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February 11 2008

Attn: 408(b)(2) Amendment
Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor, Room N–5655
200 Constitution Avenue, N.W.,
Washington, DC 20210

Subject: 408(b)(2) Amendment

Dear Sir/Madam:

Watson Wyatt is pleased to submit our comments on the Employee Benefit Security Administration's proposed amendment to the regulations under ERISA Section 408(b)(2) issued on December 13, 2007.

Watson Wyatt is a global consulting firm focused on human capital and financial management. We have provided consulting services for hundreds of defined contribution retirement plan sponsors since the inception of 401(k) plans. As part of these services, we have assisted numerous clients in selecting new service providers for their DC plans. We also have helped many clients compare fees received by their DC plan providers to competitive norms and to negotiate fee and compensation reductions. As such, we are well aware of the environment in which service providers to DC plans operate their businesses and plan sponsors select and monitor their DC providers. This puts us in an excellent position to provide input to the Department of Labor regarding the fee and service information plan sponsors need in order to meet their fiduciary requirements.

While none of our comments are limited conceptually to DC plans, the applications we discuss are focused on DC plan provider issues, given the significant attention given to DC fee issues within the DOL's Advisory Council and in other forums. We wish to emphasize that we also offer an array of services to non-DC plans, and may choose to supplement these comments with others that are focused on non-DC plan issues and applications.

Please note that we are not authorized and do not seek to provide legal advice to our clients, but instead encourage them to seek advice from their own legal counsel. When we refer to 'our understandings' of current and proposed rules, we do so in the context of our role being to identify issues for our clients to consider with the aid of their legal counsel. Our experience is that different legal counsels often have different interpretations, and different clients have varying comfort levels with legal uncertainties. We hope our comments enable the Department to achieve an even more nuanced balance between flexibility and reduced uncertainty.

Comments on Overall Purpose of Disclosure Concerning Compensation and Services

As noted in the preamble to the proposed regulation, ERISA Section 404(a)(1) requires plan fiduciaries to act solely in the interest of participants and beneficiaries and for the exclusive purposes of (1) providing benefits to participants and beneficiaries, and (2) defraying reasonable expenses of administering the plan. ERISA section 408(b)(2) expands on the "reasonable expenses" concept introduced in Section 404(a)(1) by providing an exemption from the prohibited transaction rules for sponsors and their service providers as long as the arrangement or contract is reasonable, the services provided are necessary and no more than "reasonable compensation" (fees) is paid for the services.

The proposed regulatory amendment and the accompanying prohibited transaction exemption make significant strides towards ensuring plan sponsors receive clear information about the total fees and compensation a provider receives and the services it provides. Although the EBSA's proposed regulatory amendment focuses on clarifying the meaning of a "reasonable" contract or arrangement, it also has significant ramifications for plan sponsors as they strive to ensure that the compensation and fees received by their service providers are "reasonable" since the amendment specifies the fee and compensation information service providers must furnish to participants.

Our experience suggests that market competition is diminished when the portion of total fees and compensation allocated to support investment management services and the portion supporting all other services furnished by a provider (i.e., administration and other plan activities related to employee communication and education) is not known. We have negotiated fee and compensation reductions in several instances where total fees were found to be within competitive norms BUT fees allocated to support administration and other non-investment related services were found to be in excess of market rates. In many of these cases, reductions in participant fees have been negotiated. However, the allocation of fees and compensation between investment management services and administration and other plan activities is not clearly identifiable in many cases where services are bundled.

In order to allow the market to effectively set competitive prices, we strongly encourage the Department to require service providers to furnish clear information regarding the allocation of fees and compensation between investment management services and non-investment management related services in bundled service arrangements to plan sponsors.

Watson Wyatt's Specific Comments

1. **Written Disclosure.** Under subsection (c)(iii) of the proposed regulation, service providers must disclose in writing the required information to plan sponsors. The proposed regulatory amendment does not prescribe how service providers must disclose required information to plan sponsors. The preamble to the amended regulation indicates that the Department expects service providers to furnish comprehensive, straightforward and helpful information to plan sponsors. Comments on how duplicate disclosure can be avoided have been requested.

   Comment: In order to ensure transparency of fees and compensation, we recommend that service providers be required to summarize their fees and compensation in a single written document. We further recommend that this written summary cite any additional specific documents (e.g., prospectus, record keeping agreements, etc) that more fully describe each fee. In order to support full disclosure, we also recommend that the written document summarizing a provider's fees be required to include a description of any asset-based charges that are temporarily waived (e.g., 12b-1 fees, management fees, etc.). We recognize that many current arrangements are documented now through multiple documents, and that synthesizing them into a single document will take service providers and sponsors some effort. Therefore, we think the Department should consider a somewhat longer effective date than is generally proposed for this particular requirement; however, we note that the overall intent – to make it easier for sponsors to assess reasonableness of fees – requires an ability by the sponsor to identify all fees, and a single document will support that objective. If the Department believes an extension is warranted for this requirement (or does not add it), we would encourage you to identify the accessibility and quality of presentation of fee information as one of the criteria that a plan sponsor should consider in assessing providers.

2. **Contract Renewal or Extension**. Subsection (c)(iii) of the proposed regulation requires service providers to furnish specified information to plan sponsors before an existing contract is extended or renewed. The proposed regulatory amendment does not define what constitutes contract renewal or extension.

   Comment: For clarity purposes, we recommend that the proposed regulatory amendment be modified to clearly define the terms contract extensions and renewals.

3. **Disclosure of Revenue Sharing Amounts for Proprietary Funds**. Subsection (c)(iii)(A)((3) of the proposed regulation describes fee disclosure requirements for bundled service arrangements. Service providers generally are not required to disclose how total fees are allocated among affiliates, subcontractors or other involved parties. Fees that are separately charged against plan investments, however, must be disclosed. The Preamble to the proposed regulation requires disclosure of asset based fees that are in addition to the "investment management fee" and lists these revenue streams as among those that may be included: "float revenue, 12b-1 distribution fees, wrap fees, and shareholder servicing fees."

   Comment: The Preamble (and proposed regulation) leave unclear whether a component of something labeled as an 'investment management fee' that actually goes to pay recordkeeping or other non-management costs (as may but need not be evidenced by payment to an affiliate of the actual investment manager) needs to be disclosed. We are aware of some service providers who construe the term "revenue sharing" to include only items such as those specified in the list of examples given in the Preamble, notwithstanding that there may be components of an expense ratio (and possibly even of an 'investment management fee') that have no specific name but which do indeed go to pay non-investment management services. We think a more complete definition of 'revenue sharing' considers the real economics involved, and not the terminology used, and that such a definition – e.g. payment of any portion of fees charged against assets for non-investment management purposes – is more clearly consistent with the intent of the proposed regulations. Use of an economic definition would assure that subtransfer agent and other fee reimbursements are fully disclosed (and would be consistent with the practices of some service providers.

   Our understanding of current DOL rules is that they require non-investment providers to disclose all revenue sharing amounts (economically defined) received from non-proprietary investment funds (those not managed or sponsored by an affiliate) but not all of the revenue sharing received from a provider's proprietary funds. Instead, the disclosure of only select components of proprietary revenue sharing, such as 12b-1 fees, is clearly required. As noted in the previous section, Watson Wyatt's experience is that full disclosure of all revenue sharing amounts allows plan sponsors to be better informed buyers and, as a result, can lead to lower overall plan fees. This is true regardless of the proprietary nature of the investment funds utilized. Thus, we recommend that the proposed regulation be modified to clearly require separate disclosure of revenue sharing amounts (economically defined) related to proprietary investment funds.

   We are also appreciative of there being a variety of currently preferred disclosure approaches among DC service providers with respect to proprietary revenue sharing, ranging from complete non-disclosure to the use of estimates to specific formulas. We are also aware of comments by some very large DC service providers that their current accounting systems do not support precise tracking of proprietary revenue sharing. One way for the Department to help address such concerns is to make more clear that only disclosure of material amounts is needed, provided that if non-material amounts are not being disclosed due to accounting systems or other reasons, that that fact be disclosed as well.

We also wish to draw the Department's attention to a special type of 'proprietary' fund that is sometimes marketed as other than proprietary: a 'fund of funds' where one investment manager picks other investment managers (which may or may not be affiliated), and it is the 'picked' investment managers that perform ongoing trading at an individual security level within the pooled investment vehicle. We believe that the final regulations should more clearly require disclosure of the fees being paid for each of the 'investment management' functions being performed in a fund of funds. The overall fund manager (the one picking the other managers) should be required to disclose (a) the total management fee for the fund of funds; (b) the fees it is receiving for its oversight functions; and (c) the fees being received by each of the investment managers of the individual funds. We believe such disclosure is required by the proposed regulations, but that this complete disclosure -- -which is pro-competitive and should not create any administrative or trade secret burdens that we can identify – should be more clearly required by the final regulations.

4. **Specificity of Services.** Subsection (c)(1)(iii)(A) of the proposed regulations requires service providers to fully disclose all services covered under the terms of a contract or arrangement. The preamble to the proposed regulation notes that this information is necessary to ensure compensation and fees received by a provider are reasonable.

   Comment: We agree that the specific services covered by a contract must be disclosed to the plan sponsor in order to ensure fees received by the provider are reasonable. Most providers have a suite of services that are standardly provided to plan sponsors of similar size. However, plan sponsors may not fully utilize services included in the terms of a contract. For example, a contract may provide for five days of provider-led employee meeting each year. The sponsor may not use the full five days each year. Is the sponsor required to negotiate fee reductions or additional services during years in which services covered under the terms of the contract are not fully used? What are the obligations of the provider in these instances?

   We suggest that sponsors and service providers be allowed to negotiate service agreements that allow for flexibility in specific utilization, so that there is not a requirement to have specific fee reductions for non-material non-usage. Thus, a sponsor and service provider may agree to the provision of a suite of services, not all of which are expected to or need to be used, in the pursuit of reduced transaction costs. Allowing this type of flexibility is consistent with the objective of matching compliance costs to the value achieved by new guidance. However, we also think that the regulations should offer guidance that 'use it or lose it' agreements where the value lost is material are not in compliance.

5. **Fiduciary Nature of Services**. Subsection (c)(1)(iii)(A)(4) of the proposed regulations requires subject contracts to state whether any of the services will be provided by the provider in their capacity as a fiduciary under either ERISA or the Investment Advisors Act of 1940.

   Comment: The final regulations should make clear that contracts can and should require precision concerning any intended fiduciary roles, so that where a provider is expected to act in a fiduciary capacity for a specific function but not other functions, the contract should specify the expected role. We do not think that contracts should be required to specify every possible fiduciary role that is not intended, and that contracts can but need not include a list of fiduciary roles that are not intended as examples.

Requirements for the identification of fiduciary status need to be crafted and applied with recognition that ERISA does not limit the application of fiduciary status to those given a formal title but can include a party in interest based on the responsibility given to or actually exercised by that party. The final regulations should recognize that intended allocations of responsibility may be different than their actual exercise. Thus, the final regulations should allow a contract to specify that the parties have not agreed that the service provider is contracted to act as an ERISA fiduciary either generally or for a particular function, but that the service provider will still be held accountable as a fiduciary if by their assumption of responsibility or otherwise they actually function as an ERISA fiduciary with respect to a particular function. Further, actions by a service provider that cause it to be treated as an ERISA fiduciary should not cause a contract to be treated immediately as non-exempt, given the possibility that the service provider may have acted in the best interests of participants by assuming additional responsibilities. Instead, the 'assumption' of (new) fiduciary responsibility by a provider should be treated as a material change in services, and be subject to the timing rules provided for material amendments.

6. **Termination of Contract or Arrangement.** Service providers subject to the disclosure requirements outlined in the proposed regulation generally must also permit termination of the contract or arrangement without penalty when advanced notice is provided. The regulation specifies that notice requirements established by a provider must be reasonably short. Termination charges that reasonably compensate a provider for losses incurred upon early termination are not prohibited.

Comment: The regulation does not include any disclosure requirements regarding termination charges. Given that the these charges are allowable only if they reasonably compensate the provider for losses resulting from early termination, we recommend that the proposed amendment be modified to specifically require service providers to describe the nature of and method for determining any new fees that the service provider would expect to receive that would result from an unscheduled termination. We also recommend that the regulation be modified to define "prepaid services" and require contracts to specify how prepaid amounts will be treated upon early termination.

We believe that the final regulations should distinguish between 'conversion' costs that are incurred by a service provider to support transition to a new provider from 'amortization recovery' costs that were incurred at the onset of its relationship. At the onset of a contract, a plan sponsor and provider should be allowed to negotiate a level fee schedule with the understanding that the provider is amortizing some of its costs of sale and 'set up' over time, and that the plan sponsor will be subject to a 'amortization recovery' fee if the sponsor chooses to discontinue the relationship within a negotiated period of time for reasons other than failure of the provider to deliver services. This type of fee structure makes it easier for sponsors to change providers (by not having to finance all of the start up costs up front) and is thus pro-competitive.

To give an example, where a plan sponsor selects provider B, the sponsor and B may negotiate a level fee schedule that provides B with a special termination fee if the sponsor terminates the arrangement for non-service delivery reasons within two years. The reasonableness of this termination fee should be evaluated based upon comparison to the market for "conversion in" costs. We have seen numerous examples of such 'termination fee schedules' among DC recordkeeping providers, and believe there is a market that plan sponsors can use to evaluate the reasonableness of such fees. The sponsor may also negotiate with B a "conversion out" fee that requires the sponsor to pay B a fee when it chooses to discontinue the relationship (again, for reasons other than non-delivery of services) at any time. This "conversion out" fee should be evaluated based upon the reasonableness of "conversion out" costs.

We encourage the DOL to allow sponsors and providers flexibility in negotiating arrangements, while giving guidance that directs both to market standards as the measure of what is 'reasonable' where the relevant market standards are those current at the time of negotiations (and under conditions which warrant new negotiations).

7. **De Minimis Exception for In-Kind Compensation**. The regulations do not make clear whether there is any exception to written disclosure requirements for the provision by plan sponsors of de minimis in-kind services, such as the provision of meeting rooms and meals, when services are being rendered.

   Comment: We suggest the final regulations are made even clearer that such an exception exists.

In closing, we wish to express our appreciation for the attention given to these and related issues by the Advisory Council and the Department. We believe that new guidance can benefit plan sponsors, service providers and participants alike by making plan sponsor and provider obligations clearer. We expect that greater disclosure requirements will increase the availability of fee information in the marketplace, and have pro-competitive effects.

Each of the undersigned is available for any specific follow up questions or comments you have concerning this letter.

Sincerely,

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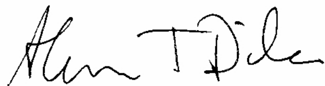

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