



STATE STREET.

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

**Proposed Regulation: Reasonable Contract or Arrangement Under Section 408(b)(2) -- Fee Disclosure**

Dear Sir or Madam,

State Street Corporation ("State Street") appreciates the opportunity to comment on the Department of Labor's ("the Department's") proposed regulation redefining what constitutes a "reasonable contract or arrangement" under ERISA Section 408(b)(2), as described in the Federal Register dated December 13, 2007.

Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With \$15.3 trillion in assets under custody and \$2.0 trillion in assets under management as of December 31<sup>st</sup>, 2007, State Street operates in 26 countries and more than 100 markets worldwide.

The level of fees paid by savings or pension plans and plan participants is an important factor in successful retirement saving, and can have a significant effect on potential retirement income. While service providers are rightly entitled to compensation for their services, fees should be reasonable, reflective of the level of service provided, and transparent to both plan sponsors and plan participants. State Street supports the Department's efforts to increase the transparency of fees charged to pension plans and their participants.

While ERISA Section 408(b)(2) already requires plan sponsors to determine that fees are reasonable, we generally agree with the Department's view that the exercise of this duty by plan sponsors could be aided through further regulatory guidance requiring greater transparency. As with the Department's previous rulemaking related to Form 5500, however, we are concerned that the proposed 408(b)(2) regulation may impose

excessive burdens on service providers, increase costs to plans and participants, and result in less, rather than greater, clarity for plan sponsors evaluating the reasonableness of fees and compensation.

In addition, we believe the proposed 90 day transition period to the new regulation is too short, particularly given the ongoing regulatory burden of implementing the new Form 5500.

State Street urges the Department to delay implementation of new 408(b)(2) regulations until interested parties have had the opportunity to assess the efficacy of the new Form 5500, and to revise the proposed regulation to adopt a more balanced, practical approach, as detailed below.

### **Disclosure of Compensation**

While we agree with the Department that it is important for plan sponsors to be provided information about indirect, as well as direct, compensation to service providers, we are concerned that the proposed regulation could be interpreted to define indirect compensation much more broadly than is reasonable or feasible.

The scope of the proposed regulation should be limited to compensation for services provided pursuant to the service provider's contract with the plan sponsor, in connection with the service provider's relationship to the plan. Compensation received independent of the service providers' direct relationship with the plan should not be included in the 408(b)(2) disclosure.

For example, a directed trustee may also be the custodian for an unrelated mutual fund in which the plan invests. The plan fiduciary has the sole authority to select the mutual fund, or any other plan investment. In such a case, compensation received from the mutual fund for custodial services is completely independent of the direct service provider relationship with the plan, and would have no bearing on the reasonableness of the compensation for the directed trustee service provider relationship. Such compensation should not be included in the directed trustee's disclosure under 408(b)(2), or considered a conflict of interest (see below).

In addition, we suggest the Department revise its proposed definition of "affiliate" to clarify that the term would not include unaffiliated subcontractors, subadvisors, or vendors providing services in the ordinary course of business to the service provider. These subcontractors provide services to the service provider, not the plan, and have no independent contract with the plan. For example, a global custodian such as State Street maintains relationships with a large network of subcustodians around the world. These subcustodians provide services to State Street which may assist State Street in servicing plan sponsors, but have no relationship with State Street's plan sponsor customers. They are not parties in interest to the plan, and not, under common usage of the term, "affiliates" of the service provider. We are concerned, however, that reference to "agent" in the proposed rule's definition of "affiliate" may be interpreted to inappropriately capture these subcontractors, resulting in the often impossible duty of the service provider to collect data describing all compensation received by the

subcontractor for all services provided to all service providers to the plan. We suggest the proposed rule be revised to clarify that such relationships do not fall under the definition of “affiliate” for purposes of the 408(b)(2) disclosure.

## **Disclosure of Conflicts of Interest**

State Street understands the importance of managing and disclosing conflicts of interest, but is concerned that the scope of the disclosures required under the proposed regulation are too broad, creating potentially high levels of irrelevant disclosures, and imposing potentially onerous compliance burdens on service providers.

Under the proposal, service providers would be required to describe any “material financial, referral, or other relationship or arrangement with a money manager, broker, other client of the service provider, other service provider to the plan, or any other entity that creates or may create a conflict of interest for the service provider in performing services pursuant to the contract or arrangement.” Particularly for a large service provider, such as State Street, the scope of this requirement could be interpreted to cover an indeterminate number of parties with whom we may have a wide variety of relationships, and for whom we are not in a position to know of all their relationships or activities.

In addition to the practical challenges created by the proposal, we see little benefit to plan sponsors deriving from such a broad and costly inventory of potential conflicts of interest. Internal conflicts of interests, and conflicts with affiliates, are already strictly managed by ERISA and its numerous statutory and administrative exemptions, and, under the proposed regulation, would be revealed under the new fee disclosure regime. Potential external conflicts of interest are generally only relevant to plan sponsors when the service provider has sufficient discretionary authority to inappropriately benefit from the conflicts --- which, for the vast majority of State Street’s relationships with plan sponsors, is clearly not the case.

In general, we believe the broad inventory of potential conflicts of interest suggested by paragraph c(1)(C)(iii)(D) of the proposed regulation is unnecessary, and that the information needed by plan sponsors related to conflicts of interest will be available through the proposed new fee disclosures (under c(1)(C)(iii)(A)), the proposed requirement to disclose when a service provider has the ability to independently affect its own compensation (under c(1)(C)(iii)(E)), the proposed requirement to disclose policies and procedures addressing conflicts of interest (under c(1)(C)(iii)(F)), and through general ERISA principles and other exemptions.

Should greater disclosure of conflicts of interest be deemed necessary, we suggest such disclosures be limited to known, material conflicts of interest not covered by existing prohibited transaction exemptions, and where the service provider has sufficient decision-making authority to exploit these conflicts for its own benefit. In addition, we urge the Department, in any final regulation, to address the challenges such disclosures create for large service providers, whose services and relationships interact with most other participants in the global financial services industry.

## **Coordination with Existing Exemptions**

We appreciate the Department's stated interest in views on the coordination of the proposed 408(b)(2) regulations with existing ERISA statutory and administrative exemptions.

As the Department is well aware, since 1974, numerous statutory and administrative exemptions from ERISA's prohibited transaction rule have been granted. These exemptions have been carefully developed to allow plans to operate efficiently, while protecting the interests of plan participants. Services provided under these exemptions do not rely on the service provider exemption under 408(b)(2).

State Street believes it is critical that existing statutory and administrative exemptions be respected. The statutory exemptions, of course, cannot be changed through rulemaking, but it would be disruptive and ill-advised to allow potential new 408(b)(2) regulations to effectively preempt all other statutory and administrative exemptions. Services currently provided under exemptions other than 408(b)(2) should be unaffected by any new 408(b)(2) regulation.

## **Coordination with Form 5500**

State Street suggests the Department refrain from imposing new 408(b)(2) regulations during the transition to the new Form 5500 requirements, for both practical and policy-related reasons.

First, despite some improvements in the final vs. proposed Form 5500 regulations, service providers are still working to interpret and implement the final Form 5500 regulation. While filing the Form 5500 is the responsibility of plan sponsors, much of the administrative and data collection burden falls to service providers. Existing fundamental reporting systems are being significantly reprogrammed, or new systems developed, to capture the necessary data, requiring significant investment of resources. Imposing new 408(b)(2) requirements of the type described in the proposed regulation will greatly add to this already substantial regulatory burden. We suggest delaying implementation of any new 408(b)(2) requirements until after plans and service providers have completed the necessary changes to implement the new Form 5500 regulation.

Second, it is unclear how closely the requirements of the proposed 408(b)(2) regulation match the requirements of the new Form 5500. For example, it is not clear that indirect compensation will be interpreted in the same way under these two regimes. We urge the Department to closely align the requirements of 408(b)(2) with the new Form 5500.

Finally, we support the focus of both the new Form 5500 and the proposed 408(b)(2) regulations on indirect compensation, which we believe is important in evaluating service provider relationships with plans. We note, however, that many practical questions still surround the collection and presentation of this type of data, and suggest the Department provide sufficient time to allow the experience implementing the new Form 5500 to inform development of new 408(b)(2) regulations.

## **Fiduciary Status**

State Street's relationships with plan sponsor customers provide a wide variety of services, acting in both a fiduciary and non-fiduciary capacity. While we are keenly aware of our duties as a fiduciary, we are concerned that the proposed requirement to disclose "whether the service provider (or an affiliate) will provide any services to the plan as a fiduciary either within the meaning of section 3(21) of the Act or under the Investment Advisers Act of 1940."

The determination of fiduciary status is not always determined by contract recitals --- it is a legal determination that is fact and context specific, requiring a sometimes complex legal analysis. A service provider's status as a fiduciary exists independent of 408(b)(2) or the prohibited transaction rule under section 406, and often is the basis of legal actions related to service providers. It is well settled that investment managers for ERISA plan assets must acknowledge their fiduciary status. The plan assets rule has been the determinative test for many years and should not be abrogated. Fiduciary status may be the result of acts during the course of the relationship which was not originally defined as such.

Attempting to disclose a service provider's fiduciary status for every service provided, even through a notice vs. a contract, would be a complex and time consuming legal process for service providers and plan sponsors. Regardless of the effort invested in such a disclosure, any necessary binding determination of a service provider's fiduciary status will remain with the court system.

We believe the attestation of fiduciary status required under the proposal is unnecessary and difficult to implement; we suggest the Department eliminate such a requirement in any final rule.

## **Brokerage Services**

We suggest the Department clarify that the proposed regulation is not intended to require significant changes to current fee notification practices for brokerage services. Such services are often provided without a written contract, and notification of the compensation received by the broker takes place after the transaction is completed, in the form of a confirmation.

Requiring written agreements and compensation disclosures in advance for brokerage services is problematic in several respects. Since brokerage services are transaction based, the arrangement between an asset manager and broker is generally established by virtue of the broker providing services, not through a contractual arrangement. Disclosure of compensation to the broker in advance is generally impossible, since the final costs of the transaction are dependent on a wide range of variables beyond the control of the broker.

We suggest the Department clarify that, for brokerage services, the current practice of providing disclosures regarding compensation for transactions as part of the post-trade confirmation is sufficient to meet the requirements of section 408(b)(2).

### **Master Agreements**

For certain types of services, such as transition management, service providers may enter into long-term master agreements with plan sponsors. These agreements establish a relationship between the plan sponsor and service provider, for performance of specific future services, but do not identify the costs of providing services, which are unknown at the time. When a plan sponsor chooses to request services under the master agreement, a notice is sent to the plan sponsor by the service provider confirming the specific service to be provided, including the per transaction fees, which both parties sign before services are provided.

These master agreements benefit both the plan sponsor and the service provider by allowing the parties to establish the parameters of the service relationship in advance, resulting in more efficient execution of services when needed. Given the open-ended nature of these agreements, however, and the likelihood of changing market conditions by the date services are provided, it is impossible to provide a specific fee disclosure at the time the agreement is entered into.

We suggest the Department revise the proposed regulation to specify that such master agreements do not trigger the proposed detailed compensation disclosure requirements for service providers. For these types of agreements, disclosing the procedure for provision of actual services, including disclosure of fees, should be sufficient to meet the requirements of 408(b)(2).

### **Float Income**

State Street agrees that float income is an important element in evaluating the compensation of service providers. As the Department knows, the disclosure of float income has been addressed by the Department in the past, most recently through Field Assistance Bulletin 2002-3.

We urge the Department to clarify that the disclosure of float income under Field Assistance Bulletin 2002-3 is sufficient to meet the requirements of a final new regulation under 408(b)(2).

### **Inadvertent Errors**

Despite service providers' best efforts, it is inevitable that errors in the proposed new disclosures will occur. Given the severe consequences of violating the requirements of 408(b)(2), we suggest the Department provide an explicit process for correcting inadvertent errors, such as the process provided under ERISA section 401(c) for insurance companies.

## **Form of Disclosure**

We support the Department's proposed flexible approach to the form of disclosure. We believe the Department's approach, which does not require a single disclosure document, provides the ability to incorporate information through reference to other filings or documents, and the ability to disclose compensation or fees in a variety of formats (e.g. monetary amount, formula, per capita charge, etc.) will help facilitate disclosure to plan sponsors.

We interpret the proposed regulation to properly allow disclosures in the form of a notice, rather than in the body of the contract, or through amendments of existing contracts. This is a critical issue, however, and we suggest the Department explicitly state in any final regulation that disclosures can be made by notice, and need not be included in the body of contracts.

## **Transition Period and Effective Date**

The Department's proposed 408(b)(2) changes will require significant systems and reporting changes for plan sponsors and a wide range of service providers. Capturing all of the data required under the proposed rule, and establishing methods to provide the information to plan sponsors, will require significant investment of time and resources by service providers. In addition, as noted above, these same service providers are currently working to provide information necessary to complete the new Form 5500.

As a result, the 90 day transition period proposed by the Department is much too short. Ideally, any new 408(b)(2) requirement would be timed to benefit from the knowledge gained through implementation of the new Form 5500. At a minimum, given the very high compliance burdens imposed by the proposal, we suggest any 408(b)(2) regulation take effect 18 months after it becomes final.

Even with an 18 month transition period, amending all existing contracts with plan sponsors to incorporate the requirements of the proposed regulation would be extremely burdensome, costly, and, in our view, unnecessary. We urge the Department to grandfather existing contracts, and only apply the new rules to new, renewed, or materially altered contracts or relationships.

Once again, thank you for providing State Street the opportunity to comment on the proposed new regulations under 408(b)(2). While we have, as noted above, several concerns with the details of the proposal, we remain supportive of the Department's efforts to increase transparency of pension plan fees and costs, and to improve retirement security for plan participants.

Sincerely,



Stefan M. Gavell