



January 22, 2007

The Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N- 5669  
U.S. Department of Labor  
200 Constitution Avenue, NW.  
Washington, DC 20210

Attn: 401(k) Plan Investment Advice RFI (Disclosures)

E-mail to [e-ORI@dol.gov](mailto:e-ORI@dol.gov)

Ladies and Gentlemen:

This letter addresses the disclosure aspects of the request for information relating to 401(k) Plan Investment Advice (RFI). There is a separate comment letter addressing the computer model certification aspects of the RFI.

DALBAR appreciates the opportunity to submit comments in response to the request for information relating to the requirement that fees and compensation be disclosed to participants and beneficiaries.

Regardless of whether an arrangement provides for non-varying fees [section 408(g)(2)(A)(i)] or uses a computer model under an investment advice program [section 408(g)(2)(A)(ii)], the arrangement also must satisfy section 408(g)(4) through (9) in order to qualify as an "eligible investment advice arrangement."

These comments are intended to assist in the development of regulatory guidance and in the assessment of economic costs and benefits relating to ERISA section 408(g)(8)(B) that directs the Secretary to:

- Issue a model form for the disclosure of fees and other compensation required by section 408(g)(6)(A)(iii) that meets the standards for presentation of information prescribed in section 408(g)(8)(A).

## SUMMARY OF COMMENTS

The following is a summary of comments provided here:

- Failures of Current Disclosure Methods: Current disclosures are ineffective and often ignored due to the burden placed on investors to use them.
- Participant Behavior Segments: Participants in a given plan fall into four segments each requiring different support and comparable fee disclosures: Self Supported, Computer Centric, Personal Adviser and Uninvolved.

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- Assessment of Materiality: Disclosures need to be limited to those that have a material effect and influence the decisions participants can make.
- Definition of "Affiliate": Fees and compensation to affiliates must be disclosed but this requires a definition of what constitutes an affiliate.
- Dual Purpose of Disclosure: Fee and compensation disclosures are used by plan sponsors in prudent selection of fiduciary advisers and by participants in deciding whether to use the designated adviser.
- Costs and Benefits: Direct and indirect impacts of fee and compensation disclosures are reviewed.
- Standards for Presentation [ERISA section 408(g)(8)(A)]: Suggestions for achieving effective disclosures.
- Specific Answers: Response to five specific requests for information.
- APPENDIX -Sample Model Disclosure Document

## ABOUT DALBAR

DALBAR was founded in 1976 and has served as the independent expert to financial firms in several areas of business. Financial firms use DALBAR for its unbiased ratings and evaluations and consultation in their pursuit of excellence. DALBAR measures and evaluates how well investors are served, consistent with various financial regulatory requirements in the areas of:

- Written Communications (Required disclosures, sales materials, education materials)
- Personal Financial Advice (Due diligence and certification of advisers)
- Technology (Web based, Automated phones, e-business)
- Phone Centers (Service and sales)

During the course of its business, DALBAR has collected, evaluated and published reports on written and electronic communication from most financial services firms. Fee disclosures have always been a key element in these evaluations.

Recognizing DALBAR's capabilities in this area, the GAO (Government Accountability Office) contracted with DALBAR in 2005 to evaluate the Social Security Administration statement to participants. Results were published to Congress.

DALBAR is in a unique position to assist in the creation of regulations to comply with section 408(g)(6)(A)(iii). DALBAR has samples available of past and present practices as well as standards that reflect investor preferences and understanding and will make this information available to EBSA.



Additionally, DALBAR has recently developed and tested a model disclosure that is intended for use by fiduciary advisers (See Appendix for a sample). This model includes all disclosures required for fiduciary advisers under PPA, including the fee and other compensation disclosure required under section 408(g)(6)(A)(iii).

## FAILURES OF CURRENT DISCLOSURE METHODS

The weaknesses in current disclosure practices have been highlighted by DALBAR and are anecdotally understood by most to be ineffective. These disclosures have not prevented inappropriate decisions or increased competition. Among the weaknesses of current practices are:

- Investors seldom read the disclosures and therefore do not consider the information contained in making decisions. An example is the clustering together of required disclosures and making it obvious that these are “routine” requirements.
- In those limited cases when disclosures are considered, the investors who do consider them seldom have an appropriate context to weigh them appropriately. An example is a fee disclosure by one institution when competitors don’t make comparable disclosures. Investors balk at the fee simply because it is disclosed.
- Disclosures serve to protect those making the disclosure from litigation by investors and not to introduce competitive forces. Examples are the history of cases in which litigant’s excessive claims were denied.
- Fee disclosures seldom describe the services that are paid for, skills, work quality or track record of the provider, leading to a comparison of costs without a comparison of the benefits. Examples include the disassociation of fees from the services (services/benefits are not shown) provided as well as associating the fee with a benefit that is not associated with the fee (using market appreciation to justify high fees).
- Disclosures often reflect only negatively on the adviser, who is unenthusiastic about presenting or explaining the contents. The enthusiasm of the adviser has a material effect on whether the participant or beneficiary pays attention to the disclosure. Content that reflects positively or benefits the adviser should be included to have an enthusiastic and therefore an effective presentation.
- An excessive number of disclosures that are not material or relevant to the participant often cause participants to disregard all disclosures. Disclosures should be limited to those that are directly relevant to the participant. Additionally, the number and length of disclosures presented on any one page should be limited.



It is our view that simply adding a disclosure, even if the average participant understands it, would serve little purpose without both a presentation that attracts participants to read it and provides a context for making decisions. In fact, a disclosure will lead to inappropriate decisions without the proper context.

Succeeding sections offer suggestions that overcome these problems and make disclosures more effective:

- Participant Behavior Segments
- Assessment of Materiality
- Definition of "Affiliate"

DALBAR has developed a model disclosure that addresses these failures and conforms to ERISA section 408(g)(6)(A)(iii). See Appendix for example of DALBAR's model disclosure for fiduciary advisers, which includes ERISA section 408(g)(6)(A)(iii) disclosures.

## PARTICIPANT BEHAVIOR SEGMENTS

Methods of financial decision-making vary greatly in any large group, such as participants in a retirement plan. These decision-making methods can be grouped into four distinct segments described below. The Pension Protection Act includes the support required for each of these segments.

Effective fee disclosures will enable participants to assess and compare the costs associated with using the support provided to each segment of investment decision-making. Consequently, standards for fee and compensation disclosure should be consistent for all four segments.

The primary behavior segments and associated support are:

- **Self Supported:** This may be the smallest segment and includes participants that conduct their own research and analysis.  
Support: This group makes investment decisions independently and does not rely on the plan sponsor or provider.
- **Computer Centric:** This is a larger segment than Self Supported and is likely to grow as computer solutions become more widely adopted in years to come. This segment is willing and able to enter highly sensitive personal information into a computer and then act on the advice that the computer provides.  
Support: A fiduciary adviser that qualifies under ERISA section 408(g)(3), using a computer model serves this segment of participants. Disclosures appropriate for a computer model is provided.



- **Personal Adviser:** This is the next to the largest segment and requires personal interaction with an investment professional. This segment includes a high concentration of pre-retirees and participants with complex financial situations.

Support: A fiduciary adviser that qualifies under ERISA section 408(g)(2)(i) serves this segment of participants. Disclosures appropriate for advisers with non-varying compensation is provided.

- **Uninvolved:** This is the largest segment of participants and consists of a high concentration of participants that are more than a decade from retirement.

Support: The Qualified Default Investment Arrangement under ERISA section 404(c)(5) serves this segment. Required notices for QDIA are provided.

## ASSESSMENT OF MATERIALITY

Disclosure of an excessive number of fees is counterproductive in informing participants. This is counterproductive based on the average participant's response to a list of fees and the accompanying explanations. The burden of reading and understanding of these explanations lead most participants to ignore the disclosure. For the disclosure to be useful there should be no more than three types of fees and each must be material enough for participants to consider them relevant.

Fees that require disclosure are those that have a material effect on the participant or the adviser's income. Suggested guidelines for fees that must be disclosed are:

- When the annual cost for a participant exceeds \$5.
- When the adviser receives compensation of more than \$1,000 in one year.

In the event that there are more than two such fees or compensation, disclosures should aggregate multiple fees and present them as "annual costs" and "one time costs", as appropriate.

## DEFINITION OF "AFFILIATE"

ERISA section 408(g)(6) requires that a fiduciary adviser include disclosure of fees and other compensation to all affiliates of a fiduciary adviser. It is therefore necessary to determine of what entities and relationships constitute such an affiliate.

The suggested solution is to define what an affiliate of a fiduciary adviser is, as an entity in which the adviser has a material interest (more than 5%).



## DUAL PURPOSE OF DISCLOSURE

The disclosures to plan participants required under ERISA section 408(g)(6) must also be made to the plan sponsors under section 408(10)(A)(i) which states that “the terms of the eligible investment advice arrangement require compliance by the fiduciary adviser with the requirements of this subsection [408(g)]. The requirement that the eligible investment advice arrangement complies with all of 408(g) requires plan sponsors to also consider these disclosures during prudent selection of a fiduciary adviser, required under section 408(g)(10)(B). These 408(g)(6) disclosures therefore serve two purposes:

- Prudent selection of fiduciary adviser for eligible investment advice arrangement.
- Participant election to use a fiduciary adviser.

Both of these purposes were considered in the development of the sample provided in the Appendix and the comments offered here.

## COSTS AND BENEFITS

The costs associated with the fee and compensation disclosures required by ERISA section 408(g)(6) are borne by the fiduciary adviser and the plan sponsor.

### Fiduciary Adviser Costs

- Obtain and update information
- Provide validation through independent audit
- Distribute disclosure to participants
- Answer questions from plan sponsors and participants concerning disclosures

### Plan Sponsor Costs

- Review fees and compensation to make determination that they are reasonable.
- Answer questions from participants concerning disclosures

The 408(g)(6) disclosures are beneficial to participants, plan sponsors and fiduciary advisers.

### Participant Benefits

- The participant is able to select the method of assistance that is both suitable and cost effective.
- The participant is able to assess the conflicts of interest that could prejudice recommendations from a fiduciary adviser.



#### Plan Sponsor Benefits

- Fee and compensation disclosures enable the plan sponsor to prudently select the fiduciary adviser that is made available to participants.
- Plan sponsors enjoy the protection from liability that is offered by an eligible investment advice arrangement.

#### Fiduciary Adviser Benefits

- Fiduciary advisers are insulated from certain litigation in the event of loss by participants.

### STANDARDS FOR PRESENTATION [SECTION 408(G)(8)(A)]

Section 408(g)(8)(A) requires that the fee and compensation disclosure shall be written in a manner calculated to be understood by the average plan participant.

Since the education, language and comprehension skills vary widely among participants it is necessary to use different disclosures for different participant groups, based on the average in each group. Can the disclosure “calculated to be understood” by employees of an investment firm also be used for academic institutions and for employees at a manufacturing plant?

Effective presentation will also require an understanding of the use to which the disclosures will be put. The primary uses of the fee and compensation disclosures are:

- Plan sponsors’ prudent selection of fiduciary advisers.
- Participants’ selection of the most suitable type of investment support.

Both plan sponsors and participants require comparison of dissimilar methods of providing advice. It is therefore essential that disclosures are made in such a way that direct cost comparisons can be done between:

- Qualified default investment alternatives (section 404(c)(5)) that are used by participants that choose to be uninvolved in investment decisions.
- Fiduciary advisers that qualify under ERISA section 408(g)(2)(i) that are used by participants who choose to use a personal adviser.
- Fiduciary advisers that qualify under ERISA section 408(g)(3), using a computer model that are used by participants that choose to use the computer.

We suggest a single model, applicable to all methods that complies with the requirements:

The disclosure must be tested for understanding by average participants and tests documented to provide evidence of understanding by typical participants in a plan(s) or others that can reasonably be expected to have similar reading and comprehension skills.



## SPECIFIC ANSWERS

1. In general, what types of information relating to fees received by fiduciary advisers and their affiliates would be helpful to participants and beneficiaries in making their investment decisions?

The most important determinant of what fees require disclosure should be the effect on the adviser and/or on participant assets. There are several advantages to making materiality the standard:

- The number of disclosures is reduced so that material fees are not obfuscated in a long list of unimportant ones.
- The cost of acquiring the information is reduced.
- The participant is more likely to make an informed decision.

It is suggested that materiality standards be deemed to exist if either of the following are true for any one adviser or adviser representative:

- More than \$1,000 income or change in net worth in one year is derived from the source.
- Fee of over \$5 annually is paid directly by or on behalf of a participant in the plan.

The following information is contained in the model disclosure sample (Appendix) with respect to fees and other compensation. It should be noted that the context in which these fees and compensation are presented is as important as the specific information presented. Fee and compensation disclosure consists of:

- Employment compensation (salary, bonus, incentive, etc.) and context of compensation earned by others in a similar occupation.
- Amount of annual fiduciary adviser fee expressed in dollars (not basis points).
- Frequency of payment and dollar amount of periodic payment (quarterly in the sample).
- When invoiced (at the end of the calendar quarter in the sample).
- Context (showing the range of fees typically charged for similar services).
- Nature of other compensation received by fiduciary adviser or affiliates from investment firms.





- Rates used in computing such compensation.
  - Percentage of total revenue earned from these firms.
  - Proportion of such compensation derived from each firm.
2. What types of fees and compensation (including those provided by third parties) would be encompassed by ERISA section 408(g)(6)(A)(iii)? In relevant part, this provision refers to “all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property.”

Subject to a test of materiality, fees and compensation encompassed by ERISA section 408(g)(6)(A)(iii) should include compensation from all sources to the fiduciary adviser as well as compensation to any affiliated firm. These include:

- Compensation received for services provided as a fiduciary adviser,
- Compensation that can be affected by the advice given,
- Compensation that could influence the fiduciary adviser or be perceived as a conflict of interest.

These would include but not be limited to:

- Fees paid by plan sponsor
- Fees paid by participant
- Fees withdrawn from plan assets
- 12b-1 fees
- Transfer agent fees
- Commissions
- Sales charges
- Compensation advances
- Non-cash compensation
- Salary and bonuses
- Other incentive compensation



When more than three of these compensation types are determined to be material, the disclosures should be made in aggregated as “annual costs” and “one time costs”.

3. What challenges might be encountered in assembling and/or presenting the information on fees and compensation described in section 408(g)(6)(A)(iii) in a manner that is clear and understandable by the average plan participant? Are there any suggestions as to how these challenges can be addressed by the Department?

Four types of challenges can be reasonably anticipated:

- 1) Willingness to Make Disclosures. Private compensation arrangements in firms that are affiliated with prospective fiduciary advisers will not be willing to disclose these arrangements.

The Department can address this challenge by defining what must be disclosed to include only those items that have a material effect on the fiduciary adviser that influences the participant’s investment selection. Material effect can be defined as over 1% of fiduciary adviser’s income or net worth. Investment selection includes the choices participants make as well as the investment options available in the plan.

- 2) Comparability of Disclosures. Current practice is to make disclosures that are most easily obtained from the regulatory environment and computer systems in effect. Considering that fiduciary advisers may include RIAs, Banks, Insurance companies and Broker/Dealers there is likely to be variation in disclosures. The issue of comparability is of greatest importance for plan sponsors to make prudent selection of fiduciary advisers.

The Department can address this challenge by defining two methods for computing fee disclosures; one for fiduciary advisers with non-varying fees [section 408(g)(2)(A)(i)] and another for those using a computer model [section 408(g)(2)(A)(ii)].

- 3) Access to Information. Prospective fiduciary advisers may not have access to complete information from affiliated companies. For example, independent practices may not be privy to information from their broker/dealer firms.

The Department can address this problem by permitting a fiduciary adviser to disclose that the information is not available and declare that unavailable information is not believed to be relevant.

- 4) Making Presentation Understandable. The primary challenge is that there could be an unlimited number of versions for different unique groups of participants.

The Department can address this defining what constitutes a unique group and a level of understanding expected for each group. Groups could be defined as one or more plans with the same prevailing level of academic accomplishment. So that plans where most employees are high school graduates would constitute one group and another might be for plans where high school undergraduates are dominant and a third for plans where college graduates are the norm.

4. Is there a form or format for presenting information on fees and compensation described in section 408(g)(6)(A)(iii) (e.g., narrative, chart, combination of both) that might be particularly suitable in giving participants a clear and understandable description of the fees and compensation received by a fiduciary adviser or its affiliates? Is there an optimal time frame, relative to when the advice is provided, for providing this information to participants and beneficiaries? What impact, if any, will the receipt of a model form have on investment decisions made by participants and beneficiaries?

The Appendix contains a sample of a presentation that puts fees and compensation in a form that is likely to be read, understood and used appropriately by both plan sponsors making prudent selection of a fiduciary adviser and a participant seeking advice.

This presentation is best made to plan sponsors before the selection of the fiduciary adviser. This disclosure is an essential part of the required prudent selection.

This presentation should be made to participants (or beneficiaries) before he/she decides to enroll for the fiduciary adviser's services. This enrollment should acknowledge the receipt of the presentation (electronically or on paper).



Participants should also receive an annual statement of fees concurrent with the annual renewal of the eligible investment advice arrangement.

As discussed earlier, the impact of the receipt of a model form will depend greatly on its presentation and context. This will vary from having no effect on investment decisions, on one hand, to being the primary deciding factor in whether to use the fiduciary adviser at all.

5. Persons that may qualify as "fiduciary advisers" are invited to provide forms that they currently use, or might use, to provide the kinds of fee and compensation information described above. As described in ERISA section 408(g)(11)(A), "fiduciary advisers" may include investment advisers registered under the Investment Advisers Act of 1940, certain banks and similar financial institutions, insurance companies qualified to do business under the laws of a State, and brokers or dealers registered under the Securities Exchange Act of 1934. Commenters are reminded that submissions are made solely for the purpose of assisting the Department. Accordingly, no inferences should be drawn as to whether the forms submitted meet the standards for presentation described in ERISA section 408(g)(8)(A).

DALBAR is not a prospective fiduciary adviser but maintains an extensive inventory of written and online communication that contain disclosures. This material can be made available to the Department, if requested.

Thank you for your consideration of these comments in developing the final regulations.

A handwritten signature in black ink, appearing to read 'L. S. Harvey', is written over a yellow diagonal bar.

Louis S. Harvey  
President



APPENDIX  
SAMPLE MODEL DISCLOSURE DOCUMENT

# Chris Q. Professional Fiduciary Adviser Disclosures

- DALBAR Audit Report
- Services Provided
- Fiduciary Adviser Fees
- Statement of Participants' Rights
- Privacy Policy
- Plan Adviser Affiliation
- Plan Provider Affiliation
- Acceptance of Fiduciary Responsibility
- Performance of Plan Investments  
(Under separate cover)

Chris Q. Professional, 2006 DALBAR Rated



# Fiduciary Adviser Audit Report

We have conducted an audit of Fiduciary Adviser, Chris Q. Professional as required by the Pension Protection Act of 2006 (Act), Section 601 (A)(2)(g)(5) and found no material problems. The audit consisted of:

- Examination of adviser's background from publicly available records and disclosures made by adviser.
- Review of representative sample of experiences of adviser's client.
- Review of disclosure documents use in connection with delivery of advice.
- Determination that fees charged for advice services are fair and reasonable.
- Examination of records maintained as required by the Act.

We have found no evidence to suggest that Chris Q. Professional is not fit to serve as a Fiduciary Adviser that will act in the sole interest of participants and beneficiaries of a retirement plan.

*Dalbar, Inc.*

Chris Q. Professional, 2006 DALBAR Rated



## Fiduciary Adviser Services Provided

Chris Q. Professional, acting as fiduciary adviser will:

- Review employee's finances, personal goals and preferences
- Determine an appropriate investment strategy
- Assist employee in implementing the strategy

Chris Q. Professional will offer additional services that are considered to be appropriate and in the best interest of the employee being advised. These services include:

- Additional investment services outside of the plan being served.
- Life insurance coverage that may be indicated.
- Estate planning services that may be indicated
- Debt management services if needed

Chris Q. Professional, 2006 DALBAR Rated



## Fiduciary Adviser Fees

The services of Chris Q. Professional to advise each retirement plan participant are paid by an annual fee of \$700, made in quarterly installments of \$175.

Fees are invoiced to the plan sponsor at the end of each calendar quarter.

The fee of \$700 per year is considered to be fair and reasonable on the basis that the fee for similar services typically range between \$500 and \$1,200.

Chris Q. Professional, 2006 DALBAR Rated





# Statement of Participants' Rights

The recipient of advice from Chris Q. Professional may separately arrange for the provision of advice by another adviser, that could have no material affiliation with and receive no fees or other compensation in connection with this plan.

Chris Q. Professional, 2006 DALBAR Rated



# Fiduciary Adviser Privacy Policy

Chris Q. Professional, as an employee of Acme 401(k) Services, Inc., is required to maintain all personal information about any client in the strictest confidence.

Information about any employee of a client of Acme is disclosed only for the purposes of conducting due diligence and audits required by the Pension Protection Act of 2006.

Chris Q. Professional, 2006 DALBAR Rated



## Acceptance of Fiduciary Responsibility

I, Chris Q. Professional, understand and agree to act as a fiduciary and accept the personal responsibility for the advice I provide to employees that elect to use my services. As a fiduciary, I will act in the best interest of these employees and their beneficiaries.

The advice I provide as a fiduciary will be based on my best judgment of what a prudent person would do under the same circumstances.

As a fiduciary I am not responsible for the financial results that are achieved or not achieved, provided that I can document the prudent process used to arrive at advice given to employees.

Chris Q. Professional, 2006 DALBAR Rated



## Fiduciary Adviser Plan Adviser Affiliation

Chris Q. Professional has disclosed that he is employed by Acme 401(k) Services, Inc., which acts as a Plan Adviser for multiple retirement plans. Under that employment, Chris Q. Professional:

- Earns a salary that is commensurate with other employees of the firm performing similar services. This compensation is within the compensation level of other firms offering similar services.
- Earns an incentive of 25% of fees paid by clients of Acme 401(k) for services provided by Chris Q. Professional.
- Has been employed by Acme 401(k) for three years.

Chris Q. Professional, 2006 DALBAR Rated



## Fiduciary Adviser Plan Provider Affiliation

Acme 401(k) Services Inc., which employs Chris Q. Professional, is party to contracts with providers of investment and other services to retirement plans. It is Acme's intent to enter into additional such contracts in the future.

Under these contracts Acme receives compensation to oversee certain plans in which investments are managed by the firms under contract with Acme. The fees received under these contracts vary from a low of .07% of assets to a high of .20% of assets, depending on the specific services rendered. In the last 12 months, Acme earned 45% of its revenues from such contracts.

Providers currently under contract with Acme and respective proportion of 2005 revenue are:

- |                       |     |
|-----------------------|-----|
| • Mutual Fund X       | 15% |
| • Mutual Fund Y       | 12% |
| • Insurance Company Z | 10% |
| • Record Keeper A     | 8%  |

Chris Q. Professional, 2006 DALBAR Rated