INVESTMENT ADVISER
ASSOCIATION

February 11, 2008

Via Electronic Filing

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure

Ladies and Gentlemen:

The Investment Adviser Association[1] appreciates the opportunity to provide comments concerning the proposed regulation under section 408(b)(2) of ERISA (the "Proposed Regulation").[2]

Background

Section 408(b)(2) of ERISA allows employee benefit plans to enter into a variety of crucial arrangements with service providers, such as investment advisers, trustees, and recordkeepers, that would otherwise be prohibited in the absence of the exemption. Such arrangements are permitted under this section,[3] however, only if they are reasonable and

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[1] The Investment Adviser Association (formerly the Investment Counsel Association of America) is a not-for-profit association that represents the interests of SEC-registered investment advisers. Founded in 1937, the IAA's membership today is comprised of more than 500 firms that collectively manage in excess of $9 trillion for a wide variety of individual and institutional clients. For more information, please visit our web site: www.investmentadviser.org.

[2] *Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure*, 72 Fed. Reg. 70988 (2007). Because of the potential scope and complexity of this Proposed Regulation and the significant impact it will have on investment advisers, we reserve the right to submit supplemental comments to this letter. We also note that the Securities and Exchange Commission recently announced that it will consider at a February 13, 2008 open meeting whether to propose changes to Part 2 of Form ADV and related rules. SEC News Digest (Feb. 6, 2008). We intend to submit updated comments concerning these proposed changes.

[3] We note that existing statutory and class prohibited transaction exemptions also permit a variety of service arrangements, and are available as alternatives to the section 408(b)(2) exemption. For example, Prohibited Transaction Exemption 84-14 provides an exemption from the prohibited transaction provisions of sections 406(a)(1)(A)-(D) of ERISA with respect to assets managed by qualified professional asset managers (QPAMs). Individual exemptions are also in effect for various parties. The availability of these exemptions should not be affected by the Proposed Regulation in any way; thus, our comments relate only

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necessary for the establishment or operation of the plan, and if no more than reasonable compensation is paid therefor. Under the Proposed Regulation, a contract or arrangement for services to the plan would not be considered "reasonable" unless it required certain disclosures by the service provider and the provider in fact provided the information.

The IAA applauds the Department's efforts to ensure that plan fiduciaries receive the information they need in order to assess the reasonableness of the plan's arrangements with service providers. Plan fiduciaries' understanding of the fees paid by the plan is especially important, because such fees directly impact the investment returns realized by the plan, and, in the defined contribution plan context, the actual benefits received by participants.

We also note, however, that section 408(b)(2) provides a critical and widely used exemption from ERISA's prohibited transaction provisions. In order for plans to continue to operate and receive the services necessary to their operation, such as trustee, recordkeeping and investment management services, the requirements for such contracts and arrangements must be clear and workable and not impose unnecessary costs or administrative burdens on plans or their service providers. In this respect, unless a service provider is able to conclude with confidence that the requirements of the exemption have been met before agreeing to provide or continue a service-provider relationship, the provider could not provide the services that the plan depends upon.[4]

Our comments focus on the potential impact of the Proposed Regulation on plans and their service providers, and suggest clarifications and changes designed to reduce costs, confusion, duplication and administrative burdens upon both plans and their service providers.[5] We are especially concerned about the potential impact of the Proposed Regulation on small investment advisers and small plans, and note that the cost/benefit impact of the Proposed Regulation must be assessed separately for small entities under the Regulatory Flexibility Act.[6] In general, we find the Department's cost estimates for the Proposed Regulation unrealistic, especially in the context of small plans and service providers, which most likely will not have the "in-house" expertise to analyze and apply the new rules. If such entities must turn to outside counsel and consultants for

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to the requirements of the Proposed Regulation to the extent that service providers need to rely on section 408(b)(2) for relief from the prohibited transaction provisions.

[4] Of course, an adviser to an entity that is not considered to hold plan assets would not need the protection of section 408(b)(2) and would not be subject to the Proposed Regulation.

[5] As the Department noted in its preamble to the Proposed Regulation, "[c]osts to service providers might be ultimately borne by plans and their participants." 72 Fed. Reg. 70997, n. 24.

[6] 5 U.S.C. § 601, et seq.; *see* 72 Fed. Reg. at 71000-01 (noting the possibility "for a substantial number of small entities to bear costs that could be considered significant"). We note that the SEC's database of Form ADV filings for 2007 indicates that, of the 5854 SEC-registered investment advisers with retirement plan clients, 2646 (45.2 percent) have one to five employees, and 1161 (19.8 percent) have between 6 and 10 employees. *See, e.g., Evolution/Revolution: A Profile of the Investment Adviser Profession*, published by the Investment Adviser Association and National Regulatory Services (July 2007).

assistance, they will compensate these experts not only for their analysis of the rule, but also the application of the rule to each of their arrangements, incurring significant expense.

Large firms would also incur additional costs and administrative burdens under the Proposed Regulation. Such firms potentially could be required to develop and provide disclosures concerning a wide variety of service and compensation arrangements and disseminate them to diverse and numerous plan fiduciaries. Given their wide range of financial products and services, and their various structures, large firms are unlikely to benefit from economies of scale; each product and relationship will require individual analysis and disclosure. In addition, the incorporation of this information into the type of sophisticated and complex information technology system that supports a full-service financial services organization would require thousands of hours and substantial lead-time.

As described in further detail below, we recommend that the Department reduce the costs and administrative burdens under the Proposed Regulation through:

- Use of existing disclosure materials;
- Recognition of the interplay between the Proposed Regulation and Form 5500;
- Clarification of disclosure requirements in bundled services arrangements; and
- Extension of the effective date.

We also request a longer time period for notifying plan fiduciaries of material changes to services contracts, and the addition of a reasonableness standard and a prescribed timeframe within which a service provider must provide information requested by plan fiduciaries.

Utilization of Existing Disclosure Vehicles

We applaud the Department for attempting to avoid duplicate disclosures by permitting advisers to use Form ADV to provide disclosure to plan fiduciaries. As you know, SEC-registered investment advisers are already subject to a comprehensive disclosure regime under the Investment Advisers Act of 1940. The information in Form ADV, prescribed by the Securities and Exchange Commission, is available to all of an adviser's clients,[7] including ERISA plans, and contains extensive disclosures, especially

[7] Part I of Form ADV is filed and available to the public electronically through the Investment Adviser Registration Depository (IARD) at http://www.sec.gov/IARD. Part II of Form ADV must be provided to clients and prospective clients initially at the time of contract and offered annually. Advisers will soon be required to file Part II on the IARD.

as to services,[8] compensation,[9] and conflicts of interest, as well as the adviser's code of ethics.[10] The specific compensation to be received by the adviser for its services to the plan are detailed in the contract between the adviser and plan.

Similarly, the Investment Company Act of 1940 and the Securities Act of 1933, also administered by the Securities and Exchange Commission, require that mutual funds be offered for sale to the public pursuant to a prospectus, which discloses the fees and expenses paid by the funds to the funds' service providers, such as investment management and transfer agent fees. The prospectus also states whether the funds are sold subject to a sales load, and whether Rule 12b-1 fees are assessed against plan assets.[11]

The preamble to the Proposed Regulation anticipates that service providers will incorporate Form ADV and prospectus disclosures by reference in their section 408(b)(2) disclosures.[12] In addition, the preamble states that the Proposed Regulation would require that service providers "clearly describe these additional materials and explain to the responsible plan fiduciary the information they contain."[13] We are concerned that the additional descriptions and explanations would require the preparation of duplicative materials by investment advisers and mutual funds as well as superfluous reviews of these materials by plan fiduciaries.

We urge the Department, therefore, to include in the final regulation a "safe harbor" with respect to compensation and conflicts of interest disclosure. For investment

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[8] *See* Item 5.G. of Form ADV, Part 1A (Information About Your Advisory Business – Advisory Activities) and Item 1.A. of Form ADV, Part II (Advisory Services and Fees).

[9] *See* Item 5.E. of Form ADV, Part 1A (Information About Your Advisory Business – Compensation Arrangements) and Items 1.A. and 13 of Form ADV, Part II (Advisory Services and Fees and Additional Compensation).

[10] *See* Items 7 and 8 of Form ADV, Part 1A (Financial Industry Associations and Participation or Interest in Client Transactions) and Items 8 and 9 of Form ADV, Part II (Other Financial Industry Activities or Affiliations and Participation or Interest in Client Transactions). Investment Advisers Act rule 204A-1 requires investment advisers to establish, maintain and enforce a written code of ethics. 17 C.F.R. §275.204A-1.

[11] The disclosure requirements applicable to mutual funds are contained in Form N-1A, Registration Statement under the Securities Act of 1933 and/or the Investment Company Act of 1940. The expenses and fees related to the fund are detailed in Item 3 (Risk/Return Summary: Fee Table), Item 5 (Management, Organization, and Capital Structure), Item 6 (Shareholder Information), Item 7 (Distribution Arrangements), Item 12 (Management of the Fund), Item 14 (Investment Advisory and Other Services), Item 15 (Portfolio Managers), Item 16 (Brokerage Allocation and Other Practices), Item 18 (Purchase, Redemption and Pricing of Shares), and Item 20 (Underwriters). Conflicts of interest are specifically addressed in Item 15(a)(4) (Portfolio Managers). Items 1 through 8 must be included in a fund's prospectus, and the subsequent items must be included in the fund's Statement of Additional Information.

[12] 72 Fed. Reg. 70990.

[13] *Id.*

advisers the safe harbor should provide that the use of the adviser's Form ADV, along with its written contract with the plan, should be deemed to satisfy the disclosure requirements under section 408(b)(2). A similar safe harbor should be provided for the use of the mutual fund prospectus. The type and nature of the disclosure in these documents, along with the advisory contract, are the same as that contemplated by the Proposed Regulation.[14] In addition to content considerations, the uniform presentation of this information under the securities laws constitutes a preferable format that facilitates plan fiduciaries' comparisons among various advisers and funds. Further, formats used for securities law disclosures are well established, having been in use for many years; therefore, plan fiduciaries are already familiar with these documents. Finally, use of Form ADV disclosure will reduce the costs and burdens of this Proposed Regulation for both advisers and plans.

If the Department were not to provide for a safe harbor for these existing disclosures, we strongly believe the proposed conflict of interest disclosures as currently drafted are too broad and unworkable. For example, the Proposed Regulation could be read to require investment advisers and other service providers to track down all of the plan's service providers,[15] even those of which it was not otherwise aware, in order to uncover and disclose any relationships with the other service providers.[16] Service providers would not necessarily know all of the entities providing services to the plan and would, at a minimum, have to request the plan sponsor to provide and certify to such a list before the time of contract. Even with this information, however, an adviser may be unaware of a business interest (completely unrelated to the plan) that one of its affiliates might have with one of the other service providers to the plan. We submit that service providers should only be responsible for disclosing potential conflicts of which they are aware that directly relate only to the services they provide to the plan.

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[14] Under the Investment Advisers Act, an investment adviser must fully and fairly disclose to its clients all material facts, including conflicts of interest, necessary for informed decision-making. Lemke & Lins. *Regulation of Investment Advisers,* at 169 (2007); *see SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); Information for Newly-Registered Advisers at http://www.sec.gov/divisions/investment/advoverview.htm ("[Y]ou must provide full and fair disclosure of all material facts to your clients and prospective clients. Generally, facts are "material" if a reasonable investor would consider them to be important. You must eliminate, or at least disclose, all conflicts of interest that might incline you -- consciously or unconsciously — to render advice that is not disinterested.") *See also In re Arleen W. Hughes*, Exch. Act Rel. No. 4048, 27 SEC 629 (Feb. 18, 1948) (a fiduciary "has an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent"). Form ADV is the disclosure vehicle used by advisers to disclose these conflicts.

[15] *See* text accompanying n.35, which describes a provision of the Proposed Regulation that would appear to require a service provider that offers a "package of services" to disclose certain types of fees received by "other parties" beyond those fees received by its affiliates and subcontractors.

[16] Prop. Reg. § 2550.408b-2(c)(iii)(D), 72 Fed. Reg. 71005 (requiring disclosure of whether the service provider has any material financial, referral, or other relationship with any other service provider to the plan or other entity that may create a conflict of interest).

Interplay with Form 5500 on Indirect Fee Disclosure

The Department should further refine the Proposed Regulation to minimize administrative burdens on service providers and plans and to avoid confusion on the part of plan fiduciaries by recognizing the interplay between the compensation disclosures under section 408(b)(2) and the information required by plan fiduciaries in completing Schedule C of Form 5500. Schedule C and the Proposed Regulation are intended to complement each other.[17] As noted by Assistant Secretary of Labor Bradford Campbell, the Department intends "that the changes to the Schedule C will work in tandem with our 408(b)(2) initiative. The amendment to our 408(b)(2) regulation will provide up front disclosures to plan fiduciaries, and the Schedule C revisions will reinforce the plan fiduciary's obligation to understand and monitor these fee disclosures."[18] Accordingly, the Schedule C and the Proposed Regulation should be read together and interpreted consistently to the extent feasible.

There is, however, one critical difference between the two disclosure initiatives: in both of these contexts, service providers must disclose information on compensation and fees, but the section 408(b)(2) disclosures occur *before* the arrangement has begun, and the Form 5500 is completed *after* the service provider's fees and other plan expenses have been incurred. Therefore, unlike the fee information assembled for purposes of Form 5500, disclosures of specific amounts of certain types of compensation are not possible in the context of section 408(b)(2), because a service provider cannot know in advance the exact nature of its future compensation.

Even advance estimates of these amounts could prove confusing to plan fiduciaries if they do not "square" with the amounts eventually reported on Schedule C. In addition, the consequences of an incorrect estimation in section 408(b)(2) disclosures would be severe if the entire services contract were determined retroactively to violate ERISA's prohibited transaction provisions,[19] and potentially cause the contract to be rendered "illegal" and therefore unenforceable.[20]

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[17] The changes to Schedule C "complement the amendment proposed in this Notice in assuring that plan fiduciaries have the information they need to monitor their service providers consistent with their duties under section 404(a)(1) of ERISA." 72 Fed. Reg. 70988 n.4.

[18] *Written Testimony of Bradford P. Campbell Assistant Secretary of Labor Before the Committee on Ways and Means, U.S. House of Representatives* (October 30, 2007).

[19] The preamble to the Proposed Regulation also refers to potential excise taxes under section 4975 of the Internal Revenue Code. As we note in our separate comments on the proposed prohibited transaction exemption accompanying the Proposed Regulation, the excise tax provisions of section 4975 should not be triggered by a failure to satisfy the final regulation under section 408(b)(2), because no changes have been proposed to the regulation under section 4975(d)(2).

[20] In this regard, we urge the Department to clarify that a service provider could correct an inadvertent error (for example, in estimating potential future compensation, if such estimation is ultimately required by the final regulation) within a specified period of time after discovery, and avoid triggering a prohibited transaction. If, on the other hand, a prohibited transaction were triggered, we maintain that, in the event that excise taxes apply (see n.19), the calculation of such taxes should be based solely on that portion of the compensation rather than the entire contract.

We have identified two specific areas in which the interplay of Schedule C with the Proposed Regulation needs to be refined: soft dollars and other non-monetary compensation, such as gifts and entertainment.

Soft Dollars

The disclosure requirements applicable to soft dollar arrangements under section 408(b)(2) should conform to the information required under Schedule C. The Proposed Regulation requires disclosure of soft dollar arrangements in section 2550.480b-2(c)(1)(iii)(A)(*1*) and (*3*), but does not explicitly include all of the specific guidance that the Department provided in connection with Schedule C. For example, in the Schedule C context, the Department has stated that soft dollars "received by an investment manager in the form of research or other permissible services in connection with securities trades on behalf of plan clients need not be separately reported on Schedule C" provided that certain general disclosures are made.[21] Instead, a service provider may provide an estimate or formula, or, where appropriate, a general description, of the compensation along with other disclosures.[22]

Further, in the Form 5500 adopting release, the DOL recognized the difficulty in providing a formula or estimate for proprietary research and stated that "in such circumstances, a description of the eligibility conditions sufficient to allow a plan fiduciary to evaluate them for reasonableness and potential conflicts of interest would satisfy" the disclosure requirement. Similarly, the Proposed Regulation permits a service provider to "describe its compensation or fees in such a way that the responsible plan fiduciary can evaluate its reasonableness."[23] We submit that the same principles should apply in both contexts to permit a description of the soft dollar services provided sufficient for a plan fiduciary to evaluate their reasonableness, for the reasons outlined in our comment letter on the revisions to Form 5500 which we incorporate by reference here,[24] and those recognized by the Department in its changes to Form 5500.[25]

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[21] 72 Fed. Reg. at 64742. The Department adopted an "alternative reporting option" for certain types of indirect compensation that does not require disclosure of specific dollar amounts. Read consistently, the Proposed Regulation and the changes to Schedule C permit investment managers to all types of pension funds invested in various portfolio or account structures (including separate accounts, mutual funds, and hedge funds) to provide a description of soft dollar products and services received sufficient to allow a plan fiduciary to evaluate their reasonableness and any resulting conflicts. Neither regulation would require advisers to provide specific dollar amounts attributable to soft dollar products and services.

[22] This provision is consistent with long-held positions of the Department allowing plans to consider a range of *de minimis* amounts in assessing the reasonableness of compensation. *See* Advisory Opinion 93-24A (Aug. 11, 1994). *See also* Field Assistance Bulletin No. 2006-01 (Apr. 19, 2006), where DOL acknowledged that participant-level allocations of *de minimis* amounts of settlement proceeds may not be "cost-effective" and therefore may instead be used for other permissible plan expenses.

[23] 72 Fed. Reg. 70990.

[24] Letter to Office of Regulations and Interpretations, U.S. Department of Labor, from Karen L. Barr, Investment Adviser Association (Sept. 19, 2006).

Other Non-Monetary Compensation

In the area of other non-monetary compensation, such as gifts and entertainment, the Form 5500 rules provide for more targeted disclosure on Schedule C than would appear to be required by the Proposed Regulation. For example, the Proposed Regulation does not refer to a "de minimis" rule or "insubstantial" threshold, while the Form 5500 generally limits reporting of such compensation to amounts of $50 or more (with an annual limit of $100 on aggregated gifts and gratuities from one source).[26] Disclosure for section 408(b)(2) purposes should be similarly limited to anticipated gifts and gratuities in excess of those that would have to be reported on Schedule C. Similarly, service providers should be permitted to reasonably allocate gifts among multiple plans, if applicable.[27]

The Proposed Regulation and Schedule C define compensation consistently to include non-monetary compensation received "in connection with services rendered to the plan."[28] The Schedule C instructions further specify that "[I]ndirect compensation would not include compensation that would have been received had the service not been rendered or the transaction had not taken place and that cannot be reasonably allocated to the services performed or transaction(s) with the plan." We submit that both the Proposed Regulation and Schedule C therefore require disclosure of gifts and entertainment received by service providers only when such items are intended as "compensation" for services provided for a specific plan. The Proposed Regulation and

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[25] The disclosures made by investment advisers in Form ADV regarding soft dollar arrangements would provide sufficient detail for the plan fiduciary because the SEC also requires disclosure sufficient for clients to understand the nature of the services provided and evaluate their reasonableness. *See, e.g.*, Form ADV, Part II, Item 12; Interpretive Release Concerning Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Exchange Act Release No. 23170 (Apr. 23, 1986). We note that one difference between the advance nature of the section 408(b)(2) requirements and the after-the-fact nature of the Form 5500 requirements is that providing estimates, formulas, or ranges in advance of the contract will not be feasible or meaningful for the plan. In the Form 5500 context, an adviser could provide a formula to be applied to the amount of commissions generated by the plan transactions, which would yield a range or estimate of indirect compensation. In the 408(b)(2) context, an adviser will not know on a per plan basis what commissions will be incurred going forward. Thus the formula alone would not provide any useful information to plan sponsors and the more general descriptions used for proprietary research should suffice in the third-party context as well.

[26] 2009 Instructions for Schedule C (Form 5500) Service Provider Information, 72 Fed. Reg. 64825. Both the proposed 408(b)(2) regulation and Schedule C are inconsistent with the *de minimis* thresholds set forth in the Form LM-10 reporting requirements.

[27] 72 Fed. Reg. 64743.

[28] *Id.* The Schedule C instructions state that "[F]or this purpose, compensation is considered to have been received in connection with the person's position with the plan or for services rendered to the plan if the person's eligibility for a payment or the amount of the payment is based, in whole or in part, on services that were rendered to the plan or on a transaction or series of transactions with the plan." *See also* Proposed Regulation, 72 Fed. Reg. 70990.

Schedule C would not require disclosure regarding gifts or entertainment provided as a part of an overall relationship between the service provider and a third party.

A few examples may illustrate the application of these instructions:

Example 1: Investment manager invests, on a discretionary basis, a portion of client plan's assets in a hedge fund. The hedge fund adviser treats an employee of the manager to lunch or golf soon thereafter to thank the manager for making the investment. The lunch or golf outing (assuming more than $50 per event) is reportable because it would not have been provided had the transaction with the plan not occurred.

Example 2: Investment manager invests, on a discretionary basis, assets on behalf of many plan clients in a hedge fund. The hedge fund adviser sends a holiday basket or invites the manager to a widely-attended holiday party in recognition of a good relationship over the years. The basket or party is not reportable. There is no nexus with any particular plan services.

Example 3: Broker holds widely-attended conference and invites many investment managers. The investment managers have both ERISA and non-ERISA clients. The value of the conference would not be reportable indirect compensation to any of the attendees because the payment is not related to services performed for any particular plan. The managers would have been invited to this conference without regard for any particular plan client.

Even under this analysis, disclosure of items received in connection with a specific plan under the Proposed Regulation would be unworkable because, as noted generally above, the service provider will not know in advance what non-monetary compensation it may receive in connection with services to the plan in the upcoming year. A general description of the types of gifts or business entertainment that may occur as a direct result of services provided to the plan should suffice (and indeed is all that is possible).[29]

Similarly, in the context of other non-monetary compensation, such as "float" income, general disclosure should be permitted, because the service provider most likely would not be able to predict the amount and type of such compensation that might result from the particular arrangement *before* the arrangement begins. In the context of float income, a potential range of percentages or amounts, rather than specific or estimated dollar amounts, should suffice.[30]

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[29] The Department has acknowledged that Form ADV may include such indirect fee information and that advisers may use Form ADV to satisfy its obligations in this regard. 72 Fed. Reg. 70990.

[30] We also support the Proposed Regulation's authorization of the disclosure of compensation through the use of formulas, percentages of plan assets or per capita charges. Prop. Reg. §2550.408b-2(c)(iii)(A)(*2*).

Clarification of Disclosure Obligations in Bundled Arrangements

We urge the Department to clarify the scope of the disclosure obligations that would be imposed under the Proposed Regulation with respect to a "bundle of services" described in proposed section 2550.408b-2(c)(1)(iii)(a)(3). Under this provision, various parties to the bundled arrangement essentially would disclose their compensation arrangements through the "service provider offering the bundle of services." As a general matter, we support the use of an "all-in" compensation figure in the bundled context, and question whether further breakdown of compensation and fees is necessary. The "all-in" figure represents the amount that the plan will pay for the bundle of services; therefore, the inclusion of other figures, such as a breakdown of all fees and costs reflected in the net value of investment, would likely be confusing to plan fiduciaries if they interpreted the component fees as additional fees.[31]

In the event that the Department retains a disclosure regime that requires disclosure of both the "all-in" fee and component fees, however, we urge that the Department clarify the application of this provision in particular factual situations. The scope of the provision and its application to factual contexts are by no means clear, and raise many unanswered questions. Some of these questions are set forth below, and we intend to supplement this submission as further issues arise.

For example, the application of the provision should be clarified in the "classic" bundled services arrangement where the plan recordkeeper offers administrative services and includes within its investment offerings a variety of investment options. Such options may be proprietary mutual funds, non-proprietary mutual funds, and a variety of other types of vehicles, including collective investment trusts, unitized accounts, insurance products, and separate accounts composed of a variety of products and securities. To the extent that the recordkeeper includes such offerings on its platform, the recordkeeper will typically have trading arrangements and other arrangements in place in order to process purchases, exchanges, and redemptions from the funds. In such circumstances, it is reasonable to assume that the bundled provider would have access to disclosure documents prepared by the sponsor of the funds or other offerings, at least to the extent such disclosure documents are mandated by existing regulation. On the other hand, to the extent that the recordkeeper agrees to recordkeep the investment as an accommodation to the client and has no other relationship with the sponsor of the offering, the plan sponsor and/or its representatives are in a much better position to request appropriate disclosures, which often would need to be obtained long before entering into the bundled relationship with the recordkeeper.

We submit that the recordkeeper's disclosure responsibilities in this context should depend upon the nature of the investment option. If the investment option is a mutual fund, then the recordkeeper's only disclosure responsibility with respect to the option should be to provide the responsible plan fiduciary with the mutual fund's

[31] At a minimum, the Department should provide a format for disclosure that precludes the possibility of "double-counting" fees and expenses in the bundled context.

prospectus.[32] On the other hand, for investment options other than mutual funds, the trustee or investment manager of the option, as a plan fiduciary, would have an independent contract with the responsible plan fiduciary and would be responsible for providing the required disclosures directly to the fiduciary.

Further, we request clarification of the application of this provision to sub-advisory arrangements. For example, an investment adviser that sub-contracts with a sub-adviser for management of a portion of a plan's assets, typically in the defined benefit context, generally would not consider itself a bundled service provider, even though there is only one aggregate fee charged to the plan. Nevertheless, we recommend that the final regulation provide that the "primary" adviser be able to satisfy the disclosure requirements of the regulation, if any, by forwarding the sub-adviser's Form ADV to the plan fiduciary.[33]

Brokerage Commissions

We also request clarification regarding application of the "bundled services" provision in the context of brokerage commissions. The Proposed Regulation, as currently drafted, will not achieve its intended goals with respect to commission compensation disclosure because arrangements related to brokerage do not appear to fit the manner in which the regulation is technically structured.

The regulation applies to contracts or arrangements between service providers and the plan. An investment manager retained to manage plan assets will enter into a contract with the plan for investment management services. These services typically include not only discretionary management but also discretionary selection of brokers as appropriate to execute trades on behalf of the plan.[34] The investment manager is responsible both under the Investment Advisers Act and ERISA fiduciary principles to seek best execution for securities transactions in the plan's account. As part of that duty, the manager may select among hundreds of brokers on a transaction-by-transaction basis or an investment style-by-style basis (*e.g.*, international equity, small cap, municipal debt, etc.). The manager does not know at the beginning of each contract, each year, or even each day,

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[32] *See* our request for a safe harbor for mutual fund prospectuses, *supra*.

[33] We suggest that the Department include detailed examples to provide guidance concerning the scope of the "bundled services" provision, as well as other issues for service providers and plan fiduciaries. For example, there may be other types of sub-advisory or sub-contracting relationships where fees are not technically "priced as a package," but it may make sense for the entity that has a formal contract with the plan to provide any required information directly to the plan (see, *e.g.*, discussion of brokerage commissions that follows). We look forward to working with the Department to discuss further examples in this area.

[34] The primary exception to this scenario is in a commission recapture program or directed brokerage arrangement. In the defined benefit context, a plan may contract directly with a broker for a specified commission rate as part of a rebate program. In that instance, there is an arrangement between the plan and the broker and the Proposed Regulation would clearly apply to that arrangement, triggering disclosure obligations by the broker.

which broker it will choose to execute transactions for the plan and it would not be in the best interests of the plan to tie the manager's hands in advance in this regard. In order to have the plan's trades executed appropriately, the manager has understandings with all of these brokers but not necessarily written contracts. The brokers do not have direct arrangements or contracts with the plan – their execution of trades in plan accounts is at the discretion of the investment manager. Significantly, however, the brokerage commissions typically are charged directly to the plan account as an expense and therefore are not paid as part of a package of services offered by the manager.[35]

Given that background, the logical means of commission disclosure to plan fiduciaries would be through the use of the adviser's Form ADV. Item 12 of Part II of Form ADV requires the manager to state whether it has the authority to determine which broker is to be used and whether it suggests brokers to clients. If either arrangement is applicable, the manager must describe the factors used in selecting brokers and determining the reasonableness of their commissions.[36]

This type of disclosure is the most useful information the manager can provide, not knowing which brokers it will use or which trades it will execute in the coming year. It is not possible for advisers to provide the amount of commissions the plan will incur in advance of actually incurring them. During the year the plan will receive trade confirmation specifics with commission disclosure. In addition, again considering that regulation 408(b)(2) is intended to work in tandem with Form 5500, the sponsor will receive annual information about total commission expenditures.

The language of the Proposed Regulation, however, does not appear to facilitate this logical result. Under the Proposed Regulation, an adviser would be required to provide information about the compensation *it* receives for services provided under the contract. This disclosure would not include commissions charged by brokers because the adviser does not receive those commissions. Commissions would be required to be disclosed as compensation only where there is a contract or arrangement with the plan for the brokerage services, which is not typically the case, or where the commissions are part of a "bundle of services" offered by the service provider "that is priced as a package, rather than on a service-by-service basis," which also is not the case here. Thus, technically, the Proposed Regulation could be read to not require any commission disclosure to the plan sponsor at all – a result not consistent with the Department's goals.[37]

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[35] In this respect, paragraph (c)(1)(iii)(A)(*3*) of the Proposed Regulation provides a special rule for service providers that offer a bundle of services "priced as a package, rather than on a service-by-service basis." Under that provision, if a service provider offers a package of services, then the contract or arrangement with the plan must require only that the provider of the "package deal" make the requested disclosures.

[36] If one of the enumerated factors is "the value of products, research and services" given to the manager, then the manager must provide further information on the Form ADV.

[37] Even if one assumes that the investment adviser is the "responsible plan fiduciary" hiring the broker and therefore should receive disclosure pursuant to the Proposed Regulation, the plan sponsor still will not have received any disclosure about the commissions. We do not believe that this is the result intended by the

Accordingly, we recommend the Department clarify that an investment manager that, as part of its investment management services to a plan, selects brokers to execute the plan's trades, will satisfy all of its obligations under Proposed Regulation 408(b)(2) by providing its Form ADV brokerage commission disclosure to the plan fiduciary.

Extension of Effective Date

The Department has proposed that the final amended regulation under section 408(b)(2) become effective 90 days after its publication in the Federal Register.[38] We recommend a more extended transition period for the implementation of the final regulation, especially in light of its potential scope and importance. In order to fully assess the adequacy of the transition period, however, service providers and plan fiduciaries must determine whether existing contracts must be amended immediately or whether amendments and the related disclosure will be required only upon renewal, extension, or material modification.

We therefore request that the Department issue specific guidance concerning the issue of existing contracts and in particular if or when they would have to be amended to include the representations required by proposed subsection (c)(1)(iii).[39] We support a gradual implementation that would subject existing contracts and arrangements to the requirements of the final regulation upon their extension, explicit renewal (as opposed to automatic renewal), or material modification. Such a transition rule need not inordinately delay plan fiduciaries' receipt of the disclosures required under the final regulation, which could be required to occur by a date certain in any event. We also request clarification from the Department that investment advisers' revised agreements reflecting the final regulation would not be precluded from incorporating negative consent provisions. Under such provisions, the revised contracts would become effective automatically unless the plan fiduciaries took some action. This approach would assure that plans would continue to operate without interruption during the implementation of the final regulation, and without triggering prohibited transactions.

If all contracts were required to be amended immediately, then plan fiduciaries would need much more than 90 days to contact all of their service providers and to obtain and review the necessary disclosures. Fiduciaries also may need to implement extensive

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Department and we urge the Department to clarify that the adviser is not required to enter into written agreements with hundreds of brokers that they may or may not use for trade execution for ERISA plans. An adviser already has a duty to obtain sufficient information from its counterparties to fulfill its fiduciary duty to its clients, a duty that includes seeking best execution for client trades. Requiring advisers to obtain the 408(b)(2) disclosures from and enter into written contracts with brokers would impose significant costs and burdens without adding any protections for ERISA plans or providing any disclosure or other information to plan sponsors.

[38] 72 Fed. Reg. 70994.

[39] The cost-benefit analysis and Paperwork Reduction Act analysis in the Proposed Regulation do not include discussion of amendments to existing contracts.

systems changes to accommodate the disclosed information. The extent of these reviews and systems changes will not be fully apparent until the regulations are finalized.[40]

In addition, investment advisers and other service providers will need more than 90 days to analyze the final regulation, prepare the necessary disclosures, present them to plan fiduciaries, and respond to any questions or requests from the fiduciaries before finalization of their contracts. If advisers cannot rely on their Form ADV disclosures, then the information might have to be customized for each plan, which would require extra time. Bundled service providers may need even more time to contact the component providers within the bundle to obtain composite compensation disclosure, if required by the final regulation, and to compile this information and disseminate it to plan fiduciaries. All of these steps will necessitate systems changes that cannot be initiated until final publication of the regulation.[41]

We propose that the effective date of the final regulation recognize the significant lead-time necessary to make the necessary disclosures and contract amendments, as well as incorporate the related changes to Form 5500 reporting. Accordingly, we request that the effective date be extended to the later of: (1) 180 days after the publication of the final regulation in the Federal Register; or (2) January 1, 2009.[42]

Recommendations Concerning Other Timing Requirements

The Proposed Regulation would require that the service provider give notice to the responsible plan fiduciary of any material changes to the contract within 30 days of the provider's knowledge of the change.[43] We submit that the 30-day requirement would not provide enough time for the service provider to prepare the required notice and to disseminate the notice among its plan clients, and recommend that the time limit be changed to 60 days.[44]

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[40] We are pleased that the Department has not proposed to apply the regulation to individual retirement accounts (IRAs). The Proposed Regulation under section 408(b)(2) of ERISA does not address section 4975(d)(2) of the Internal Revenue Code, which is the equivalent statutory exemption applicable to IRAs, in either the text or the related cost estimates. Obviously, such a proposal would have had an enormous impact on the costs and burdens of the regulation and the amount of time necessary to respond.

[41] As noted above, we submit that the Department's adoption of our requested changes concerning the interplay with Form 5500, general disclosure, and use of existing disclosure would ease the administrative burdens for plan fiduciaries and service providers. Nevertheless, even with these changes, the review and implementation of the final regulation would require more than a 90-day lead-time.

[42] As we note in our separate comments on the class exemption proposed in connection with the Proposed Regulation, an extended effective date is also necessary in order for service providers and plan fiduciaries to assess fully the proposed class exemption in light of the final section 408(b)(2) regulation and provide any necessary supplemental comments.

[43] Prop. Reg. §2550.408b-2(c)(1)(iv).

[44] We note that the preamble provides helpful guidance as to what constitutes a "material" change and suggest that the guidance be incorporated into the final regulation. 72 Fed. Reg. 70992.

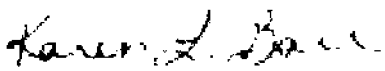
We also recommend that a reasonableness standard and a prescribed timeframe be added to the provision of the Proposed Regulation that requires service providers to provide information requested by plan fiduciaries in order to complete their required reporting and disclosures under Title I of ERISA. Service providers should be given at least 30 days to respond to any such reasonable requests.

Conclusion

We submit that our requested changes would reduce costs and ease the administrative burdens of the Proposed Regulation for plans and service providers, while providing plan fiduciaries with the information that they need in order to assess the reasonableness of their plans' services arrangements. We would be pleased to work with the Department to assist in crafting a regulation that enables plan fiduciaries to receive the information they need to assess the plan's arrangements with investment advisers and other service providers. To that end, we would appreciate the opportunity to meet with the Department to discuss our comments and appropriate examples to include in the final regulation.

Please do not hesitate to contact me if you have any questions or would like any additional information.

Sincerely,



Karen L. Barr
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