January 14, 2008

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

Attention : **408(b)(2) Amendments**

Subject : Commentary of Tim Wood, MPA
Deschutes Investment Advisors

To the Members of the Administrative Rule Committee:

I am taking this opportunity to thank the Department of the Labor and the EBSA for their work to assist America's employees in preparing for their retirement security. Fees are the biggest drag on investment return and are a significant threat to a future retiree's investment resources.

An example may place the platitude into some perspective. Let's consider two 401k plans. Both plans start with $1,000,000 and earn an identical 6.5%, on an annualized basis, before fees. Let's further assume that there are zero additions and no withdrawals to the plan for the period in question.

Plan A uses low cost mutual funds and has an all-in charge of 1% on the assets for all the services required to prudently manage the plan and assist the participants.

Plan B uses a Group Variable Annuity (GVA) contract and invests in sub-accounts, pays mortality expenses, and has other fees that are not required for the prudent administration of the plan. We will assume brokerage and GVA charges 2% on all assets in **Plan B**.

After approximately 34 years, **Plan A**, with expenses of 1%, has a plan balance of approximately **$4,983,000**. **Plan B**, with expenses of 2%, has a balance of roughly **$3,745,000**. That is $1,238,000 or almost **25% LESS**, while each plan earned an **identical rate of interest** over the 34 year period.

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The Real World

Too often, I find plan sponsors that believe that their plan is free or very low cost. This is due to ways in which platform providers have been able to disguise their fees, primarily by reducing returns on participant accounts. In the fall of 2007, I found a plan that did not disclose any fees of any type. To determine the actual fee paid required back testing returns of the investment alternatives in the plan against what was credited for those same alternatives within the confines of the plan. It was found that the plan's expenses, exclusive of investment option expense ratios, were 0.69% for a weighted expense of approximately 1.54%. Given the demographics of the plan, this fee was excessive. However, it bears repeating that the participants and the trustees believed that the plan had been delivered for nothing.

I speak with trustees on a weekly basis that are using GVA contracts that believe their plans are free or very low cost, notwithstanding the average all-in cost in the Northwest for GVAs, depending upon the demographics of the plan, of 1.7% to 2.35%.

I recently began visiting with a mid-market law firm in my hometown of Portland, OR. They are using a GVA. The attorney I was speaking with told me that the plan costs them $3,000 per year, investments of about 1%, and some incidental expenses. Using this formula, the plan would cost about $124,000, based upon the balance of the plan at the time. Regardless, of his supposition, we have been meeting and have confirmed that total costs to operate the plan in 2007 were approximately $164,000.

Further compounding the problem is that trustees are not aware if they are getting a good deal for their participants. For this law firm, we were able to put together a plan for them that has better performing investments, reduces their annual expenses by approximately $85,000 in year one and has complete fee transparency.

Weaknesses of the Proposed Rule Change

In my opinion, it appears that the amendment covers all of the types of income that incumbent providers are currently able to extract from an unknowing public. Further, the proposed prohibited transaction penalty appears to give the amendment the appropriate teeth to encourage compliance.

However, there are several weaknesses of the proposed rule change that could render the amendment meaningless over time. Vendors may be able to proclaim that they are disclosing their fees but may essentially be able to continue business as usual. My

reservation is that, unless the weaknesses are addressed, the amendment may be used as cover to continue the fleecing of nation's 401k participants.

- **The proposal does not prescribe the manner in which the disclosure is made. The fees may be expressed as a formula, a percentage of assets, or a per capita charge.**

Given the footnoted disclosures I have seen from my competitors in the past, formulas can be so confusing that many people skip over them much like the fine print in their homeowner's policy. A percentage of assets make the most sense, but it must provide some scale.

A per capita charge, unless the plan is actually priced in that manner, can be outright misleading; counterproductive to the amendment. Consider the following example:

Assume a small plan with 30 participant, $1,000,000 in assets and annual expenses of $10,000, which equals 1%. The "per capita" charge for the plan is $333.33. However, if the owner of the company has $250,000 of the entire balance, it is more likely that the owner's fee would be close to $2,500 since most components of plan fees are computed using asset charges. That is certainly true for expense ratios. A "per capita" disclosure would be misleading.

In my opinion, the fairest way to disclose the fees is through a percentage of assets figure, complete with an illustration to put the fee in context. Further, all plans should follow the same rule so that trustees will have the ability to prudently compare their plan against their peers and competing vendors. To not prescribe a standard disclosure allows for further obfuscation in the market place. I offer the following example for form and substance of a disclosure that should be made to participants as well as trustees:

"To calculate your costs to participate in the ABC 401k plans, costs are divided into two parts. Part A costs are those associated with record keeping, administration, investment advisory assistance, statements, and customer service. Part B costs are those associated with investment management to operate the investments in the plan. To understand all the fees you are paying to participate, you MUST add the two components together. In this example, we are using the cost of the Moderate Model of the plan, which is 0.22%. Your total cost per dollar invested in the ABC Plan is as follows:

Part A Charges	**0.56%**
Part B Charges	**0.22%**
Total Charge on Dollars Invested	**0.78%**

The total cost to participate in the ABC, Inc. 401k profit sharing plan 0.78% of all assets in the plan, or $7.80 on every $1,000."

Providing the end user with the actual dollar cost to invest, as this example indicates, provides participants and trustees with the scale in which to make reasonable and prudent judgments about the "reasonableness" of their fees.

- **The proposed amendment appears to only require the disclosure prior the commencement of the relationship.**

It is not unreasonable that the fees and the potential for conflicts of interest should be disclosed at least on an annual basis. In fact, I would advocate that the participants have their fees paid disclosed on their quarterly statements as in the following example:

	Previous Quarter Balance	**Investment Gain (Loss)**	**Fees**	**New Balance**
John Smith	$47,300	$1,410.00	($77.94)	$48,632.06

This statement of actual account activity is more transparent and honest than the account statements of many of the bundled providers which, when considering the same account would look like this:

	Previous Quarter Balance	**Investment Gain (Loss)**	**New Balance**
John Smith	$47,300	$1,332.06	$48,632.06

The casual observer might suggest that the two fictional account statements are the same. Both statements indicate a management fee of 0.65% with fees being deducted quarterly. However, in this environment, it has been my experience that John Smith's account statement, when the fees are not disclosed, looks more like this:

	Previous Quarter Balance	**Investment Gain (Loss)**	**New Balance**
John Smith	$47,300	$1,168.77	$48,468.77

Since fees are not disclosed, it is easier to extract additional revenue from "John" and the other participants in the ABC plan. The above "statement" uses the fees of a participant in a GVA 401k with $1,000,000, that I visited with in the spring of 2007, 2.04%.

In a fee transparent environment, John's statement should look like this:

	Previous Quarter Balance	Investment Gain (Loss)	Fees	New Balance
John Smith	$47,300	$1,410.00	($241.23)	$48,468.77

If the goal of the proposed amendments is to promote the important public policy goals of increased fee transparency and increased competition in the service provider market, the disclosures should be easy to understand and have a uniform structure nationwide.

In the immediately preceding fee transparent "account statement" the end user, whether it be a participant or a trustee, at least has an elementary idea of what they are paying, providing them with some basis for developing an informed opinion.

- **Paragraph (c)(1)(iii)(A)(3) offers an exception for bundled providers whom are the vendors most prone to hiding excessive fees from an unsuspecting public.**

The disclosure of revenue sharing arrangements that could *"legitimately be classified as proprietary or confidential"* is a serious weakness of the proposed amendment, and appears to be contrary to subsection (E) of the amendment.

Too often I have run into plans where a broker is offering "advice" which does little more than result in additional revenue sharing going to the broker. Disparate revenue streams in 401k plans continues to this day where a broker will receive, for example, 0.25% for all the money in the ABC family of funds and 0.00% for all funds invested outside the family of the platform provider. Therefore, a "proprietary or confidential" revenue sharing agreement could cause additional harm to the public as the end participant could be lulled into a false sense of complacency.

In order for the proposed amendment to have any value to the investing public, this exception should be reviewed. Bundled providers, at the very least, control a plurality of the business.

I am taking this opportunity to thank the members of the committee for this opportunity to comment and further thank all of you for your time invested in considering my thoughts.

If any interested party has any questions, please feel free to contact me at your convenience.

Sincerely,

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