December 27, 2006

Bradford Campbell
Acting Assistant Secretary
Employee Benefits Security Administration
Suite S-2524
U.S Department of Labor
200 Constitution Ave. N.W.
Washington, D.C. 20210

Re: Supplemental Comments Regarding Proposed Revision of Annual Information Return/Reports (RIN 1210-AB06)

Dear Acting Assistant Secretary Campbell;

On behalf of the Securities Industry and Financial Markets Association ("SIFMA")[1], I am writing to provide additional information as you undertake major revisions to the Form 5500 Annual Return/Report of Employee Benefit Plan ("Form 5500"). SIFMA's predecessor, the SIA, previously submitted comments regarding the proposed revisions to the Form 5500 Schedule C in a September 19, 2006 letter to Robert Doyle, Director of the Office of Regulations and Interpretations. This letter is intended to supplement the SIA's September 19 letter by providing additional comments regarding the proposed Schedule C changes that would require the reporting of commissions and fees paid to non-discretionary brokers and soft dollars received by investment managers. For the reasons set forth below, the SIFMA recommends that these proposed changes be eliminated. In addition, the SIFMA requests that the effective date of any changes to Schedule C be delayed until at least plan years beginning on or after January 1, 2009.

Brokerage Commissions and Fees:

Under the current rule, brokerage commissions and fees charged on purchase, sale and exchange transactions are not reportable on Schedule C unless the broker is acting as a fiduciary with respect to the plan. The proposed revisions would depart significantly from that rule by requiring plans to report such commissions and fees "regardless of whether the broker is granted discretion." The proposed revisions suggest that this change is appropriate because "brokerage commissions and fees may constitute a significant part of a plan's annual expenses," and because "an annual review of such expenses is part of a plan fiduciary's on-going obligation to monitor service provider arrangements with the plan." To satisfy this requirement, the plan

1 The SIFMA is the product of a recent merger of the Securities Industry Association ("SIA") and the Bond Market Association. The SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

administrator would have to obtain from the plan's service providers the total amount of commissions and fees paid to each broker-dealer that received $5,000 or more in total compensation in connection with services rendered to the plan during a plan year. If a particular broker-dealer failed to provide this information to the administrator upon request, the proposed revisions would require the administrator to identify the broker-dealer in a new section of Schedule C.

As a threshold matter, the SIFMA does not believe that an actual dollar amount each broker-dealer received from a plan in brokerage commissions, securities lending fees, trailers, float, debit interest for margin transactions, payments for order flow, overdraft charges, custody and other service fees can be calculated in many cases. Because services and fees may not be provided or allocated on a plan by plan basis, it may not be possible to report or allocate amounts on that basis. Even if an actual dollar amount could be calculated for some of types of services, it could not be calculated consistently across separately managed accounts and other investment vehicles in a way that would allow a plan to compare these fees to benefit the plan, the participants, or beneficiaries.

The plan administrator would be responsible for obtaining this information from the various plan service or investment providers. In most cases, the plan administrator will not know which broker-dealer(s) placed trades on behalf of the plan. Therefore, it is the investment manager who will be asked in the first instance to provide information to the plan administrator to satisfy the new reporting obligation.

The selection of brokerage firms is usually performed by an investment manager. There will typically be a number of investment managers and a number of separate accounts at the trustee/custodian bank for each manager. Each of these investment managers must establish an account with a brokerage firm at which it will do business. The investment manager must then also have a sub-account at each of the brokerage firms. When a broker-dealer executes a trade for the manager of a separately managed account, all the broker-dealer knows is that the trade is being executed for a particular account number at a trustee/custodian bank. The broker-dealer is not aware that the account for which it is trading is owned by a particular plan. To further complicate matters, where a plan has a number of managers with different account numbers, a broker-dealer trading on behalf of these different account numbers does not know that it is executing trades for the same plan.

The investment manager community likely would be called upon to maintain a system to track brokerage commissions paid to each broker-dealer used by the plan. Each plan investment manager also would have to work with the various broker-dealers utilized by the manager to review all trading records for a particular plan's account to eliminate amounts attributable to items such as disclosed markups on principal transactions in equity securities, third-party "soft dollar" arrangements and step-out commissions. In reviewing the trade records, the broker-dealer also would have to ensure that any block trades for multiple accounts (including other investors' accounts) are properly allocated to the investors that owned the accounts.

The SIFMA further submits that requiring plans to report on a broker by broker basis the gross dollar amount of commissions and fees paid during a plan year makes no sense. Reporting gross amounts by broker will not help the plan's fiduciaries determine whether trades executed by a particular broker were initiated by one manager or multiple managers, whether any of the managers used good judgment in selecting the broker-dealer, whether best execution was achieved, whether the plan received a low commission rate or a high commission rate on a specific trade, or whether a manager churned the plan's account by engaging in unnecessary transactions with a number of different brokers. A high gross amount could mean a number of different things, such as many trades in emerging markets, mostly agency trades, difficult to assemble blocks of securities or unfavorable commission rates. A low gross amount could mean favorable commission rates, many principal trades, or that many of the plan's managers used a "buy and hold" rather than a frequent trading investment strategy. The proposed reporting of gross amounts by broker would not help fiduciaries understand an investment

manager's trading decisions, the comparability of different brokers or whether efficient trading has occurred.

The Department does not have jurisdiction over investment companies registered under the Investment Company Act of 1940. See ERISA § 401(b)(1). However, it is instructive that the Statement of Additional Information ("SAI") included as Part B of Form N-1A requires a mutual fund to disclose only the aggregate amount of brokerage commissions paid by the fund to all brokers during its three most recent fiscal years. Disclosure of the amount of commissions paid to a particular broker is required only if the broker or its affiliate is affiliated with the fund company, its investment adviser or principal underwriter.

Wholly apart from the questionable value of this information in determining whether a particular broker-dealer's compensation is "reasonable," any value that could possibly be derived from this additional information would be substantially outweighed by the increased costs that undoubtedly would be charged through to the plans. Broker-dealers generally do not track their commissions or fees on a plan by plan basis unless they also happen to be the plan's custodian.

In short, the proposed Schedule C revisions requiring the reporting of commissions and fees paid to non-discretionary brokers will unnecessarily increase the brokerage costs incurred by plans without providing such plans with sufficient offsetting benefits to justify the increased costs. The SIFMA therefore urges the Department to retain the existing rule that does not require the reporting of commissions and fees paid to non-discretionary brokers.

Payments in Respect of Mutual Fund Shares:

Current technology in the mutual fund environment is likewise generally incapable of tracking compensation paid to broker-dealers on a plan by plan basis in connection with the purchase of mutual fund shares. Most plan investors purchase and hold mutual fund shares through "omnibus" accounts maintained by financial institutions. An omnibus account is used for convenience and as a best practice across the industry, so that the daily data exchanges and settlement transactions between fund companies and recordkeepers can be performed efficiently. These omnibus arrangements make it nearly impossible to track the dollar amount of compensation paid to a broker-dealer at the plan level. Plan level records are maintained in third-party recordkeeping systems that typically do not keep track of payments made to broker-dealers. The broker-dealer that executes transactions involving a specific mutual fund's shares receives payment from the mutual fund through an entirely separate system, either by check through a brokerage system or through NSCC, based on the aggregate transactions in the omnibus account. Every payment by check through a brokerage system is typically accompanied by hundreds of pages of backup documentation. Manually sorting through that documentation to collect and report compensation paid to a broker-dealer on a plan level basis would be extremely time consuming from a practical standpoint, as well as costly. The additional costs of gathering this information undoubtedly would be passed on to the plans because they are the only customers for whom this reporting would be required.

We also note that these payments are reflected, directly or indirectly, in the expense ratio of the mutual fund for which disclosure is provided in the prospectus. It is essential that plan fiduciaries understand the financial relationship between the mutual fund and the plan's service provider, and we applaud the Department's efforts to expand the disclosures made to the plan fiduciaries by the service providers. However, Schedule C to the Form 5500 is not the appropriate vehicle for that disclosure.

Soft Dollars:

The proposed revisions include "soft dollar payments" among the various types of indirect compensation that would be reportable on Schedule C.[2] In a "soft dollar" arrangement, an investment manager purchases brokerage and research services from a broker-dealer with a portion of the commissions paid to that broker for executing securities transactions.[3] Section 28(e) of the Securities Exchange Act of 1934 establishes a safe harbor that allows a manager to use client commissions to purchase "brokerage and research services" for its managed accounts without breaching any fiduciary duty imposed by state or federal law. Under that safe harbor, an investment manager can pay more than the market rate available rate for pure execution in exchange for a bundle of brokerage and research services, provided the manager determines in good faith that the amount of the commission was reasonable in relation to the value of the services provided.

On July 24, 2006, the SEC issued a final release narrowing the types of services that would qualify as "brokerage and research services" within the meaning of the safe harbor contained in Section 28(e).[4] The final release provides a number of concrete examples of eligible brokerage[5] and research services.[6] The SEC also made clear that it planned to evaluate whether additional disclosure and documentation requirements were necessary for soft dollar arrangements.[7]

The Department previously concluded in Technical Release 86-1 that soft dollar arrangements do not violate ERISA's fiduciary responsibility provisions if they fall within the scope of Section 28(e).[8] The Department further recognized that the SEC is responsible for administering the 1934 Act and "has exclusive authority to interpret the scope of Section 28(e) and the terms used therein." Consistent with its previous stance, the Department should defer to the SEC's ongoing evaluation of the need for additional soft dollar disclosure requirements.

The SIFMA generally supports the disclosure of soft dollar practices to help investors better understand the extent to which research services are subsidized out of commissions, as well as the benefits that those services may yield to fund performance. However, putting aside the

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2 71 Fed. Reg. at 41649 ("Examples of indirect compensation include ... soft dollar payments ...").

3 See Statement on Policies Concerning Soft Dollar and Directed Commission Arrangements, ERISA Technical Release No. 86-1 (May 22, 1986); see also ERISA Advisory Council, Report of the Working Group on Soft Dollars/Commission Recapture (Nov. 13 1997) (defining "soft dollars" as "payment for brokerage firm services, other than trade execution, through commissions generated from investment trades")

4 See Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, 71 Fed. Reg. 41978 (July 24, 2006)

5 "Brokerage services" are those that "relate to the execution of the trade from the point at which the money manager communicates with the broker-dealer for the purpose of transmitting an order for execution, through the point at which funds or securities are delivered or credited to the advised account" 71 Fed. Reg. at 41979. Eligible "brokerage services" include the activities required to effect securities transactions functions incidental to effecting such transactions, such as clearance, settlement and short-term custody services in connection with trades effected by the broker, as well as services required by SEC rules or by rules of a self-regulatory organization. Id. at 41989.

6 "Research services" must be "advice," "analyses," or "reports" within the meaning of Section 28(e)(3)(A) and (B). Eligible "research services" include: traditional research reports analyzing company or stock performance; meetings with corporate executives to obtain oral reports on company performance; seminars providing substantive content regarding issuers, industries or securities; software that provides analysis of securities portfolios; consultant advice regarding portfolio strategy; trade magazines and technical journals regarding specific industries or product lines; market data services that provide stock quotes, last sale prices and trading volumes; company financial and economic data; market research on optimal execution venues and trading strategies; and advice *from* broker-dealers on order execution. 71 Fed. Reg. at 41919, 41985-88

7. 71 Fed. Reg. at 41979 n.13, 41984 n.79

8 See also ERISA § 514(d), 29 U.S.C. § 1144(d) ("Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(b) of this title) or any rule or regulation issued under any such law").

SEC's exclusive authority to administer and interpret Section 28(e), the SIFMA does not believe that requiring plans to report "soft dollar payments" on Schedule C of the Form 5500 is the proper method of achieving additional disclosure of soft dollar arrangements. To comply with Section 28(e), the manager must make a good faith determination that the total amount of commissions paid is reasonable in relation to the value of the brokerage and research services provided by the broker-dealer. The Department's proposed revision goes way beyond Section 28(e) by purporting to require the manager to "unbundle" and separately value for Schedule C reporting purposes any qualified "brokerage and research services" provided to the manager.

As an initial matter, we disagree with the Department's apparent assumption that qualified "brokerage and research services" should be viewed as part of a manager's "indirect compensation." On the contrary, "brokerage services" do not qualify for safe harbor protection unless they satisfy the eligibility criteria of Section 28(e)(3)(C) and provide the manager with "lawful and appropriate assistance in carrying out the manager's responsibilities."[9] Likewise, "research services" do not qualify for safe harbor protection unless they satisfy the eligibility criteria of Section 28(e)(3)(A) and (B) and provide the manager with "lawful and appropriate assistance in performing his investment decision-making responsibilities."[10] As reflected in the SEC's latest guidance, one of the purposes of narrowing the types of brokerage and research services that qualify for safe harbor protection was to "better tailor [the safe harbor] to the types of client commission services that principally benefit the adviser's clients rather than the adviser."[11]

Even if qualified "brokerage and research services" could fairly be viewed as indirect compensation to an investment manager (which they cannot be), the SIFMA does not believe that managers can unbundle and separately value such services with any degree of accuracy. As interpreted by the SEC, qualified "research services" include both third-party research developed by a third party and provided by the executing broker dealer, and proprietary research developed by the executing broker-dealer and provided directly to the manager.[12] Although third-party research services may be priced separately, brokerage and proprietary research services are bundled together with execution services at a single commission price. Given the wide variety of eligible non-execution brokerage and research services, the difficulty of assigning precise values to the services, and the fact that the services actually provided may differ from one trade to the next, any attempt to accurately value every component of the services provided to a particular manager on every trade executed during a plan year would be extremely costly and time-consuming.

Moreover, the SIFMA believes that any attempt to estimate the value of all of the non-execution brokerage and proprietary research services provided to a manager would be entirely subjective and arbitrary. The percentage allocation of execution and non-execution costs varies considerably from one trade to the next depending on a host of factors. Nonetheless, managers and/or broker-dealers would be forced to develop rough formulas for allocating execution and non-execution costs that could be applied to the total commissions paid to a particular broker-dealer. Because there is no accepted formula or methodology for allocating execution and non-execution costs, the SIFMA believes that the resulting estimates would be inherently subjective and arbitrary. Although these estimates would provide no meaningful information to a plan's

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9 71 Fed. Reg. at 41990; see also id. at 41989

10 71 Fed. Reg. at 41990, see also id. at 41985

11 71 Fed. Reg. at 41983 (discussing NASD, Report of the Mutual Fund Task Force, "Soft Dollars and Portfolio Transaction Costs" (Nov. 11, 2004) (hereafter "NASD Task Force Report") at 5), see also NASD Task Force Report at 6 (recommending that "the SEC narrow its interpretation of the scope of the Section 28(e) safe harbor to better tailor it to the types of soft dollar services that principally benefit the adviser's clients rather than the adviser").

12 71 Fed. Reg. at 41983-84, 41992.

fiduciaries, there is a considerable risk that the estimates would be mistaken for "hard numbers," particularly since they would be included on a Form 5500 that must be signed under penalty of perjury as being true, correct and complete.[13] The SIFMA believes that the close scrutiny being given to soft dollar arrangements by the SEC is sufficient to ensure that any potential abuses in this area are being addressed within the industry and therefore recommends that the proposed revision requiring investment managers to report "soft dollar payments" as indirect compensation be eliminated.

Effective Date of the Proposed Revisions:

At a minimum, the SIFMA requests that Department extend the effective date of any final revisions. Under the proposed revisions, the changes to Schedule C would become effective for plan years beginning on or after January 1, 2008. To meet this proposed effective date, plan service providers will have to develop, test and implement entirely new systems and procedures by December 31, 2007, which could leave them with less than a year depending on when the proposed changes are finalized. In addition, many service providers have already set aside substantial information technology and business resources to implement the extensive changes required by the Pension Protection Act of 2006. To ensure that service providers have sufficient lead time and resources to develop, test and implement procedures and systems that can achieve accurate and thorough compliance with any changes to the Schedule C reporting requirements, we strongly urge the Department to postpone the effective date of any such changes until at least plan years beginning on or after January 1, 2009.

Conclusion

Thank you for considering our supplemental comments regarding the proposed revisions to Schedule C of Form 5500. For the reasons explained in this letter and in the SIA's September 19 letter, we believe that the proposed changes in the reporting of service provider compensation would unnecessarily increase plan costs without providing plan fiduciaries with any meaningful information to use in carrying out their responsibilities. Please do not hesitate to contact us if you have any questions regarding this letter.

Sincerely,

Liz Varley

Liz Varley, Vice President and Director, Retirement Policy
Securities Industry and Financial Markets Association

cc: John J. Canary, Office of Regulations and Interpretations, U.S. Department of Labor
Robert J. Doyle, Office of Regulations and Interpretations, U.S. Department of Labor

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13 Notably, the Form N-1A prospectus for mutual funds does not require mutual fund companies to estimate and report the value of any research services they receive from brokers; instead, the SAI requires mutual fund companies to identify the nature of any research services considered in selecting brokers and to state whether the fund company is authorized to pay a higher commission in recognition of the value of such services. See SEC Form N-1A, Part B, Item 16 at 41.