefit wouldn't
15 be captured in these regs.
16 MR. ALLENSWORTH: I mean, I think
17 our overall goal with that comment was, to the
18 extent that there is a conflict or potential
19 conflict of interest, we recognize non-cash
20 compensation can give rise to conflicts of
21 interest that the regulation should focus on
22 the possibility of there being a conflict

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1 between the services being provided to the
2 plan asset fund and the non-cash compensation
3 being received.
4 So if your example of the total
5 business, and so there's the possibility of
6 something being attributed back to the plan
7 assets, that's sort of there, then that might
8 be a situation where disclosure is
9 appropriate. But really focusing on the
10 conflicts of it and whether or not there's
11 material conflict or a potential material
12 conflict that should be disclosed.
13 PANEL MEMBER CANARY: All right.
14 Thank you.
15 PANEL MEMBER CAMPAGNA: Focusing a
16 little bit on the plan asset vehicles, where
17 you are -- do you acknowledge that you would
18 be fiduciary --
19 MS. CHO: Of course. Of course.
20 PANEL MEMBER CAMPAGNA: Of course
21 if it's a plan asset vehicle. But I take it
22 your position is that QPAM would cover you for

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1 transactions involving that fund?
2 MS. CHO: Well, of course the
3 exemption that's used is QPAM. Of course, if
4 the QPAM decides to use an affiliate, they
5 will need to comply with other exemptions for
6 services.
7 PANEL MEMBER CAMPAGNA: Right. But
8 just the mere investment itself. The QPAM
9 exemption, as I understand it, it's been a
10 while, really deals with transactions that
11 between the fund and related parties, you know
12 buy and sell kind of transactions, it really
13 doesn't deal with the investment in the actual
14 fund. So would you still make the argument
15 that fee disclosures associated with being a
16 fiduciary would not apply in this context or
17 should be covered under the QPAM? I'm just
18 trying to understand where QPAM fits in the
19 fee disclosures if you are, in fact, an
20 acknowledged fiduciary.
21 MS. CHO: I thought you would ask
22 this question.

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1 I mean I think that, first of all,
2 there's disclosure already to the plan
3 investors as to what the exact fees will be
4 and the expenses will be of the fund.
5 The QPAMs, you know, as ERISA plan
6 fiduciaries have every incentive to lower fee
7 costs and expenses because they go against net
8 asset value of the fund and will affect the
9 performance of the fund, the performance fees.
10 I think that whether any -- I'm actually
11 personally advising ERISA plan asset funds all
12 the time, I sort of feel that the exemptions
13 that exist sort of work together fairly well
14 and beautifully, actually. And so I do
15 believe that there already is this disclosure
16 on expenses already naturally in OM and the
17 prospectus. So I'm not quite sure as to --
18 and if they are using affiliates and there
19 might be a conflict of interest, well then
20 there is certainly other exemptions that the
21 QPAM would have to comply with. So I'm not
22 seeing a necessity for an additional layer of

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1 disclosure that's in the QPAM exemption or
2 amendment of the QPAM exemption.
3 PANEL MEMBER CAMPAGNA: I'm just
4 trying to understand what the investor gets
5 with regard to your fees, if in fact it's a
6 plan asset vehicle? How does that work? Is it
7 just a subscription agreement, that kind of
8 thing that they read and then figure out
9 what's going on with respect to fees?
10 MS. CHO: No. I mean, the
11 perspective which just goes with the
12 management fees are usually one and a half to
13 three percent from fund-to-fund. And then
14 there's, of course, the performance fee.
15 The OM will disclose exactly what
16 expenses will be picked up by the limited
17 partners. And, of course, those expenses will
18 have to be necessary, direct and reasonable
19 expenses. Things such as, you know, research
20 that may not exactly benefit the plan asset
21 plan that cannot be charged to plan investors
22 already. I mean entertainments or other gifts

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1 that the managers of the fund may get that
2 have nothing to do with it, will not allow
3 that to be charged to the plan investor.
4 So I think ERISA regime already
5 provides protection as to the types of fees
6 that can and can't be charged to plan
7 investors. And our guidelines when we advise
8 ERISA plan asset funds, the fees have to be
9 necessary, direct and reasonable.
10 PANEL MEMBER CAMPAGNA: Yes.
11 Does your organization represent
12 offshore funds as well?
13 MR. ALLENSWORTH: Yes.
14 PANEL MEMBER CAMPAGNA: Now what
15 kind of regime would there be with respect to
16 those offshore funds and disclosures of
17 internal fees?
18 MR. ALLENSWORTH: The disclosure
19 is going to be --
20 PANEL MEMBER CAMPAGNA: When you
21 have plan asset vehicle?
22 MR. ALLENSWORTH: Right. And the

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1 disclosure if it's an offshore fund that has a
2 U.S. adviser, which is the typical case
3 although there are actually a number of
4 offshore funds with offshore advisers. But
5 for an offshore fund with a U.S. based
6 adviser, the disclosure is going to be the
7 same. Because it's going to be governed by
8 U.S. securities laws. It's going to be
9 governed by the Advisers Act. And it's going
10 to be governed by ERISA if it's a plan asset
11 fund.
12 So offshore fund U.S. adviser,
13 you're going to have exactly the same
14 disclosure regime. If it's an offshore fund
15 with an offshore adviser, then you're going to
16 have issues. You know, actually the question
17 is going to become whether or not they're
18 subject to U.S. laws. But if they are, then
19 the fact that it's offshore is not going to
20 change the disclosure.
21 PANEL MEMBER CAMPAGNA: And what
22 kind of disclosure is there with respect to

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1 the use of derivatives, for instance, and fees
2 associated with that? I mean, it is a
3 contract between two parties, yourself and a
4 counterparty, for instance.
5 MS. CHO: Yes.
6 PANEL MEMBER CAMPAGNA: Would
7 there be fees associated with that or do you
8 net out something to disclose to potential
9 investors in a plan asset type situation?
10 MR. ALLENSWORTH: There are fees
11 associated with it. I mean you're paying some
12 sort of fee to the counterparty in exchange
13 for the exposure to the return that you're
14 getting for the derivative contract. That's
15 going to be part of the trading costs which
16 fund will disclose in various ways, some of
17 them may break it out individually. But what
18 every investor is going to get, they know the
19 management fee, they know the performance
20 fees. Those are disclosed very clearly up
21 front. The types of expenses that are going to
22 be passed through to the front are disclosed

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1 up front. And then when you're getting
2 performance results, you're getting net
3 performance results. So you're seeing all the
4 other admin expenses backed out of the
5 numbers.
6 PANEL MEMBER CAMPAGNA: Okay.
7 MR. ALLENSWORTH: I mean, the
8 market is very competitive. And between
9 broker dealers the rates are fairly, I think,
10 identical. I mean, from my experience. You
11 don't see a great variance between different,
12 I guess, financial institutions--
13 MR. ALLENSWORTH: For the same
14 type of product.
15 MS. CHO: -- for the same type of
16 product.
17 MR. ALLENSWORTH: Right. It's
18 obvious between different products you get
19 different fees. And then to the extent again,
20 I mean I think part of the key is who are the
21 investors are. To the extent a large
22 institutional investor wants additional

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1 disclosure, they'll ask for it. And generally
2 speaking if they ask for it, they will get it.
3 And generally speaking if they ask for it,
4 they will get it. So you have both the
5 securities world telling you what you have to
6 disclose as a matter of materiality and then
7 you have the practical effect in the hedge
8 fund world which is when you're dealing with
9 large sophisticated investors, they ask for
10 the information they want that's material to
11 them and that's provided to them; or if it's
12 not, they don't invest.
13 PANEL MEMBER CAMPAGNA: Okay.
14 Thank you.
15 PANEL MEMBER BUTIKOFER: We've
16 heard the testimony that it's going to be
17 extremely costly to comply with the
18 disclosures. And my question is is how much
19 of the disclosure is going to require you to
20 tailor the disclosure for each individual
21 customer client versus, you know, kind of a
22 cookie cutter approach, if you want to say

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1 that, of I can use the same disclosure for
2 everybody?
3 MR. ALLENSWORTH: I think
4 particularly in talking about the conflicts
5 language, it's going to be impossible to
6 tailor it or impossible to do a blanket
7 disclosure. Because you're going to have to
8 know what all the relationships are that the
9 plan investor will have to see if their
10 relationships or if you have relationships
11 with anybody they have relationships with. So
12 I think that's going to be on an investor-by-
13 investor basis you're going to be looking at
14 the relationships. And you're going to have
15 to continue monitoring and updating to make
16 sure that you’re capturing new relationships
17 as they come in.
18 On the fee disclosure, again, as
19 new brokers come on, as new service providers
20 come on, then you're going to have an
21 obligation to update that as well. Although I
22 think that probably -- that's less of a cost

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1 compliance burden because that type of
2 disclosure is going to be made after the fact
3 anyway. And I think it's a matter of timing
4 rather than whether or not the disclosure gets
5 made. But I think the conflicts language, as
6 broad as it is, is going to be necessarily
7 tailored to each individual investors and
8 constantly monitored and updated.
9 PANEL MEMBER BUTIKOFER: All
10 right. Thank you.
11 CHAIR CAMPBELL: Thank you.
12 Next up is Ms. Mineka with
13 Covington & Burling. And I hope I pronounced
14 that correctly.
15 MS. MINEKA: It's actually Mineka.
16 CHAIR CAMPBELL: Mineka.
17 MS. MINEKA: But no one gets it
18 right on the first try.
19 Well, good afternoon. My name is
20 Katherine Mineka. I'm here from Covington &
21 Burling, LLP. We greatly appreciate the
22 opportunity to comment on the proposed

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1 amendment to the Department of Labor
2 regulations and to speak with you today.
3 Covington & Burling represents
4 both unregistered investment funds and their
5 managers, as well as the employee benefit
6 plans that invest in such funds.
7 Our comments today focus on the
8 impact of the proposed regulation on service
9 providers to unregistered investment funds,
10 particularly those funds that are not deemed
11 to be holding plan assets under the current
12 Department of Labor guidance.
13 The central issue that I would
14 like to discuss today is the application of
15 the disclosure provisions to funds that are
16 not deemed to be holding plan assets. This is
17 an area that the Managed Funds Association has
18 covered a bit. I think it bears additional
19 discussion.
20 The fee disclosure regulation
21 interprets section 408(b)(2) of ERISA which
22 provides a statutory prohibited transaction

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1 exemption for reasonable service arrangements
2 between plans and their service providers.
3 And while looking at the regulation on its
4 face, the fee disclosure requirement appears
5 to apply only to a person or an entity that is
6 providing services directly to a plan, it's
7 our understanding that the Department is
8 considering applying these regulations to
9 service providers to a fund that is not
10 actually holding plan assets.
11 As described in greater detail in
12 our written comments, extending the fee
13 disclosure requirement to non-plan asset funds
14 would be contrary to the Department's long
15 standing position with respect to these funds
16 and potentially detrimental to plan's ability
17 to diversity their investments through these
18 funds.
19 The Plan Asset Look-Through Rule
20 established by the Department makes clear that
21 when an employee benefit plan acquires an
22 equity interest in an operating company or in

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1 an entity in which equity participation by
2 benefit plan investors is under 25 percent,
3 the plan's assets do not include any of the
4 underlying assets of the entity. As a result,
5 the manager of the non-plan asset fund is not
6 considered to provide investment management
7 services to the plan and is not subject to
8 ERISA's fiduciary duties provisions.
9 In addition, a transaction between
10 a non-plan asset plan and a third party is not
11 considered to be a transaction with a plan
12 and, thus, is not subject to the prohibited
13 transaction restrictions in ERISA and under
14 the Internal Revenue Code. This "Look-Through
15 Rule" properly recognizes that when an
16 employee benefit plan purchases an equity
17 interest in a non-plan asset fund, the plan is
18 making an investment, more akin to purchasing
19 a security rather than hiring the fund's
20 manager as a service provider to provide
21 investment management services. And this is a
22 position taken by the Department that's been

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1 endorsed by Congress and expanded when
2 Congress added section 3(42) to ERISA in the
3 Pension Protection Act.
4 So when a plan makes an investment
5 in a non-plan asset fund, the plan fiduciary
6 is not entering into an arrangement to acquire
7 services. And so the fiduciary does not really
8 need to evaluate whether the compensation paid
9 to the managers meets the requirements for the
10 408(b)(2) exemption any more than the
11 fiduciary would need to evaluate the
12 reasonableness of the compensation paid to the
13 employee of an operating company if the plan
14 were purchasing shares in an operating company
15 on the stock market, for example. And so
16 based on that analysis, if the entity isn't a
17 service provider to the plan, it's unclear how
18 it would be considered a party in interest
19 such that the contract with the fund would be
20 a potential prohibited transaction that would
21 need relief under 408(b)(2) under another
22 exemption.

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1 Furthermore, with respect solely
2 to the manager of that fund, it's difficult to
3 see how we could apply the fee disclosure
4 requirement to the manager without also
5 classifying the manager as a fiduciary for the
6 purposes of ERISA. If the manager of the non-
7 plan asset fund is deemed to be providing a
8 service, that service will be a form of
9 investment advice or investment management
10 which would meet the functional test under
11 ERISA 3(21) to be an ERISA fiduciary. And then
12 that sort of unravels as you then have to look
13 to how was the manager appointed, is the
14 manager acting as an investment manager, were
15 they appointed under 3(38); sort of how all of
16 those established fiduciary rules and the
17 guidance thereunder that the Department has
18 put out, how that will all fit together in
19 that circumstance.
20 So in this case both the
21 Department and Congress have recognized in the
22 past that the Look-Through Rule is expressly

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1 designed to avoid treating the manager as an
2 ERISA fiduciary, and we think that's the
3 proper result in these situations.
4 On a practical level, employee
5 benefit plans have relied on the Look-Through
6 Rule to diversify their investment portfolios
7 and to invest in sophisticated financial
8 products. And managers of those portfolios
9 have relied on the Look-Through Rule to ensure
10 that they're not subject to additional
11 regulation or fiduciary liability under ERISA
12 if they accept plans as investors. This is
13 especially true for non-U.S. funds that may be
14 subject to regulation in their home countries
15 and that generally try to avoid being subject
16 to U.S. regulation, either under ERISA or
17 under the securities laws through compliance
18 with the relevant exemptions.
19 If the fee disclosure requirements
20 were extended to non-plan asset funds, this
21 would create an additional compliance burden
22 and the potential for fiduciary liability, or

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1 even the potential for confusion regarding
2 whether these managers would be treated as
3 ERISA fiduciaries could cause fund managers to
4 simply exclude employee benefit plans from
5 their investment vehicles. And also if they
6 did allow them to continue, there would be a
7 significant compliance burden that would get
8 passed along in the costs to the investors,
9 including the plans.
10 So therefore, we think that
11 extending fee disclosure to the non-plan asset
12 funds is inconsistent with the sort of
13 existing fiduciary framework and would not
14 really advance any policy needs at this point.
15 And with the consequences for plan investors,
16 it would be quite negative. And it would limit
17 their investment options and would generally
18 could cause them to have to withdraw from
19 investments that they're currently in at a
20 loss.
21 So one thing we've mentioned in
22 our comments is to the extent that the

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1 Department feels that the need for further
2 disclosure in this area is something that the
3 Department would like to explore, this is an
4 area where we think that a separate rulemaking
5 and a separate notice and comment period would
6 be appropriate, both because this issue has
7 come up sort of in the discussions that have
8 been ongoing since the proposed regulation was
9 published and I think the plans and the fund
10 managers have not necessary had an opportunity
11 to really understand the Department's position
12 and the Department's concerns and also
13 therefore not been able to think through and
14 give their feedback. And for all of us to come
15 together and understand sort of what the
16 issues are. And if further disclosure is
17 something that the Department's interested in,
18 what an appropriate way to implement would be
19 without causing these other sort of
20 significant issues.
21 And we think that separate
22 rulemaking would be beneficial both because it

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1 would allow the Department to address the
2 potential conflict that this would set up
3 within the existing guidance under ERISA, but
4 it would also really allow us to develop a
5 more full record with all of the plans as
6 investors and the fund managers. And, you
7 know, sort of allow everyone to participate
8 and be fully aware of this issue.
9 Now putting aside for a moment the
10 possibility that a service provider or an
11 investment manager to a non-plan asset fund
12 could be required to comply with the
13 disclosure requirements, assuming that that
14 is not the case and these requirements would
15 only be applied to plan asset funds, we think
16 it's important that the final guidance address
17 the possibility that a fund can change its
18 status and initially begin its life as a non-
19 plan asset fund and then either by design or
20 due to a change in the status of one of its
21 investors find itself sort of midstream
22 subject to the disclosure requirements. As

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1 written, it's unclear how that fund manager
2 and how those service providers, and how the
3 fiduciaries making investment could comply.
4 And so we think it would be helpful for the
5 final regulation to specify that both those
6 requirements would only be required at the
7 time that that conversion occurs. But also
8 that there's a mechanism and a time frame for
9 actually providing the necessary disclosures
10 that the plan fiduciaries need.
11 And another issue that we had
12 raised in our comment, and I think it was
13 discussed earlier today, is the ability of
14 employee benefit plan investors to rely on the
15 existing statutory cost and individual
16 prohibited transaction exemptions, most
17 particularly the QPAM and the INHAM exemption.
18 We request that the Department
19 clarify that service arrangements established
20 in compliance with the QPAM or the INHAM
21 exemption are not required to also satisfy the
22 requirements for relief under 408(b)(2).

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1 Looking at it from a policy
2 perspective, plan fiduciaries are required to
3 avoid entering into prohibited transactions,
4 in part because they represent situations in
5 which there is a meaningful potential for
6 self-dealing or for an undue influence on the
7 plan or some way in which the counterparty can
8 influence the plan's decision. And the
9 statutory exemption 408(b)(2) handles this in
10 one way, which is to say that the relationship
11 and the contract will be deemed not to be a
12 prohibited transaction if it meets certain
13 requirements and if there's certain
14 disclosures made and so that it's viewed as
15 reasonable in that way. And the QPAM and in
16 the INHAM exemptions address this potential
17 for a conflict and for undue influence by
18 saying if the plan has a sophisticated
19 independent third party that is knowledgeable
20 in these areas make that decision, that third
21 party, that QPAM can get the necessary
22 information and make an appropriate decision

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1 and cannot be unduly influenced. So we think
2 that it's important to have both options and
3 that they come from sort of different
4 perspectives.
5 And finally with respect to QPAM
6 and INHAM exemptions, they were obviously
7 developed quite a while ago with careful
8 consideration by the Department of Labor and
9 with input from all of the relevant parties.
10 And the Department has come to a determination
11 that the exemptions are feasible and they're
12 in the best interest of the plans and the plan
13 participants, and that they are protective of
14 the rights of the plan participants.
15 And, you know, until a
16 determination is made that there is a
17 potential problem with these exemptions or
18 something that needs to be remedied, we think
19 it's appropriate to leave them as they are and
20 to allow plan fiduciaries to continue to rely
21 on them.
22 A third issue that we would like

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1 to discuss relates to the service providers to
2 an investment fund that is in fact deemed to
3 be holding plan assets. And here this relates
4 to what I think was referred to earlier as the
5 third category of service providers that are
6 required to disclose only their indirect
7 compensation under these rules.
8 And here the situation that we're
9 concerned about is the situation where a fund
10 is deemed to be holding plan assets,
11 particularly because 25 percent or more of its
12 equity is held by plans and benefit plan
13 investors. And so under these circumstances
14 service providers to the fund could be deemed
15 to be service providers to the plan. And the
16 fund is then paying these service providers
17 out of the fund's assets.
18 So it's proportional to every
19 investor in the fund. However, if reading the
20 definition of indirect compensation, which is
21 compensation from any source other than a
22 plan, a plan sponsor or service provider, you

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1 have a situation where the plan is perhaps
2 deemed to be receiving a service from this
3 service provider, but part of the compensation
4 that the service provider is receiving could
5 be attributed to the other investors. Sort of
6 everyone's paying their proportional share,
7 but what we would just like to have made clear
8 is that that is not the kind of indirect fee
9 arrangement that the Department is concerned
10 with. And that those arrangements would not
11 be deemed to require a disclosure on the part
12 of the service provider. Mainly because in
13 these situations the service provider --
14 everyone who is investing in the plan is
15 paying their proportional share of the service
16 provider's fee. So to the extent that the
17 plan is receiving services, they're also
18 paying for them. It's just that it's sort of
19 everyone's included as an investor in the
20 plan.
21 And then finally, as a number of
22 the comments have mentioned, we would like to

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1 request that the Department consider extending
2 the transition period at least to one year
3 from the publication of the final regulation.
4 As has been noted before, there are a lot of
5 complex relationships and contracts that need
6 to be considered and evaluated and
7 renegotiated. And especially in this area
8 because many of the non-plan asset funds
9 particularly take the form of a partnership or
10 an LLC in order to -- sometimes the case that
11 in order to modify their partnership documents
12 or their other disclosure documents they would
13 need to get the consent of all or a majority
14 of the partners. And that's simply just a
15 process that will take more than three months
16 in most cases. So in general we would like to
17 sort of join the group of commentators
18 requesting additional transition relief in
19 that area.
20 And that, in closing, I appreciate
21 the opportunity comment on the proposed
22 amendment and would be happy to discuss any

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1 questions that you might have.
2 CHAIR CAMPBELL: Great. Thank
3 you.
4 Let's start down here.
5 PANEL MEMBER BUTIKOFER: All
6 right. At the very end you mentioned the
7 extension of the contracts because of the
8 cost.
9 MS. MINEKA: Yes.
10 PANEL MEMBER BUTIKOFER: There's
11 also been suggestions that instead of sticking
12 the disclosure in contracts would just allow
13 just disclosures. Are you aware of a big cost
14 difference between doing one or the other,
15 other than the cost of having to reopen and
16 redo a contract? Would it make any
17 difference?
18 MS. MINEKA: That's an interesting
19 question. I think that part of the evaluation
20 for all of the funds would be to determine
21 where they're making these disclosures
22 currently and whether those disclosures need

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1 to be updated in the documents they're
2 currently in, whether they could be made
3 selectively to plans, whether other
4 regulations they're subject to might require
5 them to disclose them to all of their
6 investors.
7 I think that's an area that
8 perhaps would require them to consider other
9 legal considerations and other practical
10 considerations. So I'm not sure I have an
11 opinion on which way would be easier or would
12 be feasible. I think that's one of the reasons
13 I think more time is appropriate is because
14 there are other regulatory regimes that govern
15 disclosure that would need to be considered.
16 And that require input from a lot of different
17 parties.
18 PANEL MEMBER BUTIKOFER: Thank
19 you.
20 PANEL MEMBER CAMPAGNA: Basically
21 the same questions of the previous MFA who
22 testified. What is your experience with

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1 respect to the 401(k) defined contribution
2 market and non-plan asset vehicles. Do
3 defined contribution plans, directed account
4 plans actually use these non-plan asset
5 vehicles?
6 MS. MINEKA: I would agree with the
7 earlier comments that it's generally these
8 non-plan asset vehicles, the vast majority are
9 receiving investments from defined benefit
10 plans. And particularly because there are
11 significant securities law regulations that
12 limit -- these funds are generally structured
13 in such a way that they cannot accept either
14 more than 100 investors or cannot accept
15 investments from individuals or entities which
16 do not meet certain levels of sophistication.
17 So although there is some SEC guidance that
18 would permit it to offer one of those funds,
19 even in part to 401(k) participants, is quite
20 difficult and I think is quite uncommon.
21 PANEL MEMBER CAMPAGNA: And now
22 with respect to plan asset vehicles, you

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1 advocate that QPAMs should apply. And again
2 when a QPAM -- I guess you would acknowledge
3 that there would be a fiduciary in that case,
4 right?
5 MS. MINEKA: When there's a plan
6 asset vehicle, to the extent that the
7 investment manager is also acting as a QPAM,
8 yes, that investment manager by virtue of
9 their status as an investment manager would be
10 a fiduciary.
11 PANEL MEMBER CAMPAGNA: So when
12 that manager uses other service providers to
13 service the fund, what would be your take on
14 their service provider status with respect to
15 that plan asset fund?
16 MS. MINEKA: The service providers
17 to the plan?
18 PANEL MEMBER CAMPAGNA: To the
19 plan asset fund.
20 MS. MINEKA: Oh, I'm sorry. To the
21 fund?
22 PANEL MEMBER CAMPAGNA: Yes.

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1 MS. MINEKA: I think in some
2 situations those relationships could be
3 covered by the investment manager and keep him
4 entering into it using the QPAM exemption. I
5 think that obviously that would not apply to
6 relationships with the QPAM itself or its
7 affiliates. Just because those relationships
8 generally are not covered by the QPAM
9 exemption.
10 PANEL MEMBER CAMPAGNA: Right.
11 MS. MINEKA: So I think those
12 relationships would need to rely on the
13 exemptions that they have traditionally relied
14 on. And to the extent that they have
15 traditionally relied on the 408(b)(2) relief,
16 they would be subject to any changes in that
17 relief.
18 PANEL MEMBER CAMPAGNA: So say the
19 investment manager uses a broker to transact
20 business for the plan asset vehicle, they
21 would have to rely on one of the class
22 exemptions, say 86-128 as was mentioned?

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1 MS. MINEKA: Right.
2 PANEL MEMBER CAMPAGNA: And your
3 belief is that there is sufficient disclosure
4 there regarding conflicts and indirect
5 compensation received by the particular
6 service provider or broker? I mean, that's
7 what we're getting at with this regulation.
8 MS. MINEKA: Right.
9 PANEL MEMBER CAMPAGNA: Indirect
10 compensation and conflicts. So when you go to
11 a 86-128 you get commissions and you get a
12 written authorization. You know, how would we
13 square those two things?
14 MS. MINEKA: Well, I think with
15 any of the existing exemptions, sort of as I
16 discussed earlier, the exemptions offer
17 different ways of addressing sort of the
18 fundamental policy concerns that the
19 prohibited transaction rules under 406 are
20 getting at. And so I think prior to requiring
21 additional disclosure under any of the other
22 exemptions, I think it would make sense for

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1 the Department to reevaluate the exemption as
2 a whole and to determine if the rationale
3 still applies, if it's still operating as it
4 was intended. I mean, many of these
5 exemptions date to the '80s and early '90s and
6 seem to have been functioning very well up
7 until this point.
8 And so I think there it's a
9 situation where if the Department identifies
10 an issue with one of those exemptions, that
11 should be addressed within the context of that
12 exemption rather than sort of requiring the
13 relationship and the contract to go through
14 two different exemptions.
15 PANEL MEMBER CAMPAGNA: Okay.
16 All right. Thank you.
17 PANEL MEMBER CANARY: I only have
18 one question and I guess I should have asked
19 the last representative this, too.
20 So do you think that when you
21 shift from a non-asset vehicle to a plan asset
22 vehicle that you still end up with the same

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1 basic investor population? You're still
2 dealing with the institution DB plans or do
3 you think the nature of the investing
4 population changes beyond maybe just more
5 employee benefit plans?
6 MS. MINEKA: I would say in that
7 context you would not see a change in the plan
8 investor population. Because at least, and
9 this is just speaking broadly, to the extent
10 that we're looking at a situation where it's a
11 partnership or some other vehicle that's
12 comply with security law exemptions, once
13 again a large part of the restriction comes
14 out of the '40 Act restrictions which are not
15 going to change based on the percent of
16 benefit plan investors that are interested.
17 PANEL MEMBER CANARY: To remain
18 an unregistered investment fund would also
19 have to require with those requirements.
20 MS. MINEKA: Right.
21 PANEL MEMBER CANARY: Regardless
22 whether they're a plan asset vehicle?

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1 MS. MINEKA: Exactly.
2 PANEL MEMBER CANARY: Okay. Thank
3 you.
4 CHAIR CAMPBELL: Adrienne?
5 PANEL MEMBER DWYER: How does the
6 plan typically invest in these non-plan asset
7 vehicles? Do they just go to the fund
8 themselves? Who do they go through? What are
9 the scenarios?
10 MS. MINEKA: I think there are a
11 variety of ways. Once again, these investments
12 are generally entered into by large plans,
13 sophisticated plans. And so there they may
14 have a sophisticated staff in-house that is
15 looking into these investments. They may have
16 outside consultants that they work with or
17 advisors. So I don't think there's any one way
18 there. But I think it's generally -- and
19 there are limits and this is a bit outside my
20 area of expertise, but there are limits under
21 securities law on how things can be marketed.
22 And my understanding is most of these funds

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1 are sort of marketed within this limit. So
2 it's generally you have sophisticated parties
3 either in-house at the plan or that are hired
4 by the plan that are investigating these
5 investment opportunities.
6 PANEL MEMBER DWYER: Would one of
7 these plans be offered, for instance, on a
8 record keeper's platform, you know with IBM
9 stock and everything else?
10 MS. MINEKA: Do you mean in a
11 401(k) context or in a -- I guess -- because
12 generally --
13 PANEL MEMBER DWYER: I guess the
14 plan goes to a record keeper and the record
15 keeper says this is the platform we're
16 offering. I guess that would be a 401(k)
17 context.
18 MS. MINEKA: Right. In general, as
19 I said, I think there are opportunities to
20 offer these funds in a 401(k) context are
21 extremely limited. So I think that's not
22 something I've personally seen, but that may

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1 in fact in certain limited circumstances
2 occur. I think generally that's not been my
3 experience.
4 PANEL MEMBER DWYER: And who are
5 the investment personnel who get paid in
6 connection with the plan's investment? So I'm
7 not worried about FedEx and those type of
8 service providers. But who are the investment
9 people who are making money on these
10 investments?
11 MS. MINEKA: In the context of a
12 plan asset fund or a non-plan asset fund?
13 PANEL MEMBER DWYER: In a non-plan
14 asset fund, even though the plan's investing
15 in it?
16 MS. MINEKA: In a non-plan asset
17 fund obviously there are different structures,
18 but there usually is a -- you know, in a
19 partnership there would be a general partner.
20 That entity may or may not be the manager.
21 There's usually some entity that is acting as
22 the manager. There is always some entity that

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1 is acting as the manager that is making
2 investment decisions. And so there is -- that
3 is sort of the entity that receives the
4 management fee would potentially receive the
5 performance fee as well. And then, you know,
6 obviously there are other service providers to
7 the fund that provide brokerage or other
8 services.
9 So I think looking at the
10 investment management level, at least there's
11 usually one entity that's receiving the fee
12 there. And that may or may not be a
13 registered investment advisor.
14 PANEL MEMBER DWYER: Okay. Thank
15 you.
16 PANEL MEMBER ZARENKO: I just have
17 one more follow up question on this issue of
18 changing from a non-plan asset fund to a plan
19 asset fund. And I just want to understand
20 what the different reasons of that would be.
21 Is it often the case that that happens
22 inadvertently because it's hard to keep track

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1 of these percentages on a day-to-day basis?
2 Is it intentional on the part of the fund's
3 managers and advisors to decide that they just
4 want to take more assets from benefit plans?
5 Is it demand driven because more plans are
6 coming to you? How does that shake out?
7 MS. MINEKA: I think generally we
8 would be looking at the second situation,
9 which is it's a decision on the part of the
10 fund manager that with that particular vehicle
11 that previously they had limited benefit plan
12 investors. There's the decision that they
13 would like to increase that number or there is
14 a particular investor they're interested in
15 bringing into the fund. But I think perhaps
16 even more importantly for the guidance, it's
17 very rare but there is a possibility for the
18 fund manager that they will be given
19 information by one of their investors that is
20 incorrect as to the benefit plan investor
21 status of one of their underlying investors.
22 One of their investors that's maybe itself a

1 fund might decide to convert to a plan asset
2 plan and spring that change on them.
3 So I think it's important whether
4 it's addressing both the situation where the
5 fund might intentionally wish to make this
6 change, but even more when the fund manager
7 has done all of its diligence and has made its
8 best efforts to limit benefit investors or to
9 comply with another exemption to operate as a
10 VCOC. Maybe something happens with one of the
11 investments that that no longer complies. You
12 know, that that manager and that fund, there
13 needs to be -- and the other service providers
14 to that fund, there needs to be a mechanism
15 whereby they can comply with this exemption
16 and meet their obligations if there is a
17 change or if there is expected to be a change
18 midstream.
19 PANEL MEMBER ZARENKO: Okay. So
20 any other fact patterns where that shift
21 occurs that you think we should know about?
22 MS. MINEKA: I think those are the

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1 major ones. And I once again think that the
2 inadvertent changes is very rare, but I think
3 it would represent a significant enough -- it
4 represents a significant enough concern that
5 it is certainly addressed generally in fund
6 documents and there are restrictions on
7 transfer and things like that to avoid that.
8 So it's certainly something that fund managers
9 I think are aware of and recognize as an
10 unlikely possibility, but still a possibility.
11 PANEL MEMBER ZARENKO: Thank you.
12 PANEL MEMBER WIELOBOB: I don't
13 have any questions.
14 MS. MINEKA: Okay.
15 CHAIR CAMPBELL: Thank you very
16 much.
17 MS. MINEKA: Thank you very much.
18 CHAIR CAMPBELL: Our next witness
19 is David Certner from AARP.
20 MR. CERTNER: AARP is the
21 preferred.
22 CHAIR CAMPBELL: All right. AARP

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1 it shall be.

2 Thank the members of the Panel.

3 I'm David Certner, the Legislative Counsel and

4 Director of Legislative Policy at AARP.

5 Thank you for convening this

6 hearing. We appreciate the opportunity to

7 discuss these important issues under the

8 proposed reg. And we also appreciate what

9 must be a long two days for you up there on

10 the Panel.

11 Let me review some points we made

12 in our previous comments, which is that we

13 believe that all workers need access to a

14 retirement in addition to Social Security. As

15 you know, there are approximately 15 million

16 active participants in 401(k) plans which are

17 now the dominant pension vehicle.

18 As you also well know, and

19 certainly the recent months have born that out

20 even more, given the calls we've gotten from

21 many of our members, those participating in

22 these plans shoulder the risks and

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1 responsibilities for their investment choices
2 and ultimately their retirement security. As
3 you also well know, plan fees compound
4 significantly over time, the larger the fees,
5 the bigger the reduction out of one's ultimate
6 retirement security. And what we have found
7 is certainly that our members that we've
8 surveyed, the participants expect that their
9 first line of defense against unreasonable
10 fees is the due diligence that the plan
11 fiduciaries will take in choosing the plan
12 investment options.
13 You may have seen that we did a
14 survey last year. We surveyed 401(k)
15 participants to get either understanding of
16 fees and investment choices, which needless to
17 say were not high, but the survey results also
18 demonstrated that participants looked to the
19 plan administrators and the plan service
20 providers to provide the plan investment and
21 fee disclosures. And when asked who should be
22 responsible for ensuring that participants

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1 have a clear understanding of the fees
2 charged, 61 percent of respondents said
3 employers, while 52 percent replied financial
4 service companies that manage 401(k). Less
5 than half put that responsibility on the plan
6 participants. Thus, it's clear that the
7 participants are relying on plan fiduciaries,
8 both to ensure that plan fees are reasonable
9 and to provide them with the plan fee
10 information.
11 Now in order for the fiduciaries
12 to meet these expectations, plans need to
13 receive complete and accurate information in
14 one document in order to compare different
15 investment options. This is particularly true
16 of the smaller employers who again, as you
17 know, do not have the same cadre of
18 consultants and attorneys who can help assist
19 in the review and determination.
20 To the extent that fees impact
21 other plans like health and welfare plans,
22 particularly those for example which may be

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1 consumer driven health plans, then fees and
2 expense disclosure would also be necessary and
3 appropriate.
4 The comprehensive information on
5 plan fees and expenses will enable the
6 fiduciaries to fulfill their responsibility to
7 ensure the reasonableness of fees.
8 Fiduciaries performing the due diligence of
9 service providers and investment options need
10 to have access to cost associated with the
11 various components, not just total costs.
12 And, again, we would emphasize that requiring
13 the service providers to provide comprehensive
14 information to the plan sponsors is very
15 important to the participants since, as you
16 know, the costs are often directly passed on
17 to them.
18 Now we believe the Department's
19 proposed rules are a good start to ensure that
20 plan fiduciaries receive key information from
21 service providers to enable them to prudently
22 select and monitor their service providers.

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1 We support the regulations general
2 disclosure requirements that all information
3 be disclosed in advance and in writing.
4 There's a full description of all services to
5 be provided to the plan under the contract and
6 that a description of all direct and indirect
7 compensation and the manner in which it was
8 received is provided to fiduciaries.
9 We believe that fiduciaries should
10 already be examining this type of information,
11 quite frankly.
12 We recommend explicitly that a
13 statement that compliance with this exemption
14 does not mean they're generally compliance
15 with fiduciary duties. And we would recommend
16 that the final regs explicitly state that
17 compliance with the final disclosure regs does
18 not necessarily mean that the fiduciary has
19 complied with his general fiduciary
20 obligations. Plan fiduciaries, obviously,
21 have the obligation to read and evaluate and
22 make prudent decisions in light of the

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1 disclosure they have received. And, of course,
2 fiduciaries must have adequate time to
3 evaluate the information they have provided.
4 And, indeed, we think plan fiduciaries have
5 the obligation to request additional
6 disclosure information if it would be prudent
7 to do so.
8 The second issue is disclosure of
9 fees for bundled services. We recommend that
10 services be unbundled, but we certainly find
11 with unbundling there are certain broad
12 categories.
13 We recommended four categories;
14 initiation fees, investment fees, plan
15 administration fees, determination fees. And
16 that the fees for those general categories be
17 disclosed.
18 We also support a bright line
19 requirement that all indirect compensation
20 including revenue sharing be disclosed to plan
21 fiduciaries.
22 Now as to the manner of

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1 disclosure. We recommend that the manner of
2 disclosure to plan fiduciaries, and we think a
3 good model for this and being consistent with
4 what the Department of Labor speed disclosure
5 document on your website is. That the fee
6 information should be given to the plan
7 fiduciary in one document in a consistent
8 manner so that the fiduciaries actually can
9 perform an apples-to-apples comparison of the
10 providers and more easily evaluate the
11 reasonableness of fees.
12 We also would recommend that the
13 fees be set forth as a percentage of assets to
14 allow for a greater ease comparison,
15 regardless of whether they're actually charged
16 in this manner. And, obviously, this is even
17 critical for a smaller employer.
18 We would say if you're committed
19 to letting service providers provide fee
20 information by incorporation and by reference,
21 then at a minimum the service provider should
22 be required to inform the fiduciary exactly

1 where the information is located, we mean the
2 document and the page number. But still
3 having people go these stacks of documents to
4 find this information is clearly not as useful
5 as it would be to provide this information in
6 one useful document that can compare with
7 other documents.
8 We also think you should be more
9 explicit about the frequency of review of fees
10 and disclosures. The regulation should
11 explicitly state that the service provider's
12 obligation to provide information concerning
13 fees and a fiduciary's obligation to request
14 information concerning fees doesn't end after
15 the service provider contract is executed. We
16 suggest that either in the reg or in guidance
17 that the Department specifically state that
18 the monitoring of these service provider
19 contracts should occur at a minimum on an
20 annual basis.
21 I would just conclude by saying
22 that the significant impact of fees on

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1 retirement security highlights the need for
2 clear investment and fee information. The
3 greater the disclosure that's required, the
4 better the plan fiduciaries can perform their
5 due diligence and monitor the service
6 providers, the more likely the fees will
7 decrease and ultimately this will lead to
8 greater retirement security for participants.
9 And I know it's been a long day,
10 but I'll be happy to answer any questions you
11 might have.
12 CHAIR CAMPBELL: Well, I was
13 wondering if you could start out by explaining
14 in a little bit more details your concern that
15 caused you to recommend that we have explicit
16 requirement in the regulation regarding
17 fiduciary duty beyond the particular
18 disclosure here?
19 MR. CERTNER: That just because
20 you meet this exemption --
21 CHAIR CAMPBELL: Right.
22 MR. CERTNER: -- doesn't mean

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1 maybe your fiduciary obligation is ending. You
2 may need to do more. So if what you've
3 gotten, for example if the information you've
4 gotten had led a prudent person to believe
5 they need to request or get additional
6 information, they still have a general
7 fiduciary obligation to do that as well.
8 CHAIR CAMPBELL: But that needs to
9 be expressly stated?
10 MR. CERTNER: I think it would be
11 useful. I mean, it may implicit and understood
12 to you, but I think it's useful to be clear
13 about that in the guidance you put forward.
14 CHAIR CAMPBELL: Okay. And also
15 you had mentioned the one document containing
16 sort of all the disclosures. We heard a lot
17 of testimony over the last two days about
18 whether it needs to be whatever is currently
19 there, whether there's a summary document or
20 some sort. By one document do you mean
21 literally one place where all the information
22 is complied or simply a document that shows in

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1 sort of one executive summary where other
2 information might be by reference?
3 MR. CERTNER: Well, that would be
4 a less desirable fallback. I think we should
5 have the one document that the fiduciaries can
6 actually look at and compare so they can
7 easily compare apples-to-apples from different
8 kinds of plans, it's all in one document. If
9 you have, well you can go to this document and
10 you find it here and this document you find it
11 here; that would require a lot more work and
12 it would have to be a lot more specific about
13 where you could find that information. And
14 clearly it will not be as helpful if we could
15 have all that information together in one
16 document where you could basically see that
17 readily and easily as opposed to having to go
18 track it down in what may be a multitude of
19 documents and prospectuses that might be in
20 front of the plan.
21 CHAIR CAMPBELL: Okay. Let's
22 start down here.

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1 PANEL MEMBER BUTIKOFER: So we've
2 heard testimony that this is possibly very
3 expensive to get all these disclosures out.
4 So merely getting the disclosure out doesn't
5 necessarily translate into a benefit either.
6 So the question that arises is if the
7 fiduciary is able to obtain all this
8 information, in whatever form, you've
9 mentioned and we've heard testimony previously
10 that this additional fee transparency has a
11 possibility of lowering fees. But can you
12 think of other benefits that we can obtain by
13 this costly disclosure?
14 MR. CERTNER: Well, I think the
15 comparison is really if you look at what large
16 companies are able to do versus smaller
17 companies. Large companies are all ready to
18 get much of this data, obviously, and more
19 leverage, they can make better decisions and
20 have better fee arrangements for their
21 employees. Now hopefully just the fact that
22 we have transparency and sunshine and

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1 transparency in general we think in many areas
2 has led to reduced fees. I think ultimately
3 for the plan participant, and certainly from
4 our perspective, that's what we're looking at.
5 What is the direct impact on plan
6 participant? I think we've seen cases where
7 arrangements and conflict of interests are too
8 high.
9 What may seem like small
10 adjustments in fees, as you well know, can
11 compound pretty significantly for individuals
12 over time. We're talking -- well, if you take
13 even just 50 basis points can have absolutely
14 dramatic, you know 15-20 percent impact on
15 your ultimate retirement security. That's a
16 lot of money we're talking about.
17 So, yes, I agree there may be some
18 additional costs to this, but the providers
19 generally will have this information
20 available, they're providing it to some
21 customers already in most situation, even
22 where you have bundled providers are generally

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1 able to provide some of that information in an
2 unbundled way to some of the bigger clients.
3 And so having this information and to extract
4 it and provide it I don't think is necessarily
5 going to be as costly.
6 And I think that savings on the
7 other end for participants can be pretty
8 dramatic.
9 PANEL MEMBER BUTIKOFER: I haven't
10 heard any discussion on this topic, but you
11 seem to allude to that the large plans already
12 have the information and the small plans may
13 not. Is possibly another benefit to the
14 regulation is that I think it levels the
15 playing field between these two plans. We've
16 often heard that small employers are at a
17 disadvantage in trying to find and hire
18 employees, or whatnot, because it's harder to
19 get benefits. Is that something you see as a
20 possibility?
21 MR. CERTNER: Well, I'm not sure
22 that it will complete level the playing field

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1 because they'll never the total leverage and
2 the size we're talking about. But in terms of
3 at least being able to get the information, I
4 think it will definitely level the playing
5 field and be more advantageous, particularly
6 to smaller employers and those you may have
7 working for them who very often find it much
8 more difficult to get access to this
9 information.
10 I mean I think it's actually fair
11 to say from what I've been hearing that just
12 this whole discussion and airing of this
13 issue, both on the Hill and at the Department
14 in the last year, has enabled people to get
15 access to that information much more readily
16 and has helped drive down fees. And we've
17 heard a number of instances where providers
18 were almost voluntarily offering to come in
19 for lower fees, given all this sort of open
20 airiness on this whole fee issue.
21 So I think we've already seen
22 benefits, quite frankly, from some of this

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1 transparency.
2 PANEL MEMBER BUTIKOFER: All
3 right. Thank you.
4 PANEL MEMBER CANARY: Thank you.
5 I'm trying to get the scope of
6 what you're talking about here. It seems like
7 you're talking really about defined
8 contribution pension plans and again maybe
9 individually participant directed plans
10 primarily in the population that you're really
11 focused on with your comments. Is that fair?
12 MR. CERTNER: Well, I think that's
13 probably from most people's perspective where
14 the focus has been, where the individual is
15 going to be directly impacted by these fee
16 arrangements, which is primarily in the
17 individual contribution area, 401(k) area in
18 particular. But there's certainly other areas
19 where I think it could have direct individual
20 impact.
21 For example, I mentioned
22 potentially as part of health plans where you

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1 have, say, consumer driven plans and there are
2 assets involved.
3 There could be, for example, in
4 design benefit plans where you have for
5 example certain cash balance arrangements now
6 in define benefit plans, you have individual
7 account plans that actually may have some kind
8 of an individual fee component involved and
9 depending on what kind of assets you're in.
10 So it may extend beyond the typical 401(k)
11 defined contribution. I think that's where
12 the focused and the most heightened degree of
13 sensitivity has been, but I don't think that
14 that's exactly where it should exclusively
15 fall.
16 It may be that you need to do
17 other things in these areas as well. And then
18 that this is the first and most important area
19 to tackle now. But I don't think exclusively
20 in the defined contribution area.
21 PANEL MEMBER CANARY: Then the
22 comment like having one document, there's

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1 another prong of this initiative, which is
2 really participant level disclosure. And I'd
3 like to get your thoughts on I guess two
4 aspects of that single document approach. Is
5 the feasibility of doing that if you're in
6 some of these other environments where you're
7 not in the individual participant directed
8 defined contribution plan, do you think it's
9 more feasible to do that when you're in that
10 kind of a marketplace?
11 And number two, is some of this
12 really better served by getting that kind of
13 disclosure to the participant rather than
14 trying to get a single document approach when
15 you're dealing with getting information to the
16 fiduciary?
17 Sort of two not really related
18 questions.
19 MR. CERTNER: Well, let me take
20 the second part, which may be easier to
21 answer.
22 You know, disclosure to

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1 participants is going to be important. But I
2 think our experience is going to be that there
3 are not going to be a lot of participants who
4 going to be able to understand and/or take
5 action on a tremendous amount of disclosure.
6 That disclosure to participants, at least what
7 you provide them, is probably going to have to
8 be a little bit more basic in terms of what
9 they need to look at. With them, providing
10 them the ability, you go somewhere else for
11 those who want more information. I just don't
12 think we're going to be able to throw tons of
13 information at participants and expect them to
14 even be able to understand and analyze it. So
15 we're probably going to have openly think
16 about a more summary, even more different kind
17 of summary than we're talking about for the
18 provider, where we're hoping is certainly a
19 higher level of degree of being able to review
20 these fees at that kind of first line of
21 defense.
22 What we give to the individual is,

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1 by definition, I think going to have be scaled
2 back. And their ability to elsewhere to get
3 more of that information.
4 So it's a little bit of a
5 different kind of summary document that we
6 would have I think provide to individuals.
7 And as much some individuals may
8 be able to really dig down and go into this,
9 and look at this and understand this, I think
10 our experience has been that the bulk of
11 individuals are on automatic pilot in many
12 respects. And for some of these plans, and
13 that may even be increasing with the number of
14 automatic enrollments and other things we're
15 doing. And I think that makes it even more
16 difficult to give disclosure. Because we're
17 seeing that the individuals are, many if not
18 most individuals are not doing what maybe some
19 of us would think would adequate due diligence
20 from any individual perspective. But I don't
21 know how much we're going to change the
22 behavior at that level for most people. And

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1 so why it's so important that we're doing at
2 the employer level and the fiduciary level.
3 PANEL MEMBER CANARY: Fine. Thank
4 you.
5 CHAIR CAMPBELL: I don't have any
6 further questions.
7 PANEL MEMBER DWYER: No questions.
8 PANEL MEMBER ZARENKO: I'd like to
9 follow up on your concerns about the
10 continuing application of 404. I don't think
11 that's anything -- I mean, we clarified in our
12 preamble that a fiduciary is obviously still
13 subject to its general fiduciary obligations
14 under 404. Did not in the proposal have
15 anything in the regulation to that effect.
16 But I just want to understand I had always
17 sort of been thinking about the 404 issue as
18 making sure that plan fiduciary understood
19 that just you get all of the disclosures
20 required by the regulation does not mean it's
21 necessarily prudent to hire that service
22 provider. Prudence may still require that you

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1 get other offers. You still have to determine
2 whether the compensation is going to be
3 reasonable. There's more to it.
4 But now I'm wondering is your
5 concern that you think fiduciaries may have to
6 get more information from that particular
7 service provider than is required by the rule?
8 MR. CERTNER: Well, only if the --
9 well, let's put it this way. Let's give you
10 an example. But if the information you're
11 getting from that service provider for
12 whatever reason, if a prudent person in that
13 situation has seen the information you're
14 getting, sees something that would suggest
15 that they ought to get information, that there
16 might be a fiduciary obligation to look into
17 some kind conflict of interest or something
18 that looks out of the ordinary in the
19 disclosure they may have gotten. So it
20 wouldn't necessarily end with the disclosure
21 they got. But if something in there gave rise
22 to the notion well maybe I should ask another

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1 question, that any other prudent person here
2 would follow up on something I've seen in this
3 disclosure, there would be a general
4 obligation to do that.
5 PANEL MEMBER ZARENKO: Okay. So
6 it is sort of that latter issue that you're
7 talking about?
8 MR. CERTNER: Right.
9 PANEL MEMBER ZARENKO: That what's
10 required by our disclosure -- our disclosure
11 requirements may not be enough in a particular
12 case --
13 MR. CERTNER: Right.
14 PANEL MEMBER ZARENKO: -- with
15 respect to a particular service provider, and
16 that's what you think needs to be clarified?
17 MR. CERTNER: Right.
18 PANEL MEMBER ZARENKO: Okay. And
19 then termination fees, I think we've had other
20 commenters just ask, but they don't think it's
21 clear in our rule whether termination fees
22 have to be disclosed. Is your concern are

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1 they not currently disclosed or are you just
2 asking that we need to clarify this in our
3 final rule that those fees in fact do in fact
4 have to be disclosed?
5 MR. CERTNER: Yes. Yes. That
6 they should be disclosed.
7 PANEL MEMBER ZARENKO: Okay. So
8 you're not aware of issues currently that
9 those kinds of fees are not being disclosed?
10 MR. CERTNER: Not -- no, not
11 specifically.
12 PANEL MEMBER ZARENKO: Okay.
13 MR. CERTNER: We want to make sure
14 those would be included, though, in the fees.
15 Certainly.
16 PANEL MEMBER ZARENKO: Okay.
17 Thank you.
18 PANEL MEMBER WIELOBOB: I have a
19 quick -- I hope it's a quick scope question.
20 Sort of the follow up on what Joe was asking
21 you.
22 I'm more interested in the welfare

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1 plan side of this. And I have to admit, I
2 hadn't really, the interests of your members
3 hadn't really crystallized in my thoughts in
4 that regard, although I know that many of your
5 members are not retired persons. They're just
6 a certain age.
7 MR. CERTNER: Forty-five percent
8 of them.
9 PANEL MEMBER WIELOBOB: Forty-five
10 percent?
11 MR. CERTNER: Are still working.
12 PANEL MEMBER Wielobob:
13 Interesting.
14 So against that backdrop could you
15 just comment briefly on the breadth of your
16 membership's interests in the welfare plan
17 side of the disclosures?
18 MR. CERTNER: Yes. We've actually
19 been discussing this. And I would be the
20 first one to confess that our focus has been
21 like others really not on the health and
22 welfare side of things, but can see how these

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1 issues could be just as important on the
2 health and welfare side as well.
3 I'm not sure this set of rules you
4 have here is necessarily going to be exactly
5 applicable to the health and welfare side. And
6 it may be that you need to do something
7 additionally or secondary on that issue.
8 Because I am not sure that we have thought
9 through all those issues yet, exactly what the
10 implications would be. But I think there are
11 certainly some areas such as the one point out
12 where there could actually be that direct
13 impact on the participant as opposed to issues
14 that maybe the plan sponsor themselves is just
15 directly dealing with where this kind of fee
16 disclosure would have a direct impact on
17 people and should be disclosed as well.
18 So we have not thought through all
19 those ramifications, I will tell you quite
20 honestly. And our thinking is that there is
21 probably going to be a need to maybe break it
22 off and think some of those things through

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1 separately.

2 PANEL MEMBER ZARENKO: Thank you.

3 CHAIR CAMPBELL: All right. Thank

4 you very much.

5 And with that we come to Mr. Kevin

6 Wiggins of Jackson Kelly.

7 MR. WIGGINS: Good afternoon. My

8 name is Kevin Wiggins. I'm an attorney with

9 the law firm of Jackson Kelly. Jackson Kelly

10 is based in West Virginia. It has offices in

11 Colorado, Kentucky and here in the lovely city

12 of Washington, D.C.

13 Jackson Kelly provides two types

14 of services to employee benefit plans. It's a

15 law firm and it provides legal services in

16 connection with ERISA. And it also acts as a

17 record keeper, a third party administrator if

18 you will, for many plans.

19 And before I continue, I think I

20 need to say that what I say here is my own

21 informal opinions and does not reflect the

22 official opinion of Jackson Kelly or its

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1 members, much like you all say when you go to
2 your seminars at the Department of Labor.
3 I'm here today to discuss
4 primarily the distinctions between legal
5 services and consulting services. And I
6 missed Mr. Saxon's, I believe it was,
7 testimony. But I believe he discussed that.
8 Our firm provides both consultant
9 services and legal services to our employee
10 benefit plan clients. And for the most part
11 it's going to be easy for us to distinguish
12 between a consulting client that is part of
13 our TPA practice and our other clients who are
14 not part of TPA practice but come to us for
15 legal advice. The distinction I think can be
16 important, though, because as you know either
17 you're in or you're out on these regulations.
18 And if you're providing legal services and
19 don't get any indirect compensation, you're
20 out. That's the way I read the regulations.
21 I think it would be -- I would
22 like to recommend that the Department in its

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1 final regulations somehow recognize that when
2 it talks about legal services, first I would
3 like for it to -- if it believes prudent to do
4 so, to focus on the practice of law. Because
5 the practice of law is more a term of art that
6 is more understood, I think, than legal
7 services. So maybe it could be legal services
8 in connection with the practice of law.
9 And then also look at the focus of
10 the services being provided. Are the legal
11 services incidental to the services being
12 provided or are they primary focus? And
13 there's precedent for this in the case law
14 looking at what is the practice of law. I
15 think that might be helpful.
16 And that's all I have to say. It's
17 late in the day, and I know you've a hard two
18 days.
19 CHAIR CAMPBELL: You know, we had
20 a discussion with Mr. Saxon and Ms. Mazo,
21 looking at the different categories, the three
22 categories established in the regulation

1 governing its applicability. And so legal
2 services with respect to the practice of law
3 or otherwise would fall under the third
4 category. But I guess some of the other
5 services would likely be in the second.
6 And I'm wondering if you had any
7 thoughts in the discussion we had there that
8 dealt with is the second category superfluous
9 in that the third category might capture
10 anyone who had an indirect relationship? Is
11 there some uniqueness to the second category
12 that's not captured by the third?
13 MR. WIGGINS: Let me clarify what
14 I think you're asking. Are you asking about
15 consulting services and legal services, or all
16 of the categories in the second category?
17 CHAIR CAMPBELL: Well, either one.
18 I mean, the original context of the question
19 in the previous testimony came up with respect
20 to non-asset advising consulting services.
21 MR. WIGGINS: Yes.
22 CHAIR CAMPBELL: And then we went

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1 into a discussion of generally if the second
2 category were eliminated, do you lose anything
3 with respect to the intent of the regulation
4 given that the third category would capture
5 anyone with indirect comp if it were not
6 limited to certain types of services.
7 MR. WIGGINS: So are you asking if
8 you include the second category and the third
9 category, all the services in the second
10 category and third category and required
11 disclosure only if they get indirect
12 compensation? Is that what you're asking?
13 CHAIR CAMPBELL: Right.
14 MR. WIGGINS: Yes. I have not
15 thought about that. I don't know the answer
16 to that without further reflection on it. But
17 it seems to me that the two categories are
18 certainly different. They're not superfluous.
19 And it gets into how do you define these
20 terms, which is one of our questions.
21 But for example, how is accounting
22 in the third category different from record

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1 keeping? In many ways accounting is just
2 keeping the books of the entity.
3 I'm not sure what the answer to
4 that. But I think most practitioners would say
5 that there is a difference. Most in the field
6 would say record keeping is maintaining
7 records, particularly I'm talking about the
8 individual account balance plans. Record
9 keeping is maintaining the account balances
10 for participants on a participant level. I
11 mean, you may have record keepers who --
12 usually trustees, who keep records of the
13 entire plan assets. But throughout all those
14 services there's a lot of auditing going on
15 and all that accounting work going on. There
16 is some overlap, but I think the terms of art
17 there are some distinctions.
18 But to answer your question, I've
19 not given thought to whether you should put
20 all of those in the B categories within the C
21 categories and require disclosure only when
22 there's indirect compensation. I guess that

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1 would make sense. Because your focus I
2 understand is the indirect compensation.
3 CHAIR CAMPBELL: Okay.
4 PANEL MEMBER WIELOBOB: All right.
5 With the change you're talking about, legal
6 services becomes legal services incident to
7 the practice of law. That's what you said,
8 correct? Something like that?
9 MR. WIGGINS: Legal services that
10 primarily that are primarily focused on the
11 practice of law.
12 PANEL MEMBER WIELOBOB: Okay.
13 When I was at a big law firm and the employee
14 benefits group had these people that were
15 called non-professionals. They were non-
16 lawyer professionals, that's what it was. And
17 in the benefits group people used to refer to
18 them as “practicing law without a license.”
19 Who are you trying to get at with
20 the distinction? Paralegals? I'm just trying
21 to get my brain around the practical reality
22 of what you'd like to do.

1 MR. WIGGINS: What I'm trying to
2 get at is I will often provide what I think as
3 consulting services to our clients that are
4 not our TPA clients. But I think those
5 consulting services are incidental to the
6 practice of law, not the primary focus. And I
7 think many lawyers in many law firms do
8 provide consulting services that are
9 incidental to providing legal services, or to
10 the practice of law in connection with
11 advising the plan. But by inserting that
12 distinction I think it would be much easier
13 for law firms and our firms to take the
14 position that we're not primarily consulting,
15 we're primarily practicing law and therefore
16 we are a C category service provider not a B
17 category service provider.
18 CHAIR CAMPBELL: So would your
19 concern there be that the test for that might
20 vary from state-to-state based on what the
21 ethics rules in that given state are about
22 when you are providing legal services and when

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1 you're not?

2 MR. WIGGINS: Again, I think this

3 comes down to how you define it. And maybe you

4 want to put definitions in the regulations

5 itself. But I think it's very difficult to

6 articulate a precise definition that

7 distinguishes consulting services from legal

8 services.

9 I think what you're suggesting is

10 if you do default to the practice of law as a

11 term of art, then that could incorporate state

12 law principles and it could be considered to

13 vary from state-to-state. I don't think that

14 would be a good idea. I think it would be

15 contrary to congressional purposes to cram

16 state law and not to subject traditional plan

17 parties to state-by-state regulation.

18 CHAIR CAMPBELL: Okay. Oh, for

19 the record, I wasn't suggesting that. I was

20 just trying to see what you were getting at.

21 If we didn't address this issue, what your

22 concern might be about what would apply in

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1 lieu of addressing the issue.
2 MR. WIGGINS: My biggest concern
3 is I don't want to look over my shoulder every
4 time I give a consulting advice and think, oh
5 my goodness do I have the right contract with
6 this engagement letter with this client now
7 that I'm giving --
8 CHAIR CAMPBELL: Right.
9 MR. WIGGINS: -- then consulting
10 advice and do I need to hang up the phone and
11 draft a new engagement letter and send it to
12 the client --
13 CHAIR CAMPBELL: Gotcha.
14 MR. WIGGINS: -- and say "Oh, now
15 I'm your consultant." If I'm primarily
16 providing legal advice.
17 CHAIR CAMPBELL: Okay. Sorry I
18 jumped in front.
19 PANEL MEMBER WIELOBOB: No, that's
20 -- I'm good. I'm done.
21 PANEL MEMBER DWYER: So I just
22 want to make sure I understand what you're

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1 asking us to do. That you have two sets of
2 services you provide, TPA services to plans
3 and administrative and then consulting
4 services that are really part of your
5 practicing law. And what you would like to do
6 is take that latter category and make it clear
7 that that's in category 3 under the reg?
8 MR. WIGGINS: I don't think that's
9 quite accurate. If that's what I said, I
10 misspoke.
11 I don't think that I provide
12 consulting services on a regular basis. If I
13 do, it's rare and it's only incidental to
14 providing the legal advice, the legal services
15 to perhaps a plan administrator or the plan
16 trustee. I think it would be very rare for me
17 to provide consulting services. But I think
18 it does happen from time-to-time and it
19 depends on how you define consulting services.
20 But what I'm concerned about is,
21 as I said before, if I do happen to be asked a
22 question that involves consulting, do I need

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1 to look over my shoulder and pull out my
2 engagement letter and say "Oh, gee, this is a
3 legal client and I don't have all those
4 disclosures there that I should have in order
5 to avoid a prohibited transaction."
6 PANEL MEMBER DWYER: Thank you.
7 PANEL MEMBER CANARY: There's one
8 thing that came up with Mr. Saxon and Ms. Mazo
9 was a possible adjustment to the language to
10 make it limited to investment consulting in
11 the category 2. Would that address your
12 concern?
13 MR. WIGGINS: Yes, that would.
14 PANEL MEMBER CANARY: Because what
15 you're doing, you would not perceive to be
16 investment consulting?
17 MR. WIGGINS: No.
18 PANEL MEMBER CANARY: It would be
19 -- I see.
20 MR. WIGGINS: I would never
21 provide investment consulting.
22 PANEL MEMBER CANARY: All right.

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1 Thank you.
2 CHAIR CAMPBELL: All right. Well,
3 thank you very much. We appreciate it.
4 And with that, we'll bring to a
5 close our hearings on this proposed
6 regulation.
7 And we very much appreciate the
8 comments that we've received from all the
9 witnesses. We appreciate their time.
10 And also, of course, want to thank
11 everyone from the Department who was here and
12 helped out and helped us put these on. We
13 don't typically do these for every regulation.
14 So this is something that was fraught with all
15 sorts of potential administrative pitfalls.
16 And we avoided those, logistical pitfalls. So
17 we appreciate that.
18 Of course, we will take all these
19 comments under consideration, as we have and
20 do all the comments in the written record that
21 we'd received previously and that we'll be
22 receiving to a certain extent on an ongoing

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1 basis as we come up with a final regulation,
2 which we will complete this year.
3 Thank you very much.
4 And that concludes this hearing.
5 (Whereupon, at 5:15 p.m. the
6 hearing was adjourned.)
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