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

Attn: 408(b)(2) Amendment

Dear Director Doyle:

The Investment Company Institute[1] is pleased to comment on the Department's proposed regulation under ERISA section 408(b)(2).[2] The objective of the regulation is to provide clarity on the information that service providers must disclose and plan fiduciaries must consider in entering into reasonable plan service contracts. The Institute has long supported effective disclosure to plan fiduciaries that enables them to fulfill their ERISA obligations.[3]

To exercise their fiduciary duty in hiring and monitoring service providers, employers must understand the services provided, the compensation paid directly to the provider, any indirect compensation the provider receives from third parties, and any compensation an affiliate of the provider receives in connection with the provider's services to the plan. The Department's proposed regulation correctly focuses on ensuring fiduciaries will have this information. The Institute

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.68 trillion and serve almost 90 million shareholders.

[2] 72 Fed. Reg. 70988 (Dec. 13, 2007). We are filing comments simultaneously on the proposed class exemption.

[3] In 2004, the Institute recommended that the Department adopt rules calling for disclosure of both direct and indirect compensation of plan service providers. See Testimony of Elizabeth Krentzman, Institute General Counsel, on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html. For more information on the Institute's long support of effective disclosure to both fiduciaries and participants, see http://www.ici.org/pdf/ppr_07_ret_disclosure_stmt.pdf.

wholeheartedly supports that objective, but recommends clarifications and modifications to improve the regulation and ensure that the rules will provide meaningful disclosure to plans.

While the proposal would cover all type of plans, the Institute's comments focus on the application of the proposal to participant-directed defined contribution plans. There are over 600,000 defined contribution plans whose sizes range from very large to very small.[4] About 90% of 401(k) plans have fewer than 100 participants, and about two-thirds of 401(k) plans have less than $1 million in assets.[5] The Department's regulation must be workable for all of these diverse plans and their fiduciaries and not impede the ability of small employers to offer 401(k) plans to their employees. As drafted, we do not believe the regulation is workable in all respects. With this in mind we urge that in adopting a final regulation, the Department be guided by the following principles:

Disclosure to plan fiduciaries should be concise, understandable and relevant. Disclosure should focus fiduciaries on the key information they need to evaluate provider services and compensation and not overwhelm them with detail. The relevance of information should be clear to the fiduciary, because the fiduciary will be expected to consider this information in entering into and monitoring service contracts. The Department should seek to avoid "disclosure overload" that will inundate fiduciaries with material that is not useful and that obscures relevant information. When disclosure is concise and understandable it assists fiduciary decision-making and avoids imposing unnecessary costs that ultimately are borne by plans and participants.

Disclosure rules should provide clarity to recordkeepers and other service providers on what disclosure is required of them. Because failure to comply with the regulation will result in a prohibited transaction, a service provider must know what information the Department expects to be provided. Service providers also must be in a position to provide the information required of them. This is especially true if one service provider is expected to be a conduit for disclosure of information about unaffiliated service providers and investment options.

The Department's disclosure rules should work consistently with securities law requirements. The SEC administers a well-developed disclosure regime for mutual funds and imposes regulatory and disclosure requirements with respect to investment adviser soft dollar practices. The SEC has projects underway to enhance the usefulness of mutual fund and soft dollar disclosures.[6] For the reasons discussed below, the Department should not require more information with respect to

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[4] U.S. Department of Labor, *Private Pension Plan Bulletin, Abstract of 2005 Form 5500 Annual Reports* (Dec. 2007).

[5] Source: ICI Tabulation of 2004 Form 5500 data.

[6] See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, SEC Release Nos. 33-8861 and IC-28064, 72 Fed. Reg. 67790 (Nov. 30, 2007); Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, SEC Release No. 34-54165, 71 Fed. Reg. 41978 (July 24, 2006).

investing in a mutual fund than is already provided in mutual fund disclosure documents available to all investors.

Our comments reflect these principles. Many of our comments focus on the application of the regulation to arrangements in which plans contract with a single provider (typically, a recordkeeper) to obtain a range of services, such as recordkeeping, compliance assistance, and participant education and advice, sometimes using the recordkeeper's affiliates and subcontractors. The recordkeeper often makes available a range of mutual funds and other investments for plan fiduciaries to select for the plan menu – in some cases some of these investments may be managed by affiliates of the recordkeeper.

Our comments cover disclosure of services and compensation, disclosure of conflicts of interest, the interaction of the regulation with section 4975 of the Internal Revenue Code, and the proposed effective date.

I. Disclosure Regarding Services and Compensation

A. The Department should retain the basic fee and compensation disclosure structure in the proposed regulation.

The Department correctly focused disclosure of service provider compensation on the services to be provided, the compensation or fees to be received by the service provider directly and indirectly from third parties, and the manner of receipt of the compensation or fees. We agree that service providers also should disclose compensation or fees that an affiliate of the service provider will receive because of the plan's contract with the service provider. For example, we agree that if a 401(k) plan recordkeeper is an affiliate of the investment manager of a mutual fund that plan fiduciaries select for the plan's menu, the recordkeeper should disclose that the investment manager is an affiliate and receives a management fee from the fund.

We strongly agree that service providers should be allowed to choose to express compensation or fees in terms of a monetary amount, formula, percentage of the plan's assets, or per capita charge (although we make suggestions below for clarification). This allows providers to disclose fees and compensation accurately and in the manner in which they are charged.

We also agree that where a service provider offers a bundle of services priced as a package, the service provider should disclose all the services and aggregate compensation or fees received directly or indirectly by the service provider, its affiliates, subcontractors, or any other party in connection with the bundle of services – but should not be required to disclose the allocation of the fees among various service components or among other parties. Our reading of the rule is that it does not mandate that service providers offering proprietary investment options disclose to fiduciaries a price for recordkeeping and administration and a separate price for investment management where this "price"

has to be generated artificially and thus will be of questionable accuracy. We strongly agree that this is the right rule and the Department should retain it in the final regulation. Requiring providers to generate artificial prices for recordkeeping and administration would favor one business model – firms that just bundle together recordkeeping and other administrative services – over another business model – firms that offer recordkeeping and administration as well as proprietary investment products, by imposing additional disclosure burdens on the full-service model.[7]

B. The Department should clarify that service providers to mutual funds are not service providers covered by the regulation.

We understand from informal comments from the Department that the Department is considering treating as a service provider for purposes of the regulation a person who provides services to a mutual fund in which a plan invests, if that person falls into one of the three categories of covered providers. For example, mutual funds engage an investment adviser to manage the fund and broker-dealers to execute the fund's portfolio trades; mutual funds also need other services in the Department's enumerated list, including banking, consulting, custody, insurance, recordkeeping, accounting, auditing, legal and valuation services. The typical mutual fund is a legal entity that has no employees of its own and pays dozens, even hundreds, of persons and entities to provide services to the fund.

ERISA section 408(b)(2), under which this regulation will be adopted, provides an exception for plan services that would otherwise be prohibited by ERISA section 406(a). Section 406(a) prohibits fiduciaries from causing certain transactions between a plan and a party in interest, including the furnishing of goods, services and facilities between the plan and a party in interest and the transfer of plan assets to a party in interest. Service providers to mutual funds are not parties in interest because they are not providing services to a plan and because the assets of the mutual fund are not assets of the plan.[8] This has been the consistent position of the Department of Labor for more than 30 years.[9] Plans

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[7] For more discussion of why 401(k) recordkeepers of all kinds "bundle" services together, and why attempts to "price" each component would be artificial, see Testimony of Paul Stevens, President and CEO, Investment Company Institute, Hearing Before the Committee on Ways and Means (October 30, 2007), available at http://www.ici.org/statements/tmny/07_house_401k_tmny.html.

[8] ERISA section 3(14)(B) defines a party in interest with respect to a plan as "a person providing services to such plan." The statute does not include a person providing services "indirectly" to a plan—nor could it, as this essentially would be limitless. Plan fiduciaries are parties in interest under section 3(14)(A), and, in defining fiduciary in section 3(21), ERISA clarifies that the investment adviser and principal underwriter of a mutual fund is not a fiduciary (or party in interest) solely by reason of a plan investing in the fund.

[9] See Interpretative Bulletin 75-3, 29 C.F.R. § 2509.75-3 ("The Department of Labor interprets [ERISA section 3(21)(B)] as an elaboration of the principle set forth in section 401(b)(1) of the Act and ERISA IB 75-2 (issued February 6, 1975) that the assets of an investment company shall not be deemed to be assets of a plan solely by reason of an investment by such plan in the shares of such investment company. Consistent with this principle, the Department of Labor interprets this section to mean that *a person who is connected with an investment company*, such as the investment company itself, its investment

do not enter into contracts or individually negotiate with the mutual fund's investment adviser or any other fund service provider. In fact, it would be illegal under the securities law for a mutual fund's investment adviser to negotiate a special deal with one of the investors of the fund.[10]

The reason that Congress exempted mutual funds from ERISA's party in interest and fiduciary rules is as relevant today as it was in 1974 – mutual funds are comprehensively regulated under the Investment Company Act of 1940 and other securities laws and provide fulsome disclosure under SEC rules.[11]

ERISA's structure provides a reason to treat service providers to mutual funds differently here than with regard to Form 5500 filing. The final Form 5500 rules include a provision, not in the original proposal, that Schedule C reporting covers persons providing services indirectly to plans on the ground that this is financial information that the Department finds necessary and appropriate to be reported under ERISA section 103(c)(5). As the Department pointed out, ERISA section 103(c)(3) does not limit Schedule C reporting to parties in interest. In contrast, these section 408(b)(2) regulations should focus on assisting fiduciaries in ensuring that no prohibited transaction occurs with a party in interest. That a recordkeeper offers plans a convenient way to pick plan investment options from a broad array of possible choices does not mean that mutual fund providers are service providers to plans. The Department should focus on what fiduciaries need to know about the recordkeeping arrangement: when the cost of recordkeeping and administration is paid through investment products, fiduciaries should understand that the recordkeeper receives compensation from third party funds and that the organization of which the recordkeeper is a part receives compensation when and if proprietary funds are selected for the plan's menu.

Plan fiduciaries selecting investment options for a 401(k) plan menu need to know the fees and expenses of all plan investments to make a prudent selection and fulfill their duties under ERISA section 404(a)(1)(B). Knowing this information also ensures that fiduciaries understand the total cost of a plan, taking into account both the fees and compensation paid to service providers and the fees and expenses of the selected investment options. The Department has stated that evaluating investment

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adviser or its principal underwriter, is not to be deemed to be a fiduciary of or party in interest with respect to a plan solely because the plan has invested in the investment company's shares.") (emphasis added).

[10] See Sections 18(f) and 22(d) of the Investment Company Act of 1940.

[11] See Subcommittee on Labor Report, Pub. L. 93-406 (Comm. Print) ("Mutual funds are currently subject to substantial restrictions on transactions with affiliated persons under the Investment Company Act of 1940, and also it appears that unintended results might occur (such as preventing a trust from redeeming its mutual fund shares) if mutual funds were not excluded from these definitions.")

fees is part of a fiduciary's duty to select investment options prudently.[12] The Department may want to underscore the obligation of fiduciaries to obtain and consider fees and expense information about investment options in the preamble to this final regulation, a Field Assistance Bulletin or an Advisory Opinion. The guidance could point out that fiduciaries, in evaluating whether to include a mutual fund in the plan's menu, should review the fund's fee table (as well as other information about the fund, such as investment objective and historical performance), and review and compare similar information for other investment products.

If the Department feels compelled to require in the 408(b)(2) regulation that someone provide plan fiduciaries with information on the fees of the plan's investments, this should be a person who has a service contract with the plan. The Department could require, for example, that service providers whose service to plans includes offering access to investment options must, as a condition of the arrangement being a reasonable arrangement, undertake to provide the responsible plan fiduciary with basic fee and expense information about the investment options chosen by the fiduciary.

This responsibility must be limited, however, to investment options that the provider makes available as part of its service – in other words investments on the provider's "platform." Plan fiduciaries sometimes engage or select investment providers not on a recordkeeper's platform, and the recordkeeper agrees to record keep the investments based on the information provided by the investment provider or directly from plan fiduciaries. In these cases, which often involve investments other than traditional collective products like mutual funds, collective trusts, or insurance separate accounts, the recordkeeper is not serving as a conduit between the plan fiduciaries and the investment – the plan fiduciaries deal directly with the investment provider.[13]

In any event, the Department must clarify that with respect to mutual funds, recordkeepers are not required to obtain and provide information beyond that contained in mutual fund disclosure documents. The SEC has extensive expertise in what information is relevant to the decision to invest in particular mutual funds and administers an effective disclosure regime. Mutual fund fees are the best disclosed and best understood fees in the entire 401(k) system, in part because the SEC's rules focus on simplicity and comparability. The best evidence of this is that 401(k) investors in mutual funds

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[12] See, e.g., Department of Labor, "Understanding Retirement Plan Fees and Expenses" (May 2004), available at http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html. This publication points out the distinction between service fees and investment fees.

[13] A different rule also may be needed where a plan offers a "brokerage window" that allows participants to invest in a wide range of securities, including mutual funds, exchange-traded funds, and equity and fixed income securities issued by operating companies. In contrast to a 401(k) plan with a limited menu of investment options, it would not be possible to disclose compensation and fees that could arise from every one of the hundreds or thousands of investment products, because it would not be known in advance what securities participants might choose. In this circumstance, it should be appropriate for the service provider to disclose at the time of contract the commissions and any other costs associated with accessing or trading within the brokerage window.

concentrate their assets in low-cost funds with below average portfolio turnover.[14] The Department's final rule should not distort this competitive market. Sound public policy requires that all investors have the same information in evaluating investments.

C. The Department should clarify the application of the bundled reporting requirement to payments from plan investments and transaction-based payments.

The scope of the Department's "bundled services" rule is not clear. As proposed, a "bundled" service provider is not required to allocate the aggregate cost of services among affiliates, subcontractors, and other parties providing services in connection with the bundle, except to the extent that the party:

> "receives or may receive compensation or fees that are a separate charge directly against the plan's investment reflected in the net value of the investment or that are set on a transaction basis, such as finder's fees, brokerage commissions and soft dollars (research or other products or services other than execution in connection with securities transactions)."

One reading of this rule, which we believe is the correct one, is that it simply ensures that where the provider or other person who provides services to the plan receives compensation or fees directly from a plan investment or receives compensation or fees on a per transaction basis, that compensation or fee must be separately disclosed. For example, this reading of the rule would require separate disclosure of a payment from a mutual fund in which the plan invests to any of the providers in the bundle in connection with the plan. It would also require disclosure of a "finder's fee" that a plan consultant is paid for securing the business from an investment the fiduciaries select for the plan or from any of the subcontracted entities providing services in connection with the bundle of services. We recommend that the Department clarify in the final regulation that this is the correct reading of the rule.

Because the proposed language is broadly written, however, it suggests that *every payment to any person* from a plan investment might be required to be separately disclosed, even if the recipients are neither providing services to the plan nor are affiliates of a person providing services to the plan. We find it hard to believe this is the result that the Department intended. When mutual funds are used as

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[14] See Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006*, ICI Fundamentals, vol. 16, no. 4 (September 2007), available at http://www.ici.org/pdf/fm-v16n4.pdf. A recent survey of plan fiduciaries found that fees were the second most considered criterion that plan fiduciaries considered in selecting the options for their plans. In 2006, 60% of plan sponsors said they considered fees in selecting the options in their plans, up from 49% in 2005. 79% of plan sponsors indicated they considered performance versus benchmark in 2006. Because performance is reported net of fees these sponsors indirectly considered fund fees in selecting plan investment options. *See* IOMA, Managing 401(k) Plans, Issue no. 08-01 (Jan. 2008).

plan investments, this broad reading of the language of the proposal would be especially unwise and unnecessary.

First, as we explained above, the typical mutual fund pays dozens, even hundreds, of persons and entities to provide services to the fund. These include everything from the fund's board of directors and its investment manager, to custodians, transfer agents, pricing services, accountants and attorneys.[15] Disclosing what the fund paid to all of these service providers would overwhelm fiduciaries and serve no useful purpose. The fees for all of these service providers are reflected in a mutual fund's fee table, which is prominently disclosed to the plan under SEC disclosure requirements. The SEC does not require funds to disclose payments to each service provider to a fund, because to do so would obscure the total cost and the breakdown of fees for investment management, distribution, and other expenses that is required to be disclosed.

A broad reading of the regulation creates similar difficulties with respect to transaction cost disclosure by suggesting that disclosure that goes beyond SEC requirements might be required. In fact, a broad reading suggests that mutual funds must provide plan fiduciaries with disclosure of the brokerage commissions that would be paid to each broker for trading the fund's portfolio during the plan's investment in the fund. We cannot understand how this disclosure provides useful information to a fiduciary. For example, an Institute member reported to us that just one of its funds, which has many billions in assets under management, used *135 different brokers* in 2007 for trading, totaling around $80 million in commissions.

Mutual funds already provide information on their trading costs. The portfolio turnover rate, a proxy for the transaction costs of the fund that provides comparability, is disclosed in a mutual fund's prospectus.[16] The fee table of a mutual fund prospectus does not focus on brokerage commissions because these are not fees under accounting rules: brokerage commission costs reduce the fund's capital gain (or increase capital loss) on a portfolio security investment—and mutual fund performance is reported net of commissions and other trading costs.[17] Item 16 of SEC Form N-1A requires a host of

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[15] The Institute's "Investment Company Service Directory," which lists providers of services and products to the mutual fund industry, contains over 175 *categories* of service providers that the fund industry uses, ranging from accounting to XBRL services.

[16] The SEC has proposed to make the turnover rate more prominent by moving it into the summary section at the beginning of every fund prospectus, immediately following fee and expense information. See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, SEC Release Nos. 33-8861 and IC-28064, 72 Fed. Reg. 67790 (Nov. 30, 2007).

[17] Mutual fund disclosure of transaction costs also does not focus solely on brokerage commissions because these are not the only "costs" of trading a portfolio of securities. For example, some securities, particularly fixed income securities, are typically traded on a principal basis with no commission generated. Other so-called transaction costs, such as "market impact costs," and "opportunity costs," cannot be quantified and expressed with accuracy. *All* of these costs are disclosed indirectly, however, in fund performance information.

information about commissions, including aggregate brokerage commissions paid during the last three years and information about fund trading policies.[18] This information appears in a fund's Statement of Additional Information.

Second, requiring a 401(k) recordkeeper to disclose to plan fiduciaries the amount and recipient of every payment made to any person by a mutual fund in the plan's line-up – information not required by SEC disclosure rules – would put the recordkeeper in the position of risking its exemption from a prohibited transaction if, despite its efforts, it fails to obtain complete information from every investment product used by any plan the recordkeeper services.

Third, because of the risk to recordkeepers in serving as conduits of third party information, this rule could have the effect of discouraging the offering of nonproprietary products. A 401(k) recordkeeper will find it easier to catalog and disclose payments made from funds managed by an affiliate rather than to seek extensive disclosure from providers of third party investment products. The rule thus could reverse the trend towards offering "open architecture" investment services in the mid- and small plan markets. If the rule were to have this effect, it also might put at a competitive disadvantage recordkeepers that are not affiliated with financial services firms and thus do not offer proprietary investment products to plans. This could also limit the range of investment choices available to participants.

Finally, as we explain above, a broad reading of the Department's proposed rule is not consistent with ERISA's prohibited transaction structure. The service providers to a mutual fund are not service providers to plans and not parties in interest. The investment company shares or units owned by ERISA plans are "plan assets," but the underlying assets of these investment companies themselves are not. ERISA section 3(21)(B) makes clear that the investment adviser and principal underwriter of a mutual fund are neither fiduciaries of the plan nor parties in interest to the plan. When a plan fiduciary selects a mutual fund for a plan, the fiduciary is making an investment.

For all these reasons, the narrower reading we discuss above is both correct and will provide a workable rule. If the Department's final rule retains any requirement that all 401(k) recordkeepers, as "bundlers," must disclose fees paid to unaffiliated persons out of the plan's investments, for the reasons we explain earlier, the Department must clarify that with respect to mutual funds, recordkeepers are

[18] Item 16 of SEC Form N-1A requires disclosure of: (1) how portfolio transactions are effected; (2) commissions paid during the three most recent fiscal years; (3) an explanation of any material difference of the commissions paid during those years; (4) identification of any affiliated brokers used; (5) the percentage of commissions paid to affiliated brokers; (6) how the fund selects brokers; (7) how the fund evaluates the overall reasonableness of brokerage commissions; and (8) information on the amount of transactions effected pursuant to a soft dollar arrangement.

not required to obtain and provide information beyond that contained in mutual fund disclosure documents.[19]

D. The Department should clarify the rules allowing disclosure of formulas and basis points.

We strongly agree, as the Department has proposed, that service providers should be allowed to express compensation and fees as a monetary amount, formula, percentage of the plan's assets, or per capita charge. We have two suggestions for clarifying the regulation in this regard.

First, we think the Department correctly drafted the text of the proposed regulation to allow the use of formulas, percentage of plan assets, or per capita charge disclosures in all cases. The preamble to the proposal suggests, however, that formulas, basis points, or per capita disclosures can be used only if the service provider *cannot* disclose compensation or fees in terms of a monetary amount. The Department should make clear that service providers can always use formulas. Adopting the more restrictive formulation in the preamble would be unwise. In some cases, disclosure of a monetary amount would not be impossible, but would be based on "guesstimates," would depend on facts that cannot be known in advance, or would be prohibitively expensive to generate. Using formulas, percentage of plan assets, or per capita charges simply will be more accurate if that is how the fee is, in fact, charged.

Second, the proposed regulation states that the "manner in which compensation or fees are expressed shall contain sufficient information to enable the responsible plan fiduciary to evaluate the reasonableness of such compensation or fees." We understand the point of this rule is to ensure service providers provide disclosures that are accurate and complete. This should be an *objective* standard, based on what a reasonable plan fiduciary would need to know to evaluate the compensation or fee, not a *subjective* standard based on each contracting fiduciary. We recommend the Department make this clear.[20]

E. The Department should incorporate a rule allowing providers to correct inadvertent errors that occur despite reasonable efforts.

Under the proposed regulation, a service contract must require a service provider to make the required disclosures "to the best of the service provider's knowledge." We agree that a service provider

[19] Of course, a plan service provider, such as a recordkeeper or consultant, still would be required to disclose payments that it receives from the mutual fund under the requirement to disclose indirect compensation.

[20] An objective standard allows service providers to create systems to capture and report the information required by the rule in a cost-effective manner.

should not be required to disclose information that it does not know. The term "best of the service provider's knowledge," however, is not a typical ERISA contract term. We recommend that a "reasonable and good faith" standard apply instead.

The rule also should provide a means for a service provider to correct inadvertent errors that occur despite reasonable efforts. The rule should incorporate a procedure similar to the procedure provided in the regulations under ERISA section 401(c).[21] These regulations require an insurance company to provide certain information to plans to prevent the general account of the insurer from being treated as plan assets. Because of the severe consequence of inadvertent failures, the regulation provides for reasonable corrections. Under the regulations, an insurer will be deemed to have satisfied the disclosure requirements if:

- The insurer made reasonable and good faith attempts at compliance;
- The insurer has in place written procedures that are reasonably designed to assure compliance, including procedures to detect any instances of non-compliance; and
- No later than 60 days after detection of an instance of non-compliance, the insurer provides the required disclosures.

We recommend the Department include a similar provision in the final regulation.

F. The Department should clarify the references to acting as a fiduciary under the Investment Advisers Act of 1940.

The proposal twice refers to fiduciaries under the Investment Advisers Act of 1940 ("Advisers Act") — first in referring to covered service providers, and second in requiring that service providers disclose whether or not they expect to provide any services as a fiduciary under the Advisers Act.

We interpret the reference to fiduciaries under the Advisers Act as intending to capture plan service providers who do not qualify as fiduciaries under ERISA but that have been interpreted by the Supreme Court to have fiduciary status under the Advisers Act.[22] For example, in its 2005 report on plan consultants, the SEC noted that some consultants who believed they were not fiduciaries under ERISA were subject to fiduciary obligations under the Advisers Act.[23] These consultants would be

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[21] 29 C.F.R. § 2550.401c-1(i)(5).

[22] See *S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

[23] U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, "Staff Report Concerning Examinations of Select Pension Consultants" (May 16, 2005), available at http://www.sec.gov/news/studies/pensionexamstudy.pdf. See also Department of Labor, "Selecting and Monitoring Pension Consultants - Tips For Plan Fiduciaries," available at http://www.dol.gov/ebsa/newsroom/fs053105.html.

covered under our interpretation of the Department's proposal because they provide services to the plan and are deemed fiduciaries under the Adviser Act. In contrast, for the reasons we discuss in Part I.B. above, we do not think the Department intended to capture persons who might be registered as investment advisers but are not providing services directly to an ERISA plan, e.g., investment advisers to mutual funds.

Second, the Department should clarify what it means by "fiduciary under the Investment Advisers Act of 1940."[24] We suggest the Department clarify whether the regulations cover only SEC-registered advisers or all "investment advisers" subject to fiduciary duties under the Advisers Act. Consultation with the SEC on this issue may be helpful.

G. The Department should ensure its rules work in situations where disclosure of all service and fees and compensation is not feasible at the time a contract is signed.

There are certain situations in which disclosure of all compensation and fees may not be possible, except in general terms. For example, Institute members who provide recordkeeping services to plans tell us that it is common for a recordkeeping agreement to be signed without the plan fiduciaries having finalized the investments that will be available on the plan menu, although the parties may have a general sense of the kind of funds that will be on the menu. Plan fiduciaries can and frequently do make changes to the plan menu during the period of the contract. In addition, in some cases, all the services that a plan will use may not be known when the contract is signed. It would be helpful for the Department to clarify in the preamble that the Department's rules adequately address these situations by limiting disclosure based on what the service provider knows at the time of the contract, and allowing for changes to disclosure later.

II. Disclosure Regarding Conflicts of Interest

A. The Department should narrow the possible breadth of the "conflicts of interest" disclosures.

We agree with the general goal of ensuring a fiduciary has information on relationships a service provider has with others to allow the fiduciary to determine whether a service arrangement is reasonable and provides no more than reasonable compensation. We are concerned, however, that the possible breadth of disclosure of "conflicts of interest" threatens to obscure the key information that fiduciaries need to know to fulfill their duties. Proposed section 2550.408b-2(c)(1)(D), boiled to its

[24] Not all persons who fall within the definition of "investment adviser" under the Advisers Act must register with the SEC. See, e.g., Sections 203(b)(3) and 203A of, and Rule 203A-2(b) under, the Advisers Act. Persons exempt from registration with the SEC are subject to the antifraud provisions of section 206 of the Advisers Act, from which the Advisers Act's fiduciary duties derive, and could also be subject to registration under state laws.

essence, requires service providers to determine whether any relationship with anyone, including other clients, "may" create a conflict of interest in performing services.

The rule specifically refers to other service providers to the plan and, typically, one plan service provider is not in a position to know all the other service providers the same plan might engage. For example, the rule could require disclosure where a 401(k) plan recordkeeper also serves as the plan recordkeeper for a firm that happens to be the plan's accountant or legal counsel. If this requirement is retained in the final regulation, it will create an enormous compliance burden because each service provider would have to collect from plan fiduciaries information identifying every other plan service provider (information that plans may not want to reveal), and then cross check against every relationship the service provider or an affiliate has.

Because the proposal broadly defines compensation and fees and requires disclosure of compensation and fees received indirectly as well as by affiliates, most of the "conflict of interest" disclosures are duplicative. In fact, we believe that the disclosure of direct and indirect compensation, as well as compensation earned by an affiliate, will be more effective than requiring a service provider who is not a fiduciary to determine that it may have a "conflict of interest." In short, this is better resolved by disclosure of the "interest" without requiring a service provider to determine that it has a "conflict."

We have been unable to find an example of a true conflict of interest that would not be disclosed to fiduciaries under the disclosures for direct and indirect compensation or that would not be prohibited by ERISA section 406. For example, a 401(k) plan recordkeeper that receives payments from investment providers to defray the cost of recordkeeping could be said to have a "conflict of interest," but these payments would be disclosed under the compensation disclosure rules. The example in the preamble—a service provider buying for the plan a parcel of real estate in which an affiliate has an interest—also would be disclosed because the definition of "compensation and fees" includes anything of value received by an affiliate because of the service provider's position with the plan. This would in any event be prohibited by ERISA section 406(b) because the service provider would be a fiduciary and would be engaging in self-dealing.

If the Department decides to retain a rule along the lines proposed, we recommend the Department focus the disclosure on service providers who are *making recommendations* regarding products, services or investments and who receive or may receive compensation or fees from the providers of those products, services or investments.[25]

[25] As discussed above, many 401(k) plan recordkeepers offer access to a platform of investment choices and also may agree to record keep investments outside the platform selected by plan fiduciaries. Offering plans these services should not by itself be viewed as making a recommendation.

B. The Department should reconsider the requirement to disclose performance-based compensation as a conflict of interest.

The proposed regulation would require service providers to disclose whether the provider or an affiliate will be able to affect its own compensation without the prior approval of a plan fiduciary, and provides as examples "incentive, performance-based, float or other contingent based compensation." We are puzzled by this requirement.

In many respects, this requirement duplicates the requirement to disclose the manner in which compensation and fees will be charged. So long as the formula or method of determining "performance-based" or "incentive" compensation is disclosed, the fact that the provider's performance actually generates the additional compensation should not require a separate disclosure. For example, a recordkeeper that charges a per account fee and provides enrollment meetings and materials designed to increase plan participation, will "increase" its compensation by increasing plan enrollment. But this is apparent from the disclosure of the per account charge.

ERISA already prohibits a service provider from affecting its compensation by literally increasing it beyond what is agreed to in the service contract. In that circumstance the person would be a fiduciary by virtue of having discretion over plan assets, and would violate the "self-dealing" prohibition in ERISA section 406(b).

C. The Department should narrow the requirement to disclose policies and procedures that address conflicts of interest.

The proposal requires that a service provider explain any policies or procedures that it or an affiliate has (1) to address actual or potential conflict of interest or (2) that are designed to ensure that indirect compensation (as described in paragraph (c)(1)(iii)(A)) or disclosed relationships or arrangements with others (as described in paragraphs (c)(1)(iii)(C), (D), and (E)) do not adversely affect the provision of services.

Large financial services companies have numerous policies and procedures to address what might broadly be thought of as conflicts of interest. These policies and procedures may be very detailed, and many may only tangentially affect the services being provided to a plan.[26] To ensure compliance with the Department's regulation, however, service providers may feel compelled to be overinclusive,

[26] Many of these policies and procedures are governed by other regulatory regimes. See, e.g., SEC Rule 38a-1 under the Investment Company Act of 1940.

which threatens to overwhelm fiduciaries and obscure useful disclosures regarding relevant policies and procedures.[27]

Accordingly, we recommend the Department retain the requirement to disclose policies related to compensation and relationships otherwise disclosed (that is, compensation described in paragraph (c)(1)(iii)(A) and relationships described in paragraphs (c)(1)(iii)(C), (D), and (E)), but we recommend deleting the requirement to disclose policies and procedures that address other "actual and potential conflicts of interest." This will avoid confusion and better ensure that the disclosed policies and procedures are relevant and useful to the fiduciary.

III. Interaction with Internal Revenue Code Section 4975

A. The Department should clarify that compliance with the regulation meets Code requirements.

The interaction between the proposal and section 4975 of the Internal Revenue Code is not clear, in that no changes to the extensive regulations under Code section 4975 are proposed.[28] We believe that the Department has authority to issue guidance on Code section 4975(d)(2)[29] and thus the Department should confirm that compliance with the regulation provides a service provider with protection from excise taxes in Code section 4975(a) and (b).

B. The Department should clarify that IRAs and similar plans are not covered by the rules.

Because the Department did not propose any regulations under Code section 4975, individual retirement plans and other plans described in Code sections 4975(e)(1)(B), (C), (D), (E), (F), and similar plans described in (G), would not be covered by the proposed regulation. We believe this is the correct result. These account plans, which include individual retirement accounts, individual retirement annuities, Archer medical savings accounts, health savings accounts, and Coverdell education savings accounts, are not governed by ERISA and do not have a fiduciary overseeing plan

[27] An explanation that the service provider offsets fees received from third parties in connection with plan services against the amount it would otherwise charge the plan (the example the Department provides in the preamble) is a useful disclosure. A detailed explanation of the procedures a service provider's affiliated investment bank has to prevent improper flow of information to an affiliated broker-dealer in anticipation of an initial public offering is not useful.

[28] 26 C.F.R. §§ 54.4975-1 through -15.

[29] See Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47713 (Oct. 17, 1978).

administration on behalf of participants. We recommend that the Department confirm that these individual account plans are not subject to the regulation.[30]

IV. Proposed Effective Date

A. The Department should delay the effective date until at least one year after publication of final rules.

In its regulatory impact analysis, the Department projects 1.1 million service provider arrangements will be affected. We think this may be understated. The rules require that certain terms be in a service contract that a plan has with a covered service provider. Although not all service arrangements are covered by the regulation, the regulation covers virtually every provider of importance to plans. The Department recently estimated that there are nearly 700,000 ERISA-governed retirement plans, 2.5 million health plans, and a similar number (that is, millions) of other welfare plans, such as life and disability insurance plans.[31]

In adopting the final Form 5500 revisions, the Department recognized that plans and service providers need significant time to adjust their systems to comply with the new requirements. The 408(b)(2) regulation creates additional difficulties because it not only requires certain disclosures but also requires revisions to contracts. With respect to Form 5500, the Department provided plans and service providers with more than a year to comply.[32]

We recommend that the rules be effective no earlier than 12 months from the date of publication of the final regulation. This recommendation is based on the Department making the clarifications and modifications to the regulation that we recommend; depending on the final rules, more time could be required.

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[30] The service arrangements in IRAs and similar individual account plans are very different than those provided to employer-sponsored ERISA plans. If the Department wishes to cover these individual account plans, it should do so with a separate proposal, facilitating comments on issues specific to these plans.

[31] See Department of Labor, Fact Sheet, "EBSA Achieves Approximately $1.5 Billion in Total Monetary Results," available at http://www.dol.gov/ebsa/pdf/fsFY07Results.pdf. We also note that the Department's regulatory impact statement uses Schedule C information, and part of the reason for changes to Schedule C was because it did not require listing of many service providers to plans. This suggests the Department's estimate of affected arrangements is understated.

[32] The compliance time is actually more than two years in the sense that Form 5500 filings for the 2009 year will not be due until mid-2010 at the earliest. Service providers will need to have systems in place on January 1, 2009, however, to capture the new information required on Schedule C.

B. The final regulation should apply only to contracts entered into or materially modified after the effective date.

It is unclear from the proposal how it applies to contracts in existence on the effective date. Whatever effective date the Department settles on, it will be impossible to amend, by even the Department's conservative estimate, over one million contracts quickly. Simply locating all of the existing contracts, and getting responses from plan fiduciaries, is a monumental undertaking. In addition, many contracts renew automatically, and the renewal could activate soon after the effective date. For this reason, we recommend that the regulation apply only to contracts entered into or materially modified after the effective date.

If the Department's final rule is effective with respect to any existing contracts, the final rule should state that service providers can comply with the regulation with respect to existing contracts by providing the disclosures required by the rules, and waiting to modify contracts until the contract is otherwise materially modified.

* * * *

We commend the Department for proposing these changes to provide clarity on the information that service providers must disclose and plan fiduciaries must consider in entering into plan service arrangements. We believe these changes will help ensure that plan fiduciaries have the information they need to determine that plan service contracts are reasonable under ERISA's standards. Please feel free to contact the undersigned at 202.326.5826 (podesta@ici.org) or Michael Hadley at 202.326.5810 (mhadley@ici.org) with any questions.

Sincerely,

Mary P. Podesta

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