

DEPARTMENT OF LABOR  
EMPLOYEE BENEFITS SECURITY ADMINISTRATION

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PUBLIC HEARING

PROPOSED AMENDMENTS TO SECTION 408(b)(2)  
REGULATION  
REASONABLE CONTRACT OR ARRANGEMENT - FEE  
DISCLOSURE

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Monday, March 31, 2008

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The Panel met in Room S-4215 A-C in the  
Department of Labor, 200 Constitution Avenue,  
N.W., Washington, D.C., 20210 at 9:00 a.m.,  
Bradford P. Campbell, Chair, presiding.

PRESENT

BRADFORD P. CAMPBELL, Chair  
JAMES BUTIKOFER, Panel Member  
LOUIS CAMPAGNA, Panel Member  
ADRIENNE DWYER, Panel Member  
JOSEPH PIACENTINI, Panel Member  
ALLISON WIELOBOB, Panel Member  
FIL WILLIAMS, Panel Member  
KRISTEN ZARENKO, Panel Member

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1 P-R-O-C-E-E-D-I-N-G-S

2 9:00 a.m.

3 CHAIRMAN CAMPBELL: All right.

4 Well, thank you all for your patience. We  
5 have resolved our recording issue. We're  
6 taking audio recording of the initial part of  
7 this hearing until our official stenographer  
8 arrives. We're advised that that should meet  
9 the muster for the record. So with that, we  
10 apologize for the delay, and we'll get going.

11 As you probably know, my name is  
12 Bradford Campbell. I'm the Assistant  
13 Secretary of Labor for the Employee Benefits  
14 Security Administration. And I want to  
15 welcome you this morning as we kick off the  
16 first of two days of administrative hearings  
17 on our proposal which establishes disclosure  
18 requirements under ERISA Section 408(b)(2).

19 The Employee Benefits Security  
20 Administration -- or EBSA -- as most of you  
21 also probably know is responsible for  
22 overseeing the administration and enforcement

1 of Title I of ERISA, which is the law  
2 governing private employer-provided benefits.

3 The plans that we oversee provide benefits to  
4 about 150 million Americans, and hold about \$6  
5 trillion in assets.

6 As an Agency, we have both  
7 regulatory and enforcement authority. And we  
8 take these responsibilities very seriously.  
9 Last year in our Civil Enforcement Program, we  
10 had monetary results of about \$1.5 billion.  
11 And our criminal program -- our investigations  
12 -- led to the indictment of 115 persons in  
13 connection with crimes against employee  
14 benefit plans.

15 As this hearing today  
16 demonstrates, we are equally vigilant in our  
17 efforts to use our regulatory authority to  
18 improve the legal environment in which  
19 employee benefit plans operate. Now as we do  
20 so, we are ever mindful of the voluntary  
21 nature of this system, and of the need to  
22 ensure that our regulations enhance not only

1 the security of benefits, but their  
2 availability as well.

3 The financial services marketplace  
4 has increased in complexity. Plan fiduciaries  
5 who are charged under the law with  
6 responsibility of making prudent decisions  
7 when hiring service providers and paying only  
8 reasonable expenses have found their jobs more  
9 difficult as the number and types of fees  
10 proliferate and as the relationships between  
11 service providers become more complex. These  
12 trends caused us to conclude that despite the  
13 success of our fiduciary and participant  
14 education and outreach efforts that a new  
15 regulatory framework was necessary to better  
16 protect America's workers, retirees and their  
17 families. That's why we initiated three major  
18 regulatory projects that each address a  
19 different aspect of these disclosure issues.

20 The first, the Public Disclosures  
21 and the Form 5500 is a completed regulation.  
22 The second, the proposal we are here today to

1 discuss as you know has been proposed, and  
2 we're having this hearing. And the third,  
3 which you'll be seeing in the next several  
4 months, is a proposed regulation addressing  
5 disclosures required to participants and  
6 participant-directed individual account plans.

7 But the purpose of this hearing  
8 today is to ensure that fiduciaries have the  
9 information they need to carry out their  
10 duties under the law and to act on behalf of  
11 participants. This is a regulation that we're  
12 going to complete by the end of the year. But  
13 even more important than getting it done is  
14 getting it done correctly. And that's why we  
15 are here today.

16 I personally am a big believer in  
17 the Public Notice and Comment process. No  
18 matter how smart our people at the Department  
19 are -- and by and large I think they're pretty  
20 smart -- and no matter how much time we've  
21 spent on this regulation -- and we did spend  
22 quite a lot of time on it -- our daily

1 business is not running plans or providing  
2 services to plans, or carrying out all the  
3 functions that go into the everyday real work  
4 of plan administration. And your comments  
5 therefore have been very helpful to us as we  
6 go through this process and look at the  
7 proposal and look at what should be in a final  
8 regulation. You've identified through your  
9 comments many issues that we can consider as  
10 we craft this final regulation, and we  
11 appreciate that.

12 As I've said before, I think the  
13 regulatory process is ideally suited for  
14 achieving the goal of this overall of better  
15 disclosure. This process lends itself to a  
16 calm and rational evaluation of the issues and  
17 a full consideration of all points of view.

18 I do want to note that we don't  
19 hold a hearing here at the Department on every  
20 regulation we propose. But we did so for this  
21 regulation because of the technical and legal  
22 issues presented, some of which are quite

1 complex. And we believe that we'll all  
2 benefit from additional comment and discussion  
3 in the public record on this proposal.

4 So in short, we're open to all of  
5 your praise and all of your criticism in equal  
6 measure. Give us your laurels and your  
7 arrows. And we will evaluate all that. We  
8 want our final regulation to work well, while  
9 well protecting workers.

10 And so with that, let me turn it  
11 over to Lou Campagna.

12 PANEL MEMBER CAMPAGNA: Hi. I'm  
13 Lou Campagna. I'm Chief of the Division of  
14 Fiduciary Interpretations with EBSA.

15 And Alan Lebowitz is sick with the  
16 flu today, and I'm going to go through his  
17 opening remarks.

18 On December 13, 2007, the  
19 Department published a Notice of Proposed  
20 Rulemaking in the Federal Register containing  
21 a proposed amendment to the regulation  
22 governing 408(b)(2) of ERISA, the statutory



1 exemption for the provision of services to  
2 employee benefit plans by persons who are  
3 considered parties in interest. The proposal  
4 would amend the provisions addressing what  
5 constitutes a reasonable contract or  
6 arrangement for purposes of the statutory  
7 exemption by establishing disclosure  
8 obligations applicable to both fiduciaries and  
9 providers of services to employee benefit  
10 plans.

11 On December 13, 2007, we also  
12 published a proposed class exemption, which if  
13 granted would relieve a responsible plan  
14 fiduciary from any liability for a prohibited  
15 transaction that could result from the plan  
16 fiduciary entering into a service contract in  
17 a situation where the service provider fails  
18 to comply with the proposed regulations.

19 To date, the Department has  
20 received over 100 public comments on the  
21 proposed regulation and class exemption. The  
22 purpose of this hearing is to receive

1 additional comments regarding the proposed  
2 regulation and exemption in order to develop a  
3 better understanding of how best to achieve  
4 the Department's goal of ensuring that  
5 appropriate fee disclosures are made to  
6 responsible plan fiduciaries.

7 As for the procedures for this  
8 hearing, we will follow the agenda that has  
9 been prepared and made available as provided  
10 for in the notice scheduling this hearing.

11 The speakers will be called in the order  
12 listed. We ask that each speaker stay within  
13 the allotted ten-minute period for their  
14 testimony. To the extent that members of the  
15 Panel have questions for speakers, the  
16 question and answer part of the testimony will  
17 not be counted toward the designated time  
18 limit. Once a speaker's opening remarks have  
19 concluded, we will allow approximately 15  
20 minutes for additional questions from the  
21 Panel.

22 We wish to note that you should

1 read nothing into the way questions may be  
2 phrased, and should draw no inferences as to  
3 the Department's views from the questions  
4 asked.

5 If you have filed a written  
6 statement with us, copies have been furnished  
7 to the members of the Panel. Accordingly, we  
8 encourage speakers to summarize their views or  
9 the views of their client in the oral  
10 testimony.

11 Prior to beginning your testimony,  
12 we ask that you identify yourself, your  
13 affiliation, and the organization you  
14 represent for purposes of our hearing reporter  
15 who is transcribing these proceedings.

16 For those who wish to supplement  
17 the record, the record of this proceeding will  
18 be kept open until the close of business on  
19 April 21, 2008. The official record of this  
20 proceeding will be open for public inspection  
21 and copies will be made available in the  
22 Public Disclosure Room of EBSA, Room N-1513,

1 U.S. Department of Labor, 200 Constitution  
2 Avenue, Washington, D.C.

3 I'll now introduce the members of  
4 the Panel. To my left is Joe Piacentini,  
5 Director, Office of Policy and Research;  
6 Kristin Zarenko of the Division of  
7 Regulations, Office of Regulations and  
8 Interpretations; Adrienne Dwyer of our  
9 Solicitor's Office; and of course, Mr.  
10 Campbell.

11 With that, the first speaker.

12 CHAIRMAN CAMPBELL: Okay. And  
13 obviously, we will have various folks from the  
14 Department coming in and out as the course of  
15 the two days go on. That probably doesn't  
16 surprise you that we didn't have eight people  
17 to spare for two solid days. So we will  
18 shuffle in and out.

19 Our first witness, please.

20 MR. GOLDBRUM: Okay. Good  
21 morning, Assistant Secretary Campbell and  
22 members of the Panel.

1                   My name is Larry Goldbrum, and I'm  
2                   General Counsel of the SPARK Institute. And  
3                   with me today is Tom Schendt, outside counsel  
4                   for the SPARK Institute. He's with Alston &  
5                   Bird.

6                   Thank you for the opportunity to  
7                   share with you our views regarding the  
8                   proposed 408(b)(2) regulations amendment. I'd  
9                   like to make this opening statement, and I  
10                  welcome the opportunity to respond to your  
11                  questions.

12                  The SPARK Institute is an  
13                  association that represents the interests of a  
14                  broad-based cross section of retirement plan  
15                  service providers including banks, mutual fund  
16                  companies, insurance companies, third-party  
17                  administrators and benefits consultants. The  
18                  Institute's combined membership services more  
19                  than 95 percent of all the fund contribution  
20                  plan participants.

21                  As you know, the SPARK Institute  
22                  has publicly supported and advocated for more

1 robust fee disclosure by retirement plan and  
2 investment providers, as well as by employers  
3 to their employees. We believe that greater  
4 fee transparency will ultimately not only  
5 benefit plan sponsors and plan participants,  
6 but also the retirement plan investment  
7 management industries. We commend the  
8 Department of Labor for taking a flexible,  
9 concept-based approach in the proposed  
10 regulations that will allow service providers  
11 to tailor disclosures to their products and  
12 customer needs.

13 As the Department knows, fee  
14 disclosure in the retirement plan and  
15 investment industries is extremely complex due  
16 to the diversity of investment products, the  
17 diversity of service provider business models,  
18 the demands of plan sponsors to shift the  
19 administrative costs of their plans to  
20 participants, and the costs associated with  
21 gathering and presenting the information. We  
22 urge the Department to continue to take the

1 lead in resolving these issues and to take  
2 deliberate and measured steps as it develops  
3 new rules and regulations.

4 We urge the Department to retain  
5 the flexible approach to fee disclosure.  
6 However, the SPARK Institute strongly opposes  
7 the recommendations made in certain comment  
8 letters that urge the Department to require  
9 that disclosure be made through a prescribed  
10 one-size-fits-all form, and pre-determined  
11 categories as a percentage of assets  
12 regardless of the fee structure or that  
13 obligates a bundled provider to aggregate and  
14 present information from third parties in a  
15 single document.

16 The retirement plan and investment  
17 industries are very competitive and dynamic,  
18 so no single form or methodology can  
19 adequately address the diversity of products  
20 and service structures without favoring one  
21 segment of the industry over others.  
22 Additionally, mandating disclosure in a

1           prescribed format or according to a specific  
2           methodology will ultimately be more costly for  
3           service providers and for plan participants.

4                       We are concerned that the proposed  
5           regulation appears to override legislative and  
6           long-standing regulatory authority regarding  
7           the definition of plan assets. The SPARK  
8           Institute recognizes the importance of and the  
9           complexity associated with developing  
10          disclosure requirements that address the  
11          Department's concerns, but that are not overly  
12          broad. The final regulation should not impose  
13          additional detailed disclosure requirements on  
14          investment managers of and service providers  
15          to non-plan asset funds, for example, mutual  
16          funds. The Department's disclosure rules with  
17          respect to such parties should not go beyond  
18          the disclosure rules of the SEC or such other  
19          regulatory authority with specific  
20          jurisdiction over the particular investment  
21          vehicle.

22                       We recognize that many investment



1 products are made available to plans through  
2 intermediaries and investment providers may  
3 not know of or deal directly with the  
4 investing plans. However, the regulations  
5 should not shift the existing investor  
6 disclosure obligations of the investment fund  
7 to the intermediary. Instead, the investment  
8 provider and the intermediary should be  
9 permitted to determine how the disclosures  
10 will be delivered to the plan as part of the  
11 arrangement between the parties to make such  
12 funds available.

13 Under our approach, an  
14 intermediary could agree to deliver a mutual  
15 fund's statutory prospectus to the plans it  
16 services on behalf of the fund in order to  
17 assist the fund in meeting the fund's  
18 disclosure obligations. Our recommended  
19 approach is not intended to relieve the  
20 intermediary of any obligation to disclose to  
21 the plan the compensation it will receive from  
22 an investment provider such as payments under

1 a 12b-1 program.

2 One of the most difficult issues  
3 that the proposed regulation attempts to  
4 address is disclosure with respect to bundled  
5 services arrangements. As we note in our  
6 comment letter, these arrangements come in a  
7 variety of forms, continue to evolve in an  
8 ever-changing market, and may be impossible to  
9 adequately define by regulation without being  
10 overly broad or too narrow. Regardless of how  
11 these arrangements are ultimately defined,  
12 several specific issues should be addressed in  
13 order to facilitate compliance with the final  
14 regulations.

15 We commend the Department for  
16 recognizing that bundled providers should not  
17 be obligated to unbundle their services and  
18 disclose the internal allocation of fees among  
19 affiliated companies. Bundled providers  
20 should disclose their compensation and fees  
21 for the services they consider to be part of  
22 their bundled arrangement, but should not be

1 obligated to make disclosures for other  
2 entities and services that the bundled  
3 provider does not consider to be part of its  
4 bundled arrangement.

5 For example, when a bundled  
6 provider at the direction of a plan sponsor  
7 makes payments to a third party that the  
8 service provider does not consider to be part  
9 of the bundled arrangement, the third party  
10 should be responsible for satisfying any  
11 applicable disclosure and contract obligations  
12 under the final regulations. Additionally,  
13 when a record keeper makes an accommodation  
14 for a plan and agrees the record keeper holds  
15 special assets or plan-specific investments,  
16 the record keeper should have no fee  
17 disclosure or contract obligations with  
18 respect to the assets, except that the record  
19 keeper should have to disclose the  
20 compensation it or its affiliates will receive  
21 for the services it provides in connection  
22 with that special asset.

1                   We agree with comments made by  
2 other groups that the fiduciary attestational  
3 requirement will be unworkable, and we are  
4 concerned that it will create opportunities  
5 for frivolous law suits. It is common for  
6 service providers to perform a variety of  
7 services for a plan, some of which are  
8 fiduciary services, and others which are not.

9                   Additionally, whether a service provider is a  
10 fiduciary is an inherently factual issue. We  
11 are concerned that the attestation will create  
12 traps for providers including those who use  
13 their best efforts to comply with the  
14 requirement and could have devastating  
15 consequences for the most well meaning service  
16 providers.

17                   We agree with comments by other  
18 groups that the proposed conflicts disclosure  
19 provisions are too broad and will be extremely  
20 difficult to satisfy. We urge the Department  
21 to take a more targeted approach that focuses  
22 on the disclosure by a service provider of its

1 financial interests with respect to plan  
2 assets.

3 The regulation should focus on  
4 revenue sharing agreements and payments from  
5 third parties. Although disclosure practices  
6 vary among service providers, most large- and  
7 mid-size retirement plans are already provided  
8 with information that discloses the provider's  
9 potential financial interest in the investment  
10 of plan assets. However, disclosure practices  
11 can be improved if all service providers that  
12 deal directly with the plan are required to  
13 disclose the financial interest they may have  
14 in connection with how plan assets are  
15 invested.

16 The SPARK Institute agrees with  
17 comments made by other groups that service  
18 contracts should not result in a prohibited  
19 transaction when a service provider makes a  
20 reasonable effort to comply with the  
21 regulation and corrects the error within a  
22 reasonable time after discovering it. The

1 proposed rules are complex, will require a  
2 learning period, and will likely be subject to  
3 different interpretations. Imposing liability  
4 on service providers with no opportunity to  
5 remediate errors could be unduly harmful to  
6 the industry.

7           Additionally, the SPARK Institute  
8 requests that the Department expressly provide  
9 protection from penalties and liability for  
10 service providers when a plan sponsor fails to  
11 take the necessary and requested affirmative  
12 action to amend their service agreement after  
13 reasonable advance notice regarding such  
14 action. Service providers should be protected  
15 from any adverse consequences associated with  
16 continuing to service the plan and receiving  
17 compensation for its services provided that it  
18 otherwise attempted to comply with the  
19 regulations, but was unable to obtain  
20 affirmative consent from the plan sponsor.  
21 Absent such relief, plan service providers  
22 will be put in the untenable position of

1           having to either refuse compensation while  
2           continuing to perform services, or discontinue  
3           providing services to the plan. Neither of  
4           those options serves the best interests of any  
5           of the parties involved, including plan  
6           participants.

7                         The SPARK Institute requests the  
8           Department extend the compliance deadline for  
9           the new regulations and adopt a two-tiered  
10          approach. For new customer agreements, the  
11          final regulation should not be effective until  
12          at least six months after they are published.

13          For existing customer arrangements, client  
14          deadlines to either amend an existing service  
15          agreement or sign a new one should be at least  
16          18 months following the date the final  
17          regulations are published. Under this  
18          approach, during the first six months  
19          following the publication date of the final  
20          regulations, the affected parties will be able  
21          to prepare to comply with them and have a  
22          longer period to address existing agreements

1           that may need to be amended.

2                       On behalf of the SPARK Institute,  
3           I thank the Panel for the opportunity to share  
4           our views. And I welcome your questions.

5                       CHAIRMAN CAMPBELL:       Thank you.  
6           Why don't we go ahead and we'll go from my  
7           left to right -- your right to left. And  
8           we'll start with Director Piacentini with  
9           questions.

10                      PANEL MEMBER PIACENTINI:     Thank  
11           you, Brad.

12                      I guess I have a short list of  
13           relatively narrow questions that in part are  
14           passed on the testimony you just presented;  
15           also partly based on the written comment that  
16           your organization submitted some time ago.

17                      As     I     understand    it,    your  
18           organization is in favor of a requirement to  
19           disclose indirect compensation that the record  
20           keeper might receive from an investment  
21           provider or some other party. I guess my  
22           question is is that disclosed now, or is that



1 something that would be a new practice that --  
2 and have I correctly understood that you think  
3 that's all right?

4 MR. GOLDBRUM: Yes. I think that  
5 that's a fair characterization of what we're  
6 proposing.

7 I would also submit that in the  
8 large- and mid-size markets, it's been our  
9 experience that for the most part that  
10 indirect compensation is being provided by  
11 record keepers. That's not to say that there  
12 can't be improvement and that there may not be  
13 broad-based disclosure among all service  
14 providers in all segments of the market, but  
15 obviously since attention has been focused on  
16 this issue, the practices have been improving.

17 PANEL MEMBER PIACENTINI: Okay.  
18 Now I also understand that you think that  
19 there are some challenges in asking an  
20 intermediary like a record keeper to provide  
21 detailed uniform information on investment  
22 products, for example, that might be available

1 in a platform. So I guess my question is is  
2 it your view that your clients -- the  
3 fiduciaries who are selecting these investment  
4 options, do they have adequate information  
5 now, or not?

6 MR. GOLDBRUM: Well, part of the  
7 issue -- I can give you an example -- if you  
8 were to ask a record keeper to make very  
9 detailed disclosure and by that I mean dollar-  
10 based disclosure of investment associated fees  
11 to a plan sponsor, part of the problem is  
12 coming up with those calculations. And it  
13 depends on when you are making that  
14 disclosure. If you're making that disclosure  
15 before the relationship even begins, that is  
16 going to be a difficult task because you  
17 really don't have good hard information to  
18 make that disclosure.

19 And then it depends on how deep  
20 the disclosure is that you require. If you're  
21 simply talking about making a disclosure with  
22 respect to the total expense ratio, that's a

1 much easier thing to do, of course, after you  
2 have that particular plan as one of your  
3 customers because you can take their assets  
4 and figure out how much at a plan level they  
5 were charged.

6 PANEL MEMBER PIACENTINI: But my  
7 question though is do the clients -- the  
8 fiduciaries -- do they have adequate  
9 information now when they're selecting a  
10 subset of investment options off of a  
11 platform? For example, even the small plan  
12 client, would they have adequate information  
13 easily enough accessible now, or not?

14 MR. GOLDBRUM: I think that the  
15 information -- again, it depends on the level  
16 of detail that you're talking about. But in  
17 general and in particular if you're talking  
18 about mutual funds, that information is  
19 readily available. What it costs to use that  
20 particular fund, that information is available  
21 in the statutory prospectuses.

22 Now how that money might be shared

1           between the parties, that will ultimately be  
2           up to the parties to disclose who is getting  
3           what. So is the financial advisor or is the  
4           record keeper receiving some form of  
5           compensation from the fund company in order to  
6           subsidize the services that it's providing?  
7           Well, to get to that level, it depends on the  
8           service provider to make that disclosure to  
9           the plan sponsor.

10                           And again, our experience has been  
11           what our members are telling us that in the  
12           large-, medium-sized market, that disclosure  
13           is being made.

14                           PANEL MEMBER PIACENTINI:     Okay.  
15           My final question then, I guess, in deciding  
16           what investment options to include in a  
17           platform, what are the main things that are  
18           considered and what are the sources of  
19           information on that?

20                           MR. GOLDBRUM:     For a plan sponsor  
21           and they pick their investments?

22                           PANEL MEMBER PIACENTINI:     For an

1 intermediary who's offering a platform with  
2 different investment options.

3 MR. GOLDBRUM: Well, the market is  
4 very, very competitive. And obviously,  
5 service providers are competing for plan  
6 business. So they're going to want to put  
7 together a fund line-up that is in today's  
8 market open architecture because in order to  
9 compete, you really do need to make not only  
10 your proprietary funds available, but the  
11 funds of other investment complexes. And  
12 you're going to want the most competitive  
13 funds out there, because ultimately when a  
14 plan picks a service provider, they want to  
15 know that you can provide the record keeping  
16 services but that also they're going to have  
17 access to some of the best funds that are out  
18 there. So they may look at historical  
19 performance of the fund. They will look at  
20 the expense ratio of the fund. But  
21 ultimately, it's going to be things like  
22 reputation of the investment manager, the

1 historical performance of the fund.

2 PANEL MEMBER PIACENTINI: So I  
3 think I'm hearing that it's more demand-driven  
4 rather than some sort of deliberate quality  
5 screen?

6 MR. GOLDBRUM: I think that a  
7 quality screen goes into it, because the  
8 quality screen helps you pick out the funds  
9 that are the most competitive funds in the  
10 marketplace.

11 The demand side of it is that you  
12 know that plan sponsors want to offer the best  
13 possible funds that are available in the  
14 marketplace.

15 PANEL MEMBER PIACENTINI: Thank  
16 you.

17 PANEL MEMBER CAMPAGNA: Picking up  
18 on some of Joe's questions, I suppose what  
19 you're saying is with respect to the funds,  
20 there's disclosure pursuant to prospectuses or  
21 whatever regarding those funds. But what  
22 isn't really a focus is the indirect

1 compensation or compensation that other  
2 service providers may be receiving, such as  
3 record keepers. That's not part of what is in  
4 the prospectus.

5 MR. GOLDBRUM: That's not in the  
6 prospectus. But it's a common practice that  
7 in the service contract that an employer has  
8 with their plan service provider that they  
9 will disclose what those indirect sources of  
10 compensation will be. And that typically will  
11 be done in the form of rates.

12 So in the front end, that type of  
13 disclosure can be made, and it's our  
14 experience that it's commonly being made.

15 PANEL MEMBER CAMPAGNA: Is there  
16 any kind of uniform nature to that, or is it  
17 just employer by employer, or service provider  
18 by service provider at this point?

19 MR. GOLDBRUM: It's probably more  
20 service provider by service provider in large  
21 part because of all the different investment  
22 products that you have out there. So if the

1 service provider is a fund company, they might  
2 take one approach. If the service provider is  
3 affiliated with an insurance company, they  
4 make take a different approach.

5 And part of what we have talked  
6 about in the past, Lou, is that the real  
7 difficulty here in trying to create a single  
8 form is that there are so many different  
9 service structures. There are so many  
10 different investment products that it really  
11 is hard to just come up with a single form.  
12 So each service provider tailors their  
13 disclosure form to what ultimately fits their  
14 product line-up.

15 PANEL MEMBER CAMPAGNA: You  
16 mentioned in your testimony that  
17 intermediaries in funds should have an ability  
18 to enter into an agreement to I guess come up  
19 with this disclosure idea. Could you  
20 elaborate on what you think that agreement  
21 might look like, or how it should be  
22 implemented?



1                   MR. GOLDBRUM: Well, part of our  
2                   issue goes to what disclosure is required with  
3                   respect to mutual funds, and sort of our  
4                   uncertainty what the regulations require in  
5                   terms of the level of detail below the actual  
6                   mutual fund itself.

7                   It's very common for bundled  
8                   providers, record keepers to have agreements  
9                   with various unaffiliated fund companies to  
10                  make their funds available. It's that  
11                  agreement that could -- and in many cases  
12                  already says that the record keeper or the  
13                  bundled provider will provide prospectuses for  
14                  that fund company to the plan sponsors. And  
15                  so that's what we're talking about.

16                  That statutory prospectus is the  
17                  official disclosure of the fund, and that's  
18                  really what an intermediary who is offering a  
19                  third party's fund should be providing to the  
20                  plan sponsor, and should not be required to go  
21                  beyond that in trying to dig into information  
22                  that's not available in that statutory

1 prospectus.

2 PANEL MEMBER CAMPAGNA: Would that  
3 apply as well if the record keeper was  
4 affiliated with the fund in offering the  
5 platform?

6 MR. GOLDBRUM: Yes. I think in  
7 order to have sort of a level playing field  
8 what we would say is that same thing, that the  
9 intermediary arm of that institution would  
10 deliver the prospectuses to the plan sponsor.  
11 And again, that does not mean that additional  
12 disclosures will not be made. In fact,  
13 additional disclosures will be made.

14 What our view is though is that  
15 the responsibility for making disclosures for  
16 unaffiliated funds should not be shifted from  
17 that third party to the intermediary because  
18 that intermediary really should not be put in  
19 a position of trying to make legal disclosures  
20 for someone that it's not affiliated with.

21 PANEL MEMBER CAMPAGNA: Last  
22 question. Going back to your comment letter,

1           you said that the record keeper should inform  
2           the plan about any inaccuracies in the fund  
3           prospectus when you're informed by the fund  
4           within a reasonable cure period.     Any  
5           elaboration on what you have in mind there?

6                         MR. GOLDBRUM:   Well, part of that  
7           issue just goes to the fact that there appears  
8           to be sort of this strict liability approach  
9           in the proposed regulation where a service  
10          provider really has no opportunity if their  
11          disclosures may be incorrect to correct them.

12          And what we're saying is that regardless of  
13          where the error's made, if the error is one  
14          that a third party had made in their  
15          prospectus or even the service provider made  
16          as a result of what it put it in its agreement  
17          with the plan, that when that error is  
18          discovered, there should be a reasonable  
19          opportunity to go ahead, notify the plans and  
20          make correction of that.

21                         PANEL MEMBER CAMPAGNA:   Thank you.

22                         CHAIRMAN CAMPBELL:   Just briefly,

1 I noticed in one of your comments earlier that  
2 you had suggested that IRAs not be covered by  
3 this regulation. Is that in part because you  
4 view the disclosures that would go to IRA  
5 holders to be more akin to disclosures to  
6 participants rather than fiduciaries, which is  
7 the subject of this regulation? Could you  
8 expand on that a little more?

9 MR. GOLDBRUM: Well, our view was  
10 that this regulation is intended to cover the  
11 disclosures that are made by a service  
12 provider to a plan who is offering the  
13 retirement plan to its employees. And when  
14 you're dealing with most of these IRAs, you're  
15 not dealing with a plan sponsor. And for  
16 those institutions that have these IRAs, it  
17 just creates a really awkward situation. So  
18 that's the basis for what we're saying to  
19 clarify that they should be excluded.

20 CHAIRMAN CAMPBELL: Thank you.

21 Adrienne?

22 PANEL MEMBER DWYER: Adrienne

1 Dwyer from the Solicitor's Office.

2 You talked earlier in response to  
3 Mr. Piacentini's questions about information  
4 being disclosed in the prospectus, but that  
5 there was additional money sharing that is not  
6 in the prospectus but that you had said that  
7 is for the most part being voluntarily  
8 disclosed by intermediaries. Can you give us  
9 some examples of what that sharing would be  
10 that is voluntarily being disclosed but is not  
11 in the prospectus?

12 MR. GOLDBRUM: Yes. Let me  
13 clarify that statement.

14 The prospectus will likely have  
15 the disclosure of the programs that ultimately  
16 are used to provide those payments -- so a  
17 12b-1 program, or a sub-transfer agency  
18 program. That may be disclosed. But what's  
19 not disclosed in the prospectus is who the  
20 fund company is making those payments to.

21 So if you are an intermediary or  
22 record keeper, and you're offering a third

1 party's fund to your plans, the fact that  
2 you're receiving that payment would not be  
3 readily apparent from going to the prospectus.

4 You could see in the prospectus that there's  
5 a 12b-1 program, but the prospectus won't tell  
6 you that I as the record keeper am receiving a  
7 payment under that program.

8 And it's that disclosure that in  
9 my experience, again, large- and medium-size  
10 plans in dealing with the large providers are  
11 receiving that disclosure. And that would be  
12 in the service agreement. So it would  
13 disclose the compensation and in addition to  
14 whatever specific items we receive, we will  
15 also receive 25 basis points from the  
16 following fund with respect to the assets that  
17 are invested.

18 PANEL MEMBER DWYER: And if I  
19 would ask you to make an educated guess about  
20 the percentage of intermediary contracts where  
21 that information is being disclosed to plan  
22 fiduciaries, what would you say?

1 MR. GOLDBRUM: That -- although  
2 after this testimony, I'm heading out to Las  
3 Vegas. Those are odds that I'm not willing to  
4 make.

5 (Laughter.)

6 MR. GOLDBRUM: So I just couldn't  
7 give you -- we could look into that and get  
8 back to you. However, sitting here right now  
9 I think it'd be difficult for me to give you  
10 an estimate.

11 PANEL MEMBER ZARENKO: I just have  
12 a follow-up questions about the prospectus in  
13 and of itself.

14 I'm sort of envisioning your  
15 members as record keepers. They have a  
16 variety of either affiliated or nonaffiliated  
17 funds on their platform. And we often keep  
18 coming back to, you know, pass through a  
19 prospectus. How helpful is a prospectus  
20 document to a plan fiduciary, especially given  
21 the wide variety and sophistication? Is there  
22 a pressure at the record keeper level to

1 educate plan fiduciaries about what's  
2 disclosed in there, and how those sort of fund  
3 level cost disclosures relate to what it's  
4 going to cost a plan? If you could just  
5 comment on that for a few minutes.

6 MR. GOLDBRUM: I'm not going to  
7 sit here and tell you that the funds  
8 prospectus is the most user-friendly document,  
9 because it is not.

10 However, when you're talking about  
11 who is going to be responsible for making the  
12 legal disclosure for a mutual fund that a plan  
13 invests in through an intermediary, you really  
14 have to come up with a practical solution to  
15 how is that disclosure going to be made. If  
16 the intermediaries are responsible for making  
17 really technical disclosure beyond what's in  
18 the prospectus for an unaffiliated party, that  
19 could cause them to not offer as many  
20 unaffiliated funds. That's a risk issue that  
21 they may not be willing to take.

22 So from the basic legal standpoint



1 and who's responsible for making disclosure  
2 for those unaffiliated funds, the prospectus  
3 is probably the best document to look to.  
4 However, because the market is so competitive  
5 and because of the focus on disclosure,  
6 ultimately plan sponsors will receive  
7 disclosure. That goes a little further.

8 But that's going to be something  
9 that the intermediary is going to tailor to  
10 what their products are and what their plan  
11 sponsors' needs and sophistication levels are.

12 But ultimately the plan sponsors have to be  
13 responsible for making sure that they're  
14 educated about the decisions that they have to  
15 make in gathering the information that they  
16 need.

17 The service providers or the  
18 intermediaries are going to try and make it as  
19 easy for them as possible. But they probably  
20 will not be willing to accept a legal  
21 responsibility for making financial  
22 disclosures for unaffiliated companies.

1                   PANEL MEMBER ZARENKO: And what  
2 about, obviously a prospectus only comes into  
3 play when we're talking about SEC-registered  
4 investment products. Do your members have a  
5 lot of non-mutual fund investments on their  
6 platforms? Is there a go-to document for  
7 those, or does it just vary a lot more what's  
8 currently being passed through about those  
9 products?

10                   MR. GOLDBRUM: You're right.  
11 There is a lot of variation. There isn't a  
12 go-to document.

13                   But again, when you're talking a  
14 bundled provider, and a bundled provider could  
15 be making insurance products available for an  
16 unaffiliated company, you don't have a  
17 prospectus to point to or to rely on. And in  
18 discussing this issue with our members, it  
19 became apparent to us that in most of those  
20 instances, the employer is signing some form  
21 of agreement already with the investment  
22 provider.

1                   And what we would propose again  
2           when you're trying to figure out who is  
3           responsible for making that legal disclosure,  
4           instead of shifting that responsibility to the  
5           intermediary that that responsibility should  
6           be between the investment provider and the  
7           plan sponsor. And pursuant to that agreement  
8           that for the most part today exists. They may  
9           not today meet the requirements that you  
10          ultimately want them to satisfy, but that's  
11          where we think the responsibility should be.

12                   PANEL MEMBER ZARENKO:     Okay.  
13          Switching gears, in your comment letter -- and  
14          we've heard there's a lot of resistance  
15          sometimes and it's hard to get plan sponsors  
16          to sign a contract -- our proposal did not  
17          include an explicit signature requirement. So  
18          I'm wondering is the issue there that you're  
19          just concerned without a signature have we  
20          satisfied your written contract or arrangement  
21          requirement? Or is the concern that if we  
22          don't have a signature, we -- a service

1 provider -- are uncomfortable that a plan  
2 fiduciary has complied with its side of the  
3 transaction? Could you just expand on that?

4 MR. GOLDBRUM: Yes. Well, it  
5 would be very, very helpful if in the final  
6 regulations it was explicitly stated that this  
7 agreement or arrangement requirement did not  
8 require a signature. If that is the case,  
9 that may make the agreement provision simpler.

10 So essentially, a service provider  
11 would send the agreement and the disclosures  
12 to the plan and they've satisfied the  
13 disclosure requirements. If that's the  
14 Department's intention, it would help to  
15 explicitly state that.

16 PANEL MEMBER ZARENKO: Do service  
17 providers want to have signatures? They just  
18 can't get them?

19 MR. GOLDBRUM: No. I don't  
20 believe that they would want to have the  
21 signatures. They would prefer not to have to  
22 get signatures.

1                   In trying to understand what the  
2                   proposal was, it was not clear whether or not  
3                   the agreement requirement required a signature  
4                   or not.

5                   PANEL MEMBER ZARENKO: Any state  
6                   contract law issues that are either created by  
7                   our proposal or that are out there right now  
8                   that we should be aware of?

9                   MR. GOLDBRUM: Yes. But I'm not  
10                  the best one to summarize those for you.

11                  CHAIRMAN CAMPBELL: Anyone else on  
12                  the Panel have any questions?

13                  All right. Any additional  
14                  comments you'd like to make.

15                  MR. GOLDBRUM: No. Thank you for  
16                  considering our views.

17                  CHAIRMAN CAMPBELL: All right.  
18                  Well, thank you for coming to testify.

19                  We had planned to do one more  
20                  testimony before the break, but our  
21                  stenographer has now arrived. So let's take  
22                  our break a little bit early so we can get

1           that set up and then we'll start with Mr. Wray  
2           when we return.

3                        Ten, 15 minutes. Thank you.

4                        (Whereupon, the above-entitled  
5           matter went off the record at approximately  
6           10:00 a.m. and resumed at 10:10 a.m.)

7                        CHAIRMAN CAMPBELL: All right,  
8           folks. If we can take our seats. We'll get  
9           started again.

10                      Our next witness is David Wray  
11           from the Profit Sharing 401(k) Council of  
12           America.

13                      MR. WRAY: Assistant Secretary  
14           Campbell and Panel members, thank you for the  
15           opportunity for us to share the views of the  
16           Profit Sharing 401(k) Council of America.

17                      Established in 1947, PSCA is a  
18           national nonprofit association of 1200  
19           companies and their six million participants.

20                      PSCA represents its members' interests to  
21           federal policymakers among its other services.

22                      It has both large and small companies. We

1 have Fortune 100 companies and we have small  
2 entrepreneurial businesses as members.

3 Qualified retirement plan  
4 fiduciaries are expected to arrange for  
5 services paid for with plan assets only, when  
6 the fees charged for those services are  
7 reasonable. However, a determination of the  
8 fees paid from a plan and how those fees are  
9 determined can be difficult.

10 The operation of today's defined  
11 contribution program requires a multiplicity  
12 of services. In addition to investment  
13 management, these plans require record  
14 keeping, administration, compliance,  
15 communication to plan participants,  
16 consultants and advisory services, specialists  
17 like firms that handle only QDRO filings, and  
18 trustee services.

19 Plan sponsors and participants  
20 expect that the services provided to their  
21 plans are of the highest quality and  
22 constantly improving. Those who provide

1 services to defined contribution retirement  
2 plans have responded with efficient,  
3 innovative and high quality solutions often  
4 using complex business models with complicated  
5 fees and fee-sharing arrangements.

6 Most plan fiduciaries do not have  
7 an expert understanding of the business models  
8 of those who provide plan services. They must  
9 rely on the fee-related disclosures provided  
10 by their service providers. Often service  
11 providers provide the information that plan  
12 sponsors need in a form that helps them meet  
13 their fiduciary obligation. Sometimes they do  
14 not.

15 In the proposed regulation, the  
16 Department of Labor has made it clear that it  
17 expects retirement plan fiduciaries to know  
18 with specificity all of those who receive  
19 compensation or fees as a result of the  
20 provision of certain plan services and how  
21 their fees are determined in order to ensure  
22 that fees paid from plan assets are



1 reasonable.

2 While PSCA applauds the  
3 Department's intent to require fee disclosure  
4 by providers to fiduciaries, we have concerns  
5 about the proposed regulation.

6 First, the proposed regulation is  
7 not clear about the extent of the information  
8 required to be disclosed. The proposed  
9 regulation could be interpreted as requiring  
10 detailed lists of every entity and individual  
11 providing any type of services to an  
12 organization providing a covered service to  
13 the plan. The Department then makes it clear  
14 that the required disclosures must be  
15 considered when determining the reasonableness  
16 of plan fees.

17 The Department must recognize that  
18 a plan fiduciary is most often a small- or  
19 medium-sized business owner with no particular  
20 expertise in ERISA law or the service provider  
21 industry. The proposed regulation should be  
22 revised to reflect this reality, otherwise

1 small business owners will likely reconsider  
2 the decision to offer a benefit plan to their  
3 workers.

4 Second, PSCA recommends that the  
5 requirement that a service provider disclose  
6 conflicts of interest be removed, but the  
7 requirement to disclose material relationships  
8 be retained. The conflict-of-interest concept  
9 is new and undefined. It is apparently not a  
10 condition that is prohibited under Section  
11 406. The inclusion of this concept in the  
12 regulations will confuse both fiduciaries and  
13 providers, adding cost and uncertainty to the  
14 administration of employer-sponsored  
15 retirement plans. Additionally, a common  
16 sense definition of material relationship  
17 needs to be provided.

18 Third, PSCA is concerned that the  
19 current state of the law does not permit the  
20 Department to require compliance with the  
21 regulations by many of those being paid from  
22 plan assets, including some investment

1 managers who receive the major portion of most  
2 plans' fees.

3                   Unfortunately, much of the  
4 discussion about the proposed regulations is  
5 not about the disclosure information to help  
6 fiduciaries ensure the plan fees are  
7 reasonable. Rather, it is about who the  
8 Department can compel to comply. It is  
9 incumbent on the Department to clarify  
10 persuasively that it has the authority to  
11 require that everyone paid from plan assets  
12 comply with the disclosure requirements.

13                   PSCA is concerned that the  
14 proposed regulations may have greatly expanded  
15 what plan fiduciaries must consider in order  
16 to ensure that fees are reasonable. At the  
17 same time, it is uncertain that the Department  
18 can compel service providers to provide the  
19 needed information. It is possible with these  
20 regulations the Department will have imposed  
21 increased accountability on plan fiduciaries  
22 without giving them what they need to act

1           appropriately, thereby expanding the liability  
2           of plan sponsors and their exposure to  
3           frivolous law suits.     This is a perilous  
4           outcome for plan sponsors that could result in  
5           reduced benefits for America's workers.

6                     You have our comments, so I'm  
7           going to skip some of the specific stuff.

8                     It is important to understand that  
9           the greatest service that a plan sponsor  
10          provides a 401(k) participant is not payroll  
11          deduction.  It is fiduciary oversight.  In  
12          today's litigious workforce, we can only be  
13          grateful that employers -- especially small  
14          companies -- are willing to take on this  
15          obligation.  The purpose of these rules should  
16          be to provide these plan sponsors with what  
17          they need in a way that facilitates their  
18          oversight of their plans.

19                    Thank you for the opportunity to  
20          testify.  I am more than happy to answer  
21          questions.  Ed Ferrigno has joined me to help  
22          if it gets too technical for me.

1 CHAIRMAN CAMPBELL: Okay. Joe?

2 MR. PIACENTINI: Thank you. I  
3 guess I'll start with questions that are  
4 similar to what I asked the previous panel.

5 So is it your sense then that  
6 after a fashion, plan sponsors are able to get  
7 the information they need now about the  
8 services they are providing, including the  
9 services associated with investment options,  
10 or not?

11 MR. WRAY: Plan sponsors who are  
12 large and aggressive get all the information  
13 that they want and need. As you move down the  
14 size of the company, this becomes more and  
15 more difficult. Small- and medium-size  
16 companies -- and for me a medium-sized company  
17 is 500 employees -- even a company of that  
18 size does not have leverage. It is only  
19 recently that the plan providers have begun to  
20 provide spreadsheets that actually list out  
21 the plan fees in a more understandable way.

22 It's still a relatively difficult

1           thing to get for small- and medium-sized  
2           companies. They really have to know what to  
3           ask for. Remember, these people are working  
4           24/7 to keep their businesses going. They are  
5           relying on a provider to help them run their  
6           plans. And they don't even know the questions  
7           to ask. And I know the Department has great  
8           information on its website and everything, but  
9           these people are not spending time researching  
10          the Department of Labor's website. I mean,  
11          they have a relationship with an intermediary.

12          And if the intermediary does not provide the  
13          information, they don't have it.

14                       MR. PIACENTINI: So a corollary  
15          question to that, we heard a lot in comments  
16          that the Department received about the costs  
17          to various intermediaries, potentially package  
18          up some of this information or provide it,  
19          even if they can get it.

20                       I guess my question is is there a  
21          corollary cost that plan sponsors -- maybe  
22          particularly small plan sponsors -- are

1           incurring now to try to do the same thing for  
2           themselves. Is that something we should be  
3           thinking about? I don't think we heard as  
4           much about that in comments.

5                       MR. WRAY: That's interesting.

6           The large companies are hiring  
7           professionals. The costs are up to \$10,000  
8           for the very most basic fee audit arrangement.

9           There's no question that small plans are not  
10          going to pay \$10,000 to do a fee audit on a  
11          plan that has \$2 million in it or something,  
12          or even \$20 million.

13                     So it would greatly facilitate the  
14          small plan sponsors' decision making if there  
15          was some systematic way of providing  
16          information in a reasonable format. We need  
17          some simplicity.

18                     I know that there's concern in the  
19          provider community about bringing things to  
20          certain kinds of standard disclosures. But I  
21          think we need some kind of standardization in  
22          this -- some kind of format that kind of

1 forces everything into an apples-to-apples  
2 comparison arrangement I think would be useful  
3 to small- and medium-sized plan sponsors.  
4 They can't afford to pay somebody to go and  
5 spend the hours it takes to read the contracts  
6 in great detail.

7 Remember, we're talking about a  
8 contractual arrangement here. These contracts  
9 are lengthy. They're complex. Analyzing  
10 those arrangements is a major undertaking to  
11 do that.

12 MR. PIACENTINI: And the last  
13 question, do plan sponsors in your experience  
14 currently get disclosure about indirect  
15 compensation received by the service  
16 providers?

17 MR. WRAY: If they know to ask for  
18 it and they are -- the large ones.

19 Understand, the large companies  
20 know practically to the penny what is going on  
21 in their plans. And they have professional  
22 people on staff who know what the questions



1 are to ask. They have providers to assist  
2 them.

3 So I mean, our concern here is not  
4 with McDonalds or IBM. It's with the small,  
5 medium-sized companies.

6 Very large companies are getting  
7 what they want. The other companies are -- I  
8 mean, it's available. It's available if you  
9 know the right questions, but the providers  
10 are not walking in and saying by the way,  
11 there's 40 basis points of revenue sharing  
12 coming out of each of these funds, and this  
13 revenue sharing equals this much money and  
14 this pays for record keeping and this and  
15 that. I mean, that stuff is not offered to  
16 people. You have to ask for it. You have to  
17 dig it out.

18 So if you want a plan's function  
19 to analyze that information as part of the  
20 decision making process, the small-, medium-  
21 sized plan sponsors need some help with that.

22 MR. PIACENTINI: Thank you.

1                   MR. CAMPAGNA: You mentioned that  
2                   you object to the conflict's provision of the  
3                   proposed regulation, and you suggest that  
4                   there be a standard of material relationships  
5                   in place. Could you elaborate on that just a  
6                   bit as to what you had in mind, and what the  
7                   difficulty is with the current conflict  
8                   provisions?

9                   MR. WRAY: I'll let Ed answer.

10                  MR. FERRIGNO: As David mentioned,  
11                  the conflict-of-interest provision is, we  
12                  think, new. When the Department of Labor  
13                  issued guidance a couple of years ago about  
14                  dealing with plan consultants, we interpreted  
15                  that as dealing with fiduciaries, and in the  
16                  proposed rule we're talking about someone  
17                  who's not in a fiduciary status. So the whole  
18                  concept of conflict of interest is new and  
19                  foreign.

20                  Just as importantly, a service  
21                  provider could arguably determine that they  
22                  are acting in their own economic interests

1 outside a fiduciary relationship, and  
2 therefore no conflict of interest exists. And  
3 then they would make a subjective decision and  
4 would not provide material information about  
5 material financial relationships because it's  
6 predicated on a conflict of interest.

7 On the plan sponsor perspective,  
8 being told by your service provider that a  
9 conflict of interest may exist or does exist  
10 could be extremely unsettling to the  
11 unsophisticated plan sponsor, and they  
12 wouldn't know how to react to that. On the  
13 other hand, if you remove the condition of  
14 conflict of interest and just require the  
15 disclosure of material financial  
16 relationships.

17 Having said that, that's an  
18 undefined term, and we recommend in our  
19 comments that there be a study with the  
20 Department of Labor and the industry to try  
21 and get a handle on what level of detail would  
22 be required.

1                   CHAIRMAN CAMPBELL:       Sorry to  
2                   interrupt.

3                   How would you conceive of that  
4                   sort of material relationships differing from  
5                   something like the Form ADV?

6                   MR. FERRIGNO:   Well, I think the  
7                   Form ADV is being revisited by the SEC.   So  
8                   we'll have to see what's going on there.

9                   And when you look at the  
10                  definition of fees and compensation, and you  
11                  put that together with material disclosure,  
12                  which really how far down the line do you have  
13                  to go.   For instance -- well, the first  
14                  question of course is who's subject to the  
15                  rule.   And if our mutual fund investment  
16                  manager is subject to the rule or not, no one  
17                  seems to know.

18                  If you then want to go to a  
19                  material financial relationship with a complex  
20                  mutual fund company, it's really how far down  
21                  the line do you go, and are you going to flood  
22                  the small- and medium-plan sponsor with an

1           overwhelming amount of information, that  
2           probably is not going to be helpful.

3                       CHAIRMAN CAMPBELL:       Sorry to  
4           interrupt.

5                       MR. CAMPAGNA:    Oh, no.

6                        You said it's important for the  
7           small employer to understand everyone that's  
8           paid out of plan assets.  And we have a lot of  
9           comments that say well, that non-plan asset  
10          vehicle -- the parties involved there are not  
11          necessarily service providers.  But you're  
12          saying that everyone who's paying out of plan  
13          assets should get some disclosure.  Could you  
14          elaborate about this?

15                      MR. WRAY:    Well, I mean we're very  
16          supportive of the Form 5500 disclosures.  And  
17          I think it's pretty clear that people who  
18          provide -- who are paid significant amounts --  
19          I mean, not de minimis amounts, but paid out  
20          of plan assets should be recognized, and the  
21          services that they provide.

22                      MR. FERRIGNO:  If I could just

1 elaborate.

2           When we're talking about plan  
3 assets, we're talking about 404(a), as opposed  
4 to the definition of plan assets. Who's  
5 subject to 406? Who has protection under 321  
6 Cap B? We think that you have to bring it  
7 back to the fiduciary responsibility comes in  
8 when plan assets are used under 404(a) to pay  
9 for administrative expenses, and that that  
10 should be the key. And I don't think that  
11 there's any question that there's not a plan  
12 asset exception under 404(a), or I don't think  
13 anyone is arguing that investment management  
14 fees are not always covered under 404(a) if  
15 plan assets are involved.

16           So we think that you have to get  
17 back to the intent of the rule, which is to  
18 get to 404(a). The DOL will tell us what we  
19 need to know under that, and then provide a  
20 tool for us to get it. And that's obviously  
21 different than considering a plan asset rule  
22 under the 25 percent rule or something like

1           that.

2                       MR. CAMPAGNA:     In your comment  
3           letter, you said that you don't think it's of  
4           value to plan fiduciaries as to how much  
5           brokers receive internal to the mutual fund  
6           for transaction costs.  Could you elaborate on  
7           that remark?

8                       MR. FERRIGNO:  I think the first  
9           question is what is the Department's position  
10          under 404(a) about fiduciary responsibility  
11          for brokerage costs that are paid with plan  
12          assets.  Then what we're really trying to say  
13          is if an investment manager has 75 brokers  
14          that they deal with that we don't see the  
15          value of getting a list of those 75 brokerage  
16          firms.  I think we read the rule -- and it's  
17          open to the final rule that under 404(a), you  
18          do have to be cognizant of brokerage costs by  
19          an investment manager.

20                      Arguably, a mutual fund investment  
21          manager, if that's the case, and we think we  
22          probably need the aggregate number and we

1 would want to know as well if there is a  
2 financial relationship between the investment  
3 manager and a particular broker. But we  
4 understand that there could be 75 to 100  
5 brokers that would have to be disclosed and  
6 that that would be pretty meaningless  
7 information under these plans.

8 MR. CAMPAGNA: But the costs  
9 associated with brokerage -- not the 75  
10 brokers -- but the costs associated --

11 MR. FERRIGNO: To the degree -- it  
12 is the Department's position that under 404(a)  
13 we are responsible for reviewing that  
14 information, then it should be disclosed. It  
15 all comes back to what the Department says we  
16 need to know under 404(a). And we'd like to  
17 see a matching principle.

18 MR. WRAY: Right. I mean, if you  
19 say that we don't need to know that -- the  
20 general prospectus type information is what's  
21 needed by a fiduciary -- we're happy to deal  
22 with that standard.



1                   Part of what's going on here is  
2                   you're listing in fair detail what it is the  
3                   plan's sponsors need to know. That's never  
4                   been listed before. It's been -- well, while  
5                   it's a fiduciary standard, it's sort of what  
6                   other people do. Now you're listing things  
7                   that we need to know. I mean, that's what  
8                   this is doing.

9                   You have great latitude in telling  
10                  us what that is. We're hoping that you keep  
11                  it simple and meaningful. But if you make it  
12                  broad, then we're saying you have to give us  
13                  the tools so that we can meet the standard or  
14                  meet the obligation that you are imposing.

15                 MR. WILLIAMS: I suppose a follow-  
16                 up would be is there one particular thing that  
17                 you would recommend that we could do to  
18                 improve disclosures that are made by  
19                 intermediaries to small plan sponsors who are  
20                 acting as fiduciaries for small plans?

21                 MR. WRAY: We think there needs to  
22                 be some sort of standardization of disclosure.

1                   MR. WILLIAMS: So we're on the  
2                   right track with requiring specific  
3                   disclosures to be made by mere service  
4                   providers who are in --

5                   MR. WRAY: As long as we can get  
6                   the information we think probably at this  
7                   point.

8                   We're in an evolutionary process.

9                   The expectations of plan fiduciaries have  
10                  changed, and they're increasing. But we think  
11                  that maybe at this point we need some specific  
12                  direction from the Department on this. And  
13                  again, as long as you can help us get the  
14                  information.

15                  MR. WILLIAMS: Right. So you're  
16                  concerned about the breadth of it?

17                  MR. WRAY: Yes.

18                  MR. WILLIAMS: And the possibility  
19                  that you don't get all the information that  
20                  you would be required to get.

21                  MR. WRAY: Right.

22                  MR. WILLIAMS: But if you had a

1 defined amount of information that you knew  
2 you were supposed to get and you got it, then  
3 I think you said the remaining concern was  
4 with the complexity of the contracts.

5 MR. WRAY: I think that that would  
6 work out. I think the industry would adapt to  
7 that and come to that.

8 MR. WILLIAMS: Certainly they  
9 would be better off with a written contract  
10 than without one.

11 MR. WRAY: Absolutely. And the  
12 contract's narrower.

13 You have written contracts. It's  
14 the service agreement that really defines what  
15 is going on, not somebody's presentation in a  
16 PowerPoint or some summary discussion.

17 So, I mean no. We need good  
18 contracts.

19 MR. WILLIAMS: And it would be  
20 helpful for the service agreement to identify  
21 conflicts so that the plan fiduciary could  
22 make assessments about --

1           MR. WRAY: You see, that's the  
2 point. What you need to know is there's still  
3 a fiduciary oversight responsibility. What  
4 you do is provide information to fiduciaries,  
5 and the fiduciaries make decisions. Whether  
6 or not there's a conflict or not ought to be a  
7 decision by the fiduciary, not by some third  
8 party.

9           You give us the information. We  
10 look at it and say oh, I've dug into this as a  
11 fiduciary. And it could look a little funny.

12         But I've worked it out. There's no conflict.

13         It's my decision as a fiduciary to determine  
14 whether there's a conflict or not -- I think,  
15 not something in the rule.

16           MR. WILLIAMS: Thank you.

17           CHAIRMAN CAMPBELL: My interests  
18 have been particularly in the conflicts as  
19 well. And I think we've had a pretty thorough  
20 discussion. Let me tip it over to Adrienne.

21           MS. DWYER: You talked about the  
22 level of specificity that we were requesting

1 in the regulation and how concerned you are  
2 about that. How do you think we could make  
3 that provision more workable?

4 MR. WRAY: We've already talked  
5 about the material disclosures. This is very,  
6 very important stuff. I hope you understand  
7 that this regulation will have enormous  
8 ramifications in the system.

9 We think that -- and of course,  
10 the time is passing, but it would have been  
11 useful to have had some kind of discussion  
12 early on about and had a working group or  
13 something look at this, get some people in the  
14 industry and some plan sponsors and regulators  
15 sit down and have a round table on this and  
16 talk about what it is that actually might be  
17 the most meaningful.

18 We certainly have some ideas. But  
19 I know the providers have their own ideas  
20 about this. And I think the best practice  
21 would be to have some kind of forum and sort  
22 of just focus on that point so we make sure

1           that -- because we don't want the providers to  
2           have to do anything that they don't need to  
3           do. Absolutely, it is correct. Everything  
4           that we require the providers to do is going  
5           to cost money, and that cost is going to be  
6           passed on to participants.

7                         We knew when we started on this  
8           disclosure project many years ago that these  
9           costs were going to be passed on to  
10          participants. Participants are paying for  
11          what we are talking about doing right now. I  
12          mean, we're talking about fees. We want the  
13          fees to be reasonable, but we are going to  
14          impose more fees on the plans. And they're  
15          going to be paid by participants. So we don't  
16          want to do that casually.

17                        So I think we want to keep the  
18          disclosure and the process as simple as  
19          possible. Basically you don't want to burden  
20          people with what they don't need. And  
21          secondly, we don't want to charge participants  
22          for something they don't need to have as part

1 of the process.

2 So I would say if we could get a  
3 group together and if there's time, that would  
4 be the way to do this. Because it needs a  
5 full airing, I think, just on that one topic.

6 MR. FERRIGNO: When you look at  
7 the definition of compensation and fees, how  
8 far down the chain do you want to go with  
9 that? Theoretically, examples have come up  
10 with the discussions with the Department about  
11 do we need to know what an investment  
12 manager's law firm is paid?

13 You could take this down to really  
14 ridiculous levels to how much -- if someone is  
15 running the cafeteria at an investment  
16 management company, yes, they are getting  
17 compensation as a result of an arrangement  
18 with the plan. So we need to get our hands  
19 around that.

20 MS. DWYER: Well, suppose you're  
21 the plan fiduciary. What do you want to know?  
22 Where do you want us to draw the line?

1                   MR. FERRIGNO: Well, part of what  
2                   you have to understand is we are at your mercy  
3                   to a certain degree about you telling us what  
4                   we need to know under the 404(a). And  
5                   certainly we don't agree with everything in  
6                   this proposed rule.

7                   But the proposed rule can be  
8                   viewed as an interpretive bulletin both to  
9                   develop what plan sponsors should be doing to  
10                  satisfy the requirements under 404(a). So to  
11                  the degree that you define that -- and we  
12                  would like to debate with you what that  
13                  definition should be -- then there should be  
14                  whoever is getting those plan assets should be  
15                  required to give us the information we need to  
16                  meet our requirements under 404(a). And with  
17                  all the debate about plan assets and 321 Cap B  
18                  and who's subject to 406, there's a disconnect  
19                  right now.

20                  MR. WRAY: I would just say that  
21                  when people -- and that was the question  
22                  earlier -- how do you make decisions. When



1           you make decisions, the fees should be and are  
2           the last consideration in a determination of a  
3           provider relationship.

4                        The first thing is can they get  
5           the quarterly statements out on time. I  
6           always say if our record keeping is the only  
7           place where perfect is just good enough, you  
8           have to demonstrate a high quality of service.

9           If you can't deliver a high quality of  
10          service, then the fees don't matter. You're  
11          looking at performance. People are looking at  
12          performance over time. They're looking at the  
13          reputation of the organization. Those are all  
14          the critical factors.

15                      When you have lined up what it is  
16          that you need and you have evaluated these  
17          other things, then you look and you see well,  
18          are the fees reasonable. Are the fees  
19          reasonable? And that's what we need. We just  
20          need to know that once we've evaluated these  
21          other things, are the fees reasonable?

22                      And in that regard, you need the

1           general categories of fees just to be sure.  
2           What are the revenue sharing arrangements?  
3           What are the overall costs that are coming out  
4           of plan assets? We don't need to go into  
5           great detail to know whether these are  
6           reasonable. Certainly not the detail that's  
7           currently in the regulation.

8                       MS. DWYER: Thank you.

9                       MS. ZARENKO: I just want to  
10           follow up on the formatting issue.

11                      You mentioned that it would be  
12           very useful for plan sponsors to have some  
13           kind of a uniform presentation of this  
14           information so they can compare apples to  
15           apples. I guess it wasn't clear if you were  
16           asking that we -- the Department of Labor --  
17           come up with some kind of a uniform disclosure  
18           format. And if so, what do you think that  
19           looks like? Would it be easy to -- especially  
20           given all the different kinds of services that  
21           we cover, the kinds of ways services are  
22           provided, and the various players -- your

1 thoughts on how easy it would be to boil it  
2 down to a standardized format?

3 MR. WRAY: Well, first I don't  
4 think it should be part of the regulations.  
5 But I do think that the Department of Labor  
6 could facilitate that process. I do think  
7 that it makes some sense to have some  
8 standardization in this.

9 A lot of the providers now are  
10 moving to a spreadsheet format of fee  
11 disclosure with their clients, which I think  
12 has been very helpful. This has come on in  
13 the last couple of years.

14 And what you do, it's a fairly  
15 simple spreadsheet. But what you do is you  
16 lay out the various investments that are in  
17 the plan, how much money is in each of the  
18 investments, the dollar amount that's being  
19 generated from each of those, a couple of  
20 categories on the side like revenue sharing --  
21 how that money is coming out. You come up  
22 with a total amount at the bottom. You put in

1 additional expenses.

2 It seems to me that there are some  
3 simplicities that could be built into the  
4 system maybe as a recommended format or  
5 something. We had our fee disclosure format  
6 work sheet at PSCA for a long time. You have  
7 one on your website. It seems to me that it  
8 may be in more detailed, more up-to-date kind  
9 of disclosure work sheet like that that  
10 recognizes the new level of disclosure that's  
11 necessary because that was sort of the old  
12 disclosure. I think it would be very helpful.

13 Again, we don't have to go into  
14 great detail -- I don't think -- in order to  
15 meet our reasonableness requirement as  
16 fiduciaries.

17 MS. ZARENKO: Sort of getting out  
18 of the weeds for a minute and just trying to  
19 focus on the bigger picture, what currently  
20 for plan sponsors are the easier aspects of  
21 service and investment relationships to  
22 understand? What are the most confusing

1 parts? Is it lengthy service provider  
2 agreements that are written in legalese? Is  
3 it the way that investments are charged to  
4 participants and beneficiaries of the plans?  
5 Is it the way the information flows from  
6 investments?

7 MR. WRAY: I think that there's  
8 still a significant number of plan sponsors  
9 that don't understand how the single point of  
10 payment arrangement flows fees to various  
11 types of service providers.

12 For example, we know the system  
13 actually is very efficient. The money is  
14 collected at one point, and then it is  
15 parceled out to people. Typically, that's at  
16 the investment management point. The money is  
17 deducted from the total plan assets by whoever  
18 is managing the money and then parceled out to  
19 the other people who actually provide the  
20 services. I think that is not well understood  
21 by a lot of plan sponsors.

22 I think that would be the part --

1 and that's pretty basic. That's just the  
2 straight revenue sharing arrangements that are  
3 there. If that were clarified, I think you'd  
4 be a long way down the road on that.

5 MS. ZARENKO: So you think that  
6 information is important to plan fiduciaries?

7 It's just that typically it's confusing?

8 MR. WRAY: And it's not provided  
9 in a way that most plan sponsors understand  
10 it. And it's certainly not offered up. You  
11 have to go and dig it out.

12 We've had articles in the  
13 newspaper where people double-count the fees  
14 in an article because they think that the  
15 amount of money to pay for record keeping is  
16 an additional fee when they didn't realize --  
17 and even the plan sponsor who was interviewed  
18 did not realize -- that actually that was  
19 already coming out of the investments  
20 management fees. There was a 40 basis point  
21 revenue share. So the total cost of the plan  
22 where 110 basis points, the employer was

1           paying 10. There was a wrap of 10 basis  
2           points, 100 basis points for fees. But  
3           actually of the 100 basis points coming out of  
4           the investments, 40 was actually paying for  
5           investments, 40 was paying for the record  
6           keeping and compliance. That confusion is --  
7           I think -- unless you have a professional  
8           advising you, it's hard to have a good picture  
9           of how that actually works.

10                   MS. ZARENKO: And this sort of  
11           sounds like the bundled issue in the extent to  
12           which allocations within a bundle should be  
13           disclosed to plan fiduciaries. And some feel  
14           that as long as a fiduciary knows the total  
15           cost, including all of these different factors  
16           and all the services that are going to be  
17           provided, that's sufficient. Whereas others  
18           believe to varying degrees what goes on within  
19           a bundle should be allocated. You sort of  
20           touched on that. But could you address that  
21           issue?

22                   MR. WRAY: Well, our view first is

1           that you could make the decision on a total  
2           basis.

3                       As I indicated, we have a  
4           multiplicity of business arrangements out  
5           there. And to ask a plan sponsor to go in  
6           there and say well, this particular function  
7           is correctly paid for looking at a plan-wide  
8           survey of QDRO retainers. We're going to  
9           check all the QDRO retainers out there and  
10          make sure that they're all lined up. No, you  
11          should be able to look at a bottom-line cost  
12          when everything has been assembled.

13                      On the other hand, it's useful to  
14          know inside what are the services you're  
15          getting and how much are they, and how's the  
16          revenue being shared within the provider  
17          arrangement. But our view is that you  
18          shouldn't have to go and evaluate each one of  
19          those fees on an individual basis, but rather  
20          look at the collective arrangement.

21                      As we said in our earlier  
22          testimony, the point is when you buy a car,



1           you don't need to know what the cost of the  
2           back seat was. You're looking at the whole  
3           package. But you want to know what's the  
4           horsepower, what are the warranties. You want  
5           to make sure you've got all the pieces down  
6           and that you like all the pieces.

7                        MS. ZARENKO: Some of the comments  
8           that we got on the conflict-of-interest  
9           provisions go to the fact that it seemed like  
10          we were asking fiduciary-like questions of  
11          non-fiduciary service providers. Do plan  
12          sponsors think of it that way? Do they make  
13          that distinction? Or do you think -- even if  
14          it was limited to just material relationships  
15          as you suggest -- that that information is  
16          equally relevant whether we're talking about  
17          fiduciary or non-fiduciary service providers?

18                      MR. WRAY: Well, service providers  
19          are not fiduciaries. They may be in some  
20          cases. But basically, they're not  
21          fiduciaries. They're not required to act as  
22          fiduciaries.

1                   MR. FERRIGNO: This is a rule on  
2 parties in interest to plans, not fiduciaries  
3 and plans.

4                   I don't think there's a lot of  
5 confusion about how conflict of interest  
6 applied when there's a fiduciary relationship.

7                   We didn't think the concept applied at all  
8 outside of a fiduciary relationship.

9                   And the proposed rule says the  
10 service provider is going to step into the  
11 shoes of the fiduciary in determining whether  
12 or not this is something that a fiduciary  
13 would consider a conflict of interest. Again,  
14 subjectively they could decide no. And  
15 therefore material information wouldn't be  
16 provided. So we just think it's cleaner to  
17 let's get our hands around what's material and  
18 just give it to the plan sponsor and let them  
19 deal with it.

20                   MS. ZARENKO: Thank you.

21                   MS. WIELOBOB: I just have one  
22 quick one.

1           You had mentioned earlier the  
2           5500, and that you support 5500. You think  
3           the information that comes there is beneficial  
4           that's reported. And a number of comments  
5           we've gotten have suggested basically that the  
6           proposal is redundant to 5500 in some  
7           respects. It's some of the information. To  
8           which I'm confused because on that point it  
9           seems to me that it would be a retrospective  
10          analysis that the fiduciary would be able to  
11          -- do you have any insights on --

12                   MR. WRAY: No, I think they're  
13           very different.

14                   The 5500 is an after the fact --  
15           how much actually is paid. It's a public  
16           document that is reported for many purposes.

17                   This is about informing a buyer of  
18           information a buyer needs when they're making  
19           the decision. By the time the 5500 process  
20           works its way through, it's years past the  
21           decision process.

22                   The point is that when the 5500

1 report is made, you want it to look like  
2 everything is all nice and neat and tied up  
3 and all the fees are reasonable. And the way  
4 you do that is you make good decisions when  
5 you hire the providers. You don't look at the  
6 5500 data and say oh my gosh, how did we end  
7 up in this spot. And then with all of the  
8 intended possibilities, including audits from  
9 the Department of Labor might come off those.

10 That's the point. You don't want  
11 the 5500 disclosure to have consequences that  
12 are adverse to plan sponsors.

13 MS. WIELOBOB: Thank you.

14 CHAIRMAN CAMPBELL: All right.  
15 Well, thank you very much. We appreciate it.

16 MR. WRAY: Thank you very much.

17 CHAIRMAN CAMPBELL: In the  
18 interests of time, we'll shuffle you off  
19 quickly, and move on to Mr. Chambers of the  
20 American Benefits Council.

21 MR. CHAMBERS: Five seconds?

22 CHAIRMAN CAMPBELL: All right.

1 MR. CHAMBERS: Well, good morning.

2 My name is Robert Chambers, and today I am a  
3 partner in the Charlotte, North Carolina,  
4 office of the law firm of Helms, Mulliss &  
5 Wicker. And I mention that because tomorrow I  
6 will be a partner in the Charlotte office of  
7 McGuire Woods, with whom Helms, Mullis is  
8 merging later on today.

9 I've advised clients with respect  
10 to 401(k) plan issues since 401(k) was added  
11 to the Internal Revenue Code. It seems like  
12 it was 1878, but I think it was 1978.

13 I'm also the past chairman of the  
14 Board of the American Benefits Council on  
15 whose behalf I'm speaking today. And Jan  
16 Jacobson, who will introduce herself, is from  
17 the Council.

18 MS. JACOBSON: And I am the Senior  
19 Counsel, Retirement Policy from the American  
20 Benefits Council.

21 MR. CHAMBERS: The Council  
22 appreciates the opportunity to present

1 testimony with respect to the disclosure of  
2 401(k) plan fees. Our goal is the creation  
3 and maintenance of an effective and fair  
4 employee benefit system that functions in a  
5 transparent manner and provides meaningful  
6 benefits at a fair price in terms of both fees  
7 and other expenses. So in this regard, we  
8 commend the Department of Labor for its  
9 efforts to enhance transparency, including the  
10 issuance of the proposed Section 408(b)(2)  
11 regulations. We understand that this was a  
12 difficult task.

13           However, as you will hear over the  
14 next two days, considerably more work is still  
15 required. We have many, many suggestions for  
16 improving the regulations, but I have limited  
17 the list to those dealing with the scope of  
18 the regulation, fiduciary safe harbors, the  
19 treatment of employer-paid services, conflicts  
20 of interest, gifts, and the regulatory  
21 effective date.

22           As drafted, the proposed

1 regulations would provide broadly to define  
2 contribution plans, define benefit plans, and  
3 health and welfare plans. We urge you to  
4 finalize the proposed regulations in three  
5 separate tranches, or components: first for  
6 disclosure for defined contribution plans;  
7 second for defined benefit plans; and finally,  
8 for health and welfare plans.

9 Our reasons for this request are  
10 as follows: 1) Each component will require a  
11 massive and time-consuming negotiated  
12 undertaking; 2) each type of plan is sold and  
13 serviced very differently, and the fee  
14 structures are quite dissimilar; 3) each type  
15 of plan has distinctive legal structures; 4)  
16 any attempt - in our view -- to bring all  
17 three types of plans into compliance at the  
18 same time, especially in the breakneck fashion  
19 contemplated in the proposed regulations, will  
20 fail. And finally, the publicity and public  
21 policy discussions regarding fee issues over  
22 the past couple of years have focused on

1 defined contribution plans in that area, so  
2 that it would seem appropriate to start there.

3 Next, the proposed regulation is  
4 silent on whether it applies to arrangements  
5 that are covered by the prohibited transaction  
6 rules of Section 4975 of the Code, but not by  
7 ERISA. This broad sector includes tax  
8 qualified retirement plans that are exempt  
9 from ERISA because they cover only non-  
10 employee business owners, also IRAs, HSAs and  
11 Coverdell Education Savings Accounts.

12 The Council strongly recommends  
13 that the Department clarify in the final  
14 regulations that these plans are not subject  
15 to the disclosure rules. There is no plan  
16 fiduciary involved in these arrangements. To  
17 the contrary, individuals understand that  
18 they're acting really in their own stead in  
19 determining which service providers to engage  
20 and what investment decisions to make. In  
21 this sense, IRA owners and other arrangement  
22 owners are far more like plan participants



1 than plan fiduciaries. And in our view, it  
2 would be neither appropriate nor sensible to  
3 impose the so-called service provider to plan  
4 scope disclosure requirements to these non-  
5 ERISA arrangements.

6 The Council greatly appreciates  
7 the innocent plan fiduciary class exemption  
8 that's been proposed in connection with the  
9 proposed regulation. The proposed class  
10 exemption however only provides protection  
11 from prohibited transaction consequences.

12 The final regulation should also  
13 provide that these disclosures serve as an  
14 adequate financial predicate for a plan  
15 fiduciary in fulfilling its duty to understand  
16 any covered service arrangement. Of course,  
17 the fiduciary would still have to evaluate the  
18 quality of the services and the reasonableness  
19 of the cost.

20 The proposed regulation also  
21 implies that any violation of the  
22 requirements, no matter how minor, will result

1 in a prohibited transaction and excise tax.  
2 This structure would benefit greatly from a  
3 correct mechanism that provides a means of  
4 dealing with reasonable errors without  
5 draconian penalties.

6 In addition, there will be times  
7 when a bundled service provider is unable --  
8 despite reasonable efforts -- to obtain  
9 accurate information needed for disclosure  
10 from the other parties to its bundle. We  
11 recommend that the Department create a class-  
12 prohibited transaction exemption for such  
13 situations similar to the one that's provided  
14 for plan fiduciaries that are unable to  
15 provide necessary information from their  
16 service providers.

17 The proposed regulation appears to  
18 provide for its disclosure requirements, but  
19 they apply not only when a plan pays for the  
20 services, but also where the employer that  
21 sponsors the plan pays for services out of its  
22 general assets. ERISA regulates only the

1 amount that a plan pays for services. It does  
2 not regulate in our view the amount that the  
3 plan sponsor directly pays. For these  
4 reasons, the Council strongly recommends  
5 clarifying that the proposed regulation does  
6 not apply where a plan service is paid for  
7 entirely out of the plan sponsor's general  
8 assets.

9 We appreciate that there's some  
10 circumstances -- some situations -- where the  
11 plan has the legal obligation to pay for plan  
12 expenses, except to the extent paid by the  
13 employer. We believe that the proposed  
14 regulation should not apply to the extent that  
15 the employer commits contractually to be  
16 responsible for specified plan fees.

17 Now on the conflicts of interest.

18 We're puzzled by two aspects of the proposed  
19 requirements to disclose conflicts of  
20 interest.

21 The first relates to a service  
22 provider's ability to affect its own fees. We

1 understand that where a service provider uses  
2 its powers in a discretionary manner to affect  
3 its own compensation, the service provider is  
4 functioning as a fiduciary, and has committed  
5 a prohibited transaction. If this is correct,  
6 we ask what must be disclosed under this rule?

7 Only prohibited transactions? Or is the  
8 proposed regulation intended to implicitly  
9 overrule the Department's prior position that  
10 the service provider's ability to affect its  
11 own compensation is a prohibited transaction?

12 We strongly doubt that that was intended, but  
13 we're left puzzled as to the actual intent.

14 Seeing no purpose for this disclosure  
15 requirement, we recommend that it be deleted.

16 The requirement to disclose  
17 conflicts of interest is also puzzling. A  
18 conflict of interest can only arise where a  
19 service provider is acting as a fiduciary in  
20 providing a service -- for example, advice --  
21 with respect to which the service provider  
22 could be seen to have divided loyalties or

1 interests that are contrary to the plan's  
2 interests. In such cases, the existence of a  
3 conflict of interest generally gives rise to a  
4 prohibited transaction. But where the service  
5 provider is not acting as a fiduciary, the  
6 service provider is simply selling a service  
7 in an arms-length transaction. No fiduciary  
8 duty of loyalty to the plan exists. And  
9 accordingly, no conflict of interest in our  
10 view can exist. In this context, what must be  
11 disclosed under the proposed regulation? Only  
12 proposed transactions for which there is no  
13 exemption?

14 We strongly support full  
15 disclosure of fees, and we strongly support  
16 enforcement of the prohibited transaction  
17 rules generally banning conflicts of interest.

18 But the regulatory disclosure rules that I've  
19 just described serve neither purpose, and  
20 should be deleted.

21 While the Council agrees with the  
22 Department that plan fiduciaries should be

1       made aware of excessive gift-giving, we  
2       request two clarifications to the rules.  
3       First, the disclosure rules should be  
4       appropriately targeted so that disclosures are  
5       only required where there is a clear and  
6       direct relationship between the so-called  
7       gifts and the plan.     Second, the final  
8       regulation should include a de minimis  
9       concept, such as the \$50 threshold in the Form  
10      5500 instructions to avoid the problem with  
11      the logoed coffee cups and occasional  
12      sandwiches that are provided in connection  
13      with the rendition of the services.

14                   Lastly, effective date.   One of  
15      the most important issues for Council members  
16      is the proposed effective date of 90 days  
17      after the publication of final regulations.  
18      Implementation of the final regulations will  
19      require immense effort by plan fiduciaries and  
20      service providers, and very little of this  
21      work we believe can be done in advance of the  
22      issuance of the final rules.     The 90-day

1 period is simply not sufficient for service  
2 providers because the rule as proposed would  
3 require significant modifications to computer  
4 systems, the training of operational and  
5 administrative staff, the preparation of new  
6 communication and administrative materials for  
7 plan fiduciaries, as well as the development  
8 of actual disclosure documents. This work, of  
9 course, is in addition to the modification and  
10 renegotiation of agreements with plan  
11 fiduciaries and service providers.

12 The Council recommends that the  
13 final regulation be generally effective for  
14 new service contracts and material  
15 modifications of existing service contracts  
16 beginning at least 12 months following  
17 publication of final rules. Notwithstanding  
18 our recommendation, if the Department requires  
19 an earlier effective date, we strongly  
20 recommend a delay in the effective date for  
21 outstanding contracts that have not been  
22 materially modified. Any revisions to

1 outstanding contracts again will be an  
2 enormous undertaking and would be in  
3 everyone's best interests if there was time to  
4 facilitate an orderly transition.

5 Thank you again for the  
6 opportunity to be here today. And Jan and I  
7 will be happy to answer any questions.

8 CHAIRMAN CAMPBELL: Well, all  
9 right. Thank you very much.

10 This time, let's start over here  
11 and go in this direction.

12 MS. WIELOBOB: I want to ask you  
13 about your suggestion that health and welfare  
14 plans and DBs be dealt with on separate  
15 tracks. Can you get into that a little bit?  
16 Tell us why you think that's the case.

17 MR. CHAMBERS: Well, as I  
18 mentioned, there are four or five different  
19 things we think that distinguish between the  
20 different types of plans. And I think that  
21 there is probably going to be a need for  
22 different kinds of disclosure requirements



1 for, for example, health and welfare plans  
2 compared to defined contribution plans. Just  
3 different things are going to be needed to be  
4 disclosed.

5 There is often an insurance  
6 element that is not generally involved in most  
7 defined contribution plans. And again, since  
8 most employers -- certainly our members --  
9 contribute to many different kinds of plans,  
10 it would be extremely difficult, particularly  
11 in connection with the very quick effective  
12 date that's currently proposed for them to try  
13 to deal with all of those different kinds of  
14 programs at the same time.

15 MS. WIELOBOB: And it may be a  
16 question more fairly asked of the insurance  
17 experts in the crowd that are here on behalf  
18 of insurance entities solely, but I'm just  
19 trying to get my arms around it. I understand  
20 categorically what the differences would be.  
21 You mentioned fee structures. But what  
22 exactly are we talking about? Why do those

1 fee structures differ in such a way that it  
2 wouldn't work under the current arrangement --  
3 the current proposal?

4 MR. CHAMBERS: Well, I think your  
5 best off speaking to them about that.

6 MS. WIELOBOB: Okay. Correction  
7 mechanism -- you mentioned that you would  
8 support some sort of correction mechanism.  
9 How do you envision that working? The reason  
10 I'm asking is again, that's one of those  
11 things that's going to be potentially  
12 retrospective. If the disclosure hasn't been  
13 made, the agreement may already be in place.  
14 The service provider may be rendering services  
15 to the plan. How would you envision as  
16 compared to the draconian penalties -- as many  
17 call them -- under the proposal? Mechanically  
18 how would you see a correction scheme working?

19 MR. CHAMBERS: We have found over  
20 the years that it's really tough to be  
21 perfect. All right? Not that we haven't  
22 succeeded all of the time. But it's very

1           difficult. And the same thing is going to  
2           apply here.

3                       Again, often I should say,  
4           particularly in light of as other folks have  
5           spoken about this morning, the depth and  
6           breadth of the relationships that have to be  
7           disclosed and therefore that need to be in  
8           writing and the various elements of all of  
9           those different arrangements, there are  
10          invariably going to be mistakes that are made.

11          And I understand that there's a good faith  
12          provision that's in there. But proving good  
13          faith in light of either litigation that's  
14          spawned by this, or in light of an audit from  
15          your organization, it would be very simple if  
16          someone could come up with a program similar,  
17          for example, to the employee plans compliance  
18          resolution system whereby voluntarily  
19          organizations could come forward and get the  
20          papal dispensation essentially that you  
21          receive through a program like that. I would  
22          think that your organization would be in the

1 interests of voluntary disclosure with a minor  
2 slap on the hand of some sort, particularly if  
3 something's been allowed to continue for a  
4 number of years where you have a potential  
5 prohibited transaction excise tax that's  
6 compounding on an annual basis. I think that  
7 that's something that probably people would be  
8 interested in not disclosing for that reason.

9 MS. WIELOBOB: Thank you.

10 MR. CHAMBERS: Is that fair?

11 MS. WIELOBOB: Yes. Thank you.

12 MS. ZARENKO: Can you just touch  
13 for a minute on to what extent --  
14 understanding that there's some clarifications  
15 about indirect compensation and conflicts that  
16 have been requested -- but are we breaking a  
17 lot of new ground in this proposal just in  
18 terms of the kinds of information that we're  
19 going for versus what's currently being  
20 disclosed to plan fiduciaries?

21 MR. CHAMBERS: Well, I think that  
22 as other folks have already said, you have to

1 look at it from several different  
2 perspectives.

3 I think that from most large  
4 employers' perspectives, this is information  
5 that most -- not all -- but most large  
6 employers already have. They have asked for  
7 it. They have to be able to mandate it. They  
8 have people in-house whose responsibility it  
9 is to get this information and to help to  
10 figure things out.

11 As you move down the food chain in  
12 plan sponsors in terms of size, we have some  
13 clients of my law firm that are quite small  
14 that have very sophisticated in-house  
15 capabilities in this regard. And so, I don't  
16 know that there's a lot of new ground that's  
17 being broken for them.

18 But I would say on average, unless  
19 someone like me, or someone from a consulting  
20 firm has sat down with small- and mid-size  
21 companies and explained to them that as was  
22 previously pointed out there's more to it than

1           just making your contribution, that there are  
2           other payments out there that you really need  
3           to be focusing on. Most people really do  
4           think that there's not a lot more that they  
5           need to know. So for them, this is breaking  
6           new ground.

7                       MS. ZARENKO: Especially I think  
8           when we're talking about those small- and  
9           medium-sized markets, I think there's a  
10          variety of reasons that have been brought to  
11          our attention as to why there might be less  
12          information that's going back and forth. They  
13          don't know what questions to ask of their  
14          service providers, or sometimes service  
15          providers are less forthcoming with detailed  
16          information that they don't believe they're  
17          required to disclose.

18                      So one of the reasons that we  
19          structured this as a prohibited transaction  
20          was because that would incentivize a service  
21          provider to come forward with information that  
22          they may or may not otherwise be providing.

1           If it's a prohibited transaction, it's a PT  
2           for both of the parties -- both on the plan  
3           side and the service provider. Do you think  
4           that was a good way to go?

5                     You can think for a minute before  
6           you answer.

7                     MR. CHAMBERS: Well, in 30-plus  
8           years in doing this, I'm trying to decide  
9           whether I've thought that any government rule  
10          was a good way to go.

11                    MS. ZARENKO: Taking that as a  
12          given.

13                    MR. CHAMBERS: I'll put it this  
14          way. It's been a better way to go than some  
15          other things that I've seen.

16                    I'm concerned -- since you talked  
17          about this primarily from the small- and mid-  
18          sized plan sponsor perspective -- I'm  
19          concerned that the way things are set up that  
20          there are going to be a lot of what we have  
21          referred to internally as gotchas, that there  
22          are going to be a lot of organizations who

1 truly are using their best efforts and good  
2 faith to comply with this and to provide  
3 meaningful benefits for their participants who  
4 are not going to have the level of  
5 sophistication necessary to review the  
6 materials that might be coming in to make  
7 meaningful decisions. And therefore they're  
8 suddenly going to be responsible for paying a  
9 prohibited transaction fee and subject to  
10 audit and things like that, as well as  
11 potential law suits. I'm very concerned about  
12 that.

13 Obviously, your organization and  
14 certainly the American Benefits Council are  
15 very interested in promoting plan formation  
16 and plan maintenance. And we need to make  
17 sure that these rules when finalized are not  
18 going to be getting small- and mid-sized  
19 companies out of the business of providing  
20 retirement benefits for fear of the additional  
21 risk that they're going to be asked to be  
22 assuming.



1 MS. ZARENKO: Okay. Going to the  
2 format issues that we talked about with our  
3 last panelists, the way our proposal was set  
4 up there was a little bit of flexibility to  
5 incorporate other materials by reference,  
6 trying to avoid duplicative disclosures,  
7 understanding that there are already materials  
8 out there. On the other hand, it would be  
9 useful to a plan fiduciary some argue to have  
10 everything in one summary document. Again  
11 would you think mandating some kind of a  
12 format for that disclosure is a good idea?  
13 Would the Department of Labor be the entity to  
14 do that? What are your views on that issue?

15 MR. CHAMBERS: I think that that's  
16 one of these pie-in-the-sky opportunities that  
17 sounds really good, but I think that when you  
18 sit down and try to put something together  
19 that is meaningful and that also -- remember,  
20 the service providers have some say here.  
21 They really do. And it's my understanding  
22 from among our members and also from some

1 other organizations that efforts to do this  
2 have already been undertaken. And as someone  
3 suggested to me earlier today, this is by  
4 people who actually like each other. And they  
5 cannot agree. They cannot agree on a format.

6 They cannot agree on a standard format. So  
7 it seems to us that the best methodology is to  
8 say tell us what information we need to  
9 provide, and then we will put it together in a  
10 format that is appropriate on a case-by-case  
11 basis.

12 MS. ZARENKO: One last question  
13 that's an investment-related disclosure. I'd  
14 asked an earlier panelist from a plan sponsor  
15 perspective, how effective is a mutual fund  
16 prospectus as a tool. In your view, what do  
17 the plan sponsors think of the prospectus?  
18 What other kinds of information about  
19 investments do they get? What's useful?  
20 What's not?

21 MR. CHAMBERS: Our plan sponsor  
22 members typically are very large employers.

1           They can hire very expensive lawyers, and they  
2           already have very expensive lawyers on their  
3           in-house staffs.     And they recognize the  
4           realities of dealing with the world of  
5           prospectuses.   And that is that a prospectus  
6           is generally as complicated and as mind-  
7           numbing as it is because of legal  
8           ramifications.   And they understand that any  
9           effort to try to dumb it down -- to try to  
10          make it more understandable -- is invariably,  
11          or could invariably lead to additional risk at  
12          some level, whether it's the employer level or  
13          the plan sponsor level -- whoever it is who's  
14          trying to do that.

15                        So they understand that number  
16          one, they have the wherewithal to have in-  
17          house people who are trying to analyze the  
18          materials that are there.   And number two, I  
19          don't know that necessarily anyone who they  
20          would hire would be able to do it any better.

21          And again three, there is this significant  
22          exposure to risk by having people take very

1           carefully   legally   drafted   documents   and  
2           reformatting them in a way so that by cleaning  
3           out a lot of the legalese that's there  
4           intentionally, and thereby perhaps incurring  
5           liability for doing so.

6                        MS. ZARENKO:   Would you say all  
7           those concerns are true as well about whatever  
8           disclosure is provided about non-registered  
9           investment products?

10                      MR. CHAMBERS:    Sure.    Sure.  
11           Because if you're investing in a particular  
12           stock -- say, for example, one of the things  
13           that really hasn't been brought up today are  
14           self-directed brokerage accounts and how all  
15           of that's going to fit in with the fund final  
16           rules.  But if my organization has a self-  
17           directed brokerage account where I could  
18           invest not just in mutual funds but also in  
19           individual stocks and bonds, there will be  
20           prospectuses or other disclosure information  
21           out on virtually all of those.  The more  
22           difficult situation is where you're investing

1 in something where that kind of publicly-  
2 available -- or that information is not  
3 available publicly.

4 MS. ZARENKO: Thank you.

5 MS. DWYER: I have one question.  
6 And it's limited to compensation relating only  
7 to defined contribution plans.

8 Your comments really focus on  
9 various protected mechanisms that you would  
10 like to see inserted into the proposed reg.  
11 Assuming they were all to be accommodated, do  
12 you think --

13 MR. CHAMBERS: You mean they may  
14 not be?

15 MS. DWYER: Well, my question goes  
16 to the substance of the compensation that the  
17 regulation encompasses. Do you think that the  
18 regulation captures the compensation that  
19 fiduciaries would need to assess the  
20 reasonableness of compensation for those types  
21 of plans?

22 MR. CHAMBERS: It goes back I

1 think to the comment that was made previously  
2 which is you need to tell us whose  
3 compensation we need to obtain.

4 If I understand your question  
5 correctly, the situation was previously  
6 posited where some of the plan assets -- I'm  
7 sorry -- some of the fees associated with the  
8 investment of plan assets are used to run a  
9 cafeteria. It could be a day care center. It  
10 could be the water cooler. To what extent do  
11 we have to get that information?

12 I think that the compensation  
13 should be -- I think we think that the  
14 compensation should be provided on the basis  
15 which enables people to decide whether the  
16 particular arrangement is reasonable. And I  
17 frankly don't think that it should be part of  
18 any employer's prerogative or need to decide  
19 well, I'm not going to be hiring an investment  
20 firm which has an in-house cafeteria, or which  
21 has an in-house day care center because if  
22 they didn't have that, maybe they could save

1           some money. You have to look at it from a  
2           reasonable perspective.

3                        So bottom-line numbers, I think,  
4           are very important. And so it's getting the  
5           baseline number, not so much who is it who's  
6           receiving it, other than people who are  
7           actually performing services directly to the  
8           plan or on behalf of the plan.

9                        MS. DWYER: Thank you.

10                      MR. CAMPAGNA: I guess in the  
11           interests of time, we'll move on.

12                      MR. CHAMBERS: I've bored  
13           everyone.

14                      MR. CAMPAGNA: You made a comment  
15           about the conflicts provisions and the  
16           particular provision that said the service  
17           provider should have to disclose whether  
18           they're influencing the fees that they receive  
19           that they have some control. Many service  
20           providers are fiduciaries, and are being hired  
21           as such.

22                      Don't you see a need by the plan

1 sponsor to know that his fiduciary may be in  
2 that role that they could actually influence  
3 the fees that they receive? Despite the  
4 prohibited transaction nature of doing that,  
5 shouldn't plan sponsor --

6 MR. CHAMBERS: Don't they have to  
7 disclose that anyway if there's a prohibited  
8 transaction?

9 MR. CAMPAGNA: Well, to the plan  
10 sponsors is my question. This is the  
11 disclosure to the plan sponsor.

12 MR. CHAMBERS: All right. So  
13 you're suggesting that if we were to limit  
14 that just to fiduciaries, and whether the  
15 fiduciary would have to explain we have the  
16 flexibility and therefore our having that  
17 flexibility is a prohibited transaction. Is  
18 that what you're saying we should be  
19 disclosing?

20 MR. CAMPAGNA: Basically.  
21 Shouldn't a fiduciary who hires a fiduciary  
22 disclose to a plan sponsor whether they have



1           this power? And that's basically my question.

2                       MR. CHAMBERS: But I think that  
3           that is part of these contractual  
4           relationships that people have been talking  
5           about already.

6                       MR. CAMPAGNA: Okay.

7                       MR. CHAMBERS: I mean, does it  
8           have to be specifically set out in that  
9           fashion? I think our suggestion is it seems  
10          odd to expose again something that is probably  
11          already being exposed. You all have ruled on  
12          this in connection with floats, for example.

13                      And I think that yes, there's  
14          information out regarding floats, for example,  
15          that you are required to provide. And there's  
16          a best practices that you've provided as well.

17          I think people are doing that.

18                      Do we need to put stars next to it  
19          and underline it -- put it in italics? It  
20          seems counterproductive.

21                      MR. CAMPAGNA: Going back to your  
22          comment letter, you talked about the need to

1 keep a lot of the class exemptions that have  
2 been granted the same, and kind of leave them  
3 out of all of this. One particular class  
4 exemption I have in mind is PTE 84-24 that  
5 talks about insurance brokerage where there's  
6 disclosure of commissions. However, what  
7 we're getting in this regulation is what the  
8 broker may receive on top of that.

9 Do you see any need to go beyond  
10 84-24's requirements when in fact what we're  
11 talking about here is receipt of indirect  
12 compensation or other conflicts that a service  
13 provider such as a broker might be receiving?

14 MR. CHAMBERS: I was not involved  
15 in drafting that particular part. Do you have  
16 anything you want to say about that?

17 MS. JACOBSON: And actually, if I  
18 remember, it's more related to the -- we have  
19 members that are both plan sponsors and  
20 service providers. And we got input on that  
21 from our service providers that are insurance  
22 companies. So I would actually like to get

1 back to you on that question.

2 MR. CAMPAGNA: Okay. Also, going  
3 to your comment letter, you state that  
4 requiring annual fees, direct commissions and  
5 loads, maintaining a brokerage account and  
6 charges related to an investment transaction  
7 should be disclosed, but that any further  
8 disclosure be adequately covered by the  
9 securities laws. So there seems to be that  
10 you have a line that you have in mind here.  
11 But it relates to investment transactions and  
12 fees related to investments, but you see  
13 something that the SEC does, and something  
14 that we can have a role in. Do you mind  
15 elaborating a bit on that?

16 MR. CHAMBERS: I think both of us  
17 are confused by the question.

18 MR. CAMPAGNA: Okay. All right.  
19 I read the comment letters. In  
20 the interest of time, I'll go to Joe.

21 MR. PIACENTINI: I have nothing.

22 CHAIRMAN CAMPBELL: All right.

1 Well, thank you very much.

2 MR. CHAMBERS: Thank you.

3 CHAIRMAN CAMPBELL: And next up is  
4 Mr. Ashton representing ASPPA.

5 MR. ASHTON: Good morning. My  
6 name is Bruce Ashton. I'm a partner with  
7 Reish Luftman Reicher & Cohen in Los Angeles.

8 And I'm here to testify on behalf of the  
9 American Society of Pension Professionals &  
10 Actuaries, and the Council of Independent  
11 Recordkeepers.

12 ASPPA is a national organization  
13 of over 6,000 retirement plan professionals  
14 who provide consulting and administrative  
15 services for qualified retirement plans  
16 covering millions of American workers. And  
17 the Council of Independent Recordkeepers, or  
18 CIKR, is a national organization of 401(k)  
19 plan service providers.

20 The Department's proposed  
21 408(b)(2) regulation will cause a sweeping  
22 change in how plan service arrangements are

1 made and documented in the future. That said,  
2 we must disagree with some of our colleagues  
3 who have testified earlier, because in our  
4 view the change is not substantive.

5 Fiduciaries are already required  
6 to know and understand all of the information  
7 in our view that must be disclosed under the  
8 proposed regulation. Rather, the regulation  
9 will result in a shift of focus -- a shift of  
10 responsibility. That is, the regulation will  
11 take the responsibility to find out  
12 information off of the plan fiduciaries whose  
13 day-to-day real job is often to run a  
14 business, and place the responsibility to  
15 disclose the information on the experts whose  
16 day-to-day real job is to service plans.

17 Some may argue that the changes  
18 are too sweeping, that the Department has gone  
19 overboard in the proposed regulation. We  
20 disagree. In our view, the proposed  
21 regulation only requires service providers to  
22 tell the truth. And how can that be bad?

1           A number of people have commented  
2           that the amount of disclosure that's required  
3           will overwhelm the poor plan fiduciaries as  
4           though they were all Blanche Dubois who had to  
5           rely on the kindness of strangers. In my  
6           view, that is not giving plan fiduciaries  
7           enough credit. After all, in my experience,  
8           they are business people who are used to  
9           looking at business transactions and ought to  
10          be given the credit that they can ferret out.

11          Once they're given the information, they can  
12          ferret out what's important to them and make a  
13          decision.

14                 We believe there are a number of  
15                 areas in which the proposed regulation, as  
16                 well conceived as it is, can be improved. We  
17                 have submitted a lengthy comment letter with  
18                 our extremely cogent and well-thought out  
19                 views on what ought to be done. Let me just  
20                 highlight some of our proposals.

21                 It is critical that responsible  
22                 plan fiduciaries understand the aggregate

1 costs being borne by their plans. It is  
2 equally critical that they understand the  
3 compensation being received by service  
4 providers, and by those who have an interest  
5 in transactions involving plan assets. As the  
6 Department has pointed out in prior guidance  
7 -- the Sun America opinion comes to mind --  
8 the amount of compensation being received by a  
9 party may have a material impact on its  
10 recommendations, actions or judgment. Thus,  
11 in our view, the responsible fiduciaries must  
12 understand the transaction costs such as  
13 commissions, finders' fees and the like being  
14 paid to third parties in connection with the  
15 plan's investments.

16 One of the principal requirements  
17 of the proposed regulation is the disclosure  
18 of conflicts of interest. An important  
19 element of that disclosure is the transaction  
20 fees, first because of the issue of self-  
21 interest versus participant interests, and  
22 second because the transaction fees often

1 impact the value of the plan's investments and  
2 ultimately the funds available for  
3 participants at retirement. We urge,  
4 therefore, that distinct disclosure of  
5 transaction fees be retained in the final  
6 regulation.

7 Second, ERISA makes it clear that  
8 only the shares of mutual funds held by a plan  
9 are assets of the plan, and that the assets of  
10 the mutual fund themselves are not plan  
11 assets. ERISA also makes it clear that  
12 investment managers of mutual funds in which a  
13 plan invests are not fiduciaries, nor even  
14 parties in interest of the plan.  
15 Nevertheless, in today's 401(k) environment,  
16 mutual fund investment managers are clearly  
17 providing an indirect service to plans because  
18 their actions directly affect the value of  
19 plan assets, that is, the mutual fund shares,  
20 which are plan assets. Accordingly, we submit  
21 that direct and indirect compensation of the  
22 fund manager should have to be disclosed.



1           As a practical matter, however,  
2           except where the fund manager is affiliated  
3           with the plan record keeper, trustee or other  
4           covered service provider, there does not seem  
5           to be a mechanism for making that disclosure  
6           except through another service provider, such  
7           as an independent record keeper. Thus to the  
8           extent information regarding the direct and  
9           indirect compensation of the fund manager is  
10          required to be disclosed, the final regulation  
11          should make it clear that the party making the  
12          disclosure -- in our example, the independent  
13          record keeper -- may rely on information  
14          provided by the mutual funds without any duty  
15          to verify the accuracy of the information  
16          beyond commercially reasonable efforts.

17                 In this connection, we also  
18                 suggest that the Department issue a prohibited  
19                 class exemption similar to that proposed for  
20                 responsible plan fiduciaries, exempting the  
21                 record keeper from excise taxes under 4975, if  
22                 the fund manager fails to provide accurate or

1 complete information to the covered service  
2 provider. And it would also seem reasonable  
3 in this context for such an exemption to  
4 include the requirement that the covered  
5 service provider notify the Department if the  
6 fund manager fails or refuses to provide the  
7 information.

8 We also encourage the Department  
9 to require compensation disclosure in three  
10 general categories: 1) investment-related fees  
11 and expenses; 2) transaction-related fees and  
12 expenses, for example, commissions, 12b-1  
13 fees, finders' fees and the like; and 3)  
14 record keeping and administrative fees and  
15 expenses. We also submit that this type of  
16 disclosure should be required of all providers  
17 whether or not considered a bundled provider  
18 under the proposed regulations.

19 To respond to Ms. Zarenko's  
20 question earlier, we have attached to our  
21 written comments a suggested form of our form  
22 of disclosure. And if anyone in the audience

1 would like a copy, I'd be happy to take your  
2 card and send it to you.

3 An element of the proposed  
4 regulation that has received limited attention  
5 is the fact that the responsible plan  
6 fiduciary will be required to do something  
7 with the information they receive, that is,  
8 make a prudent, informed decision. In this  
9 context, uniform disclosure will, we believe,  
10 help facilitate the outcome in that it would  
11 make the disclosures uniform, which would  
12 facilitate consistent comparisons among  
13 providers, and it would provide the  
14 responsible plan fiduciary with information  
15 and categories that are most relevant to its  
16 decision to engage or replace a service  
17 provider.

18 Such uniform disclosure would not  
19 replace other written materials, other  
20 disclosures, or formal contracts, but would in  
21 our view provide a single comparable source  
22 for the extensive disclosures through which a

1 responsible plan fiduciary will need to sift  
2 in order to make a decision.

3 We also encourage the Department  
4 to require a consolidated form of disclosure  
5 for all service providers even where other  
6 forms of disclosure are provided and  
7 additional documents are incorporated by  
8 reference. In our view, a consolidated  
9 summary of the information required by the  
10 proposed regulation would be more readily  
11 usable by a fiduciary than, for example, a  
12 stack of 25 or 50 prospectuses -- even summary  
13 prospectuses -- and would make the process of  
14 comparison of service providers both clearer  
15 and simpler. In the small plan market, we  
16 believe this type of disclosure would be  
17 essential to provide the most meaningful  
18 disclosure to the decision makers.

19 Uniformity could also help service  
20 providers by ensuring that they do not  
21 inadvertently omit a disclosure item, and by  
22 making compliance less burdensome for the

1 service provider.

2 Let me just touch on a few of our  
3 other comments, and then I would be pleased to  
4 answer your questions.

5 Failure to satisfy any element of  
6 the final regulation would appear to cause a  
7 prohibited transaction. This could be a harsh  
8 result in cases of inadvertent or immaterial  
9 breaches, and we urge the Department to  
10 consider including a materiality standard for  
11 all disclosures, or alternatively a substance  
12 compliance exception. Further, we urge the  
13 Department to provide for a cure period for  
14 inadvertent failures and clarification that  
15 correction of a failure would only apply to  
16 compensation related to missing information  
17 and not to all compensation received by the  
18 service provider.

19 Finally, it may be appropriate to  
20 add correction of a failure to disclose to  
21 your already highly successful BFC program.

22 Finally, with respect to the

1 conflict-of-interest disclosure, we recommend  
2 that the Department provide greater clarity  
3 regarding the types of relationships that it  
4 believes should be disclosed in order to  
5 assist covered service providers in meeting  
6 this requirement.

7 Thank you for the opportunity to  
8 present these remarks. I'd be happy to answer  
9 your questions.

10 MR. CAMPAGNA: Do you want to do  
11 the same order?

12 MS. WIELOBOB: I don't have  
13 anything.

14 MS. ZARENKO: I first want to  
15 follow up on allocating compensation and fees  
16 into the different sort of service categories  
17 -- the investment, the record keeping, and the  
18 transactional. I think from a regulatory  
19 standpoint, when you try to do that it often  
20 gets difficult to draw lines, and sort of  
21 define your way around it. Do you think that  
22 would be easy for us to do? It seems like

1           those categories might get a little fuzzy in  
2           some instances.

3                       MR. ASHTON: Well, let me put it  
4           this way. It took a group of people involved  
5           in the industry about a day to come up with a  
6           form. So, I anticipate that the folks on this  
7           Panel and others in the Department are equally  
8           as sophisticated, and with our help could come  
9           up with such a categorization.

10                      Do I think it's easy? No. But do  
11           I think it's possible? Yes.

12                      MS. ZARENKO: Part of the reason  
13           I'm asking the question is just as you know,  
14           we have a model plan fee disclosure form on  
15           our website, and some people find it to be  
16           very useful. Some people find it to be very  
17           non-useful for that exact reason. They don't  
18           think their particular services or the way  
19           they structure and charge their fees -- even  
20           that three-page form -- they can't make it  
21           fit.

22                      MR. ASHTON: I guess our view is

1           that the three broad categories that we've  
2           outlined -- that is, costs or compensation  
3           related to the investments, costs and  
4           compensation related to the record keeping and  
5           administration of the plan, and costs and  
6           compensation related to the transaction  
7           whereby the plan enters into the arrangement  
8           -- with those broad categories, that in my  
9           view and our view should cover the deal.

10                   MS. ZARENKO: To the extent there  
11           would be --

12                   MR. ASHTON: And may I add just  
13           one more thought? And that is suppose  
14           somebody gets it in the wrong category? So  
15           what? As long as it's --

16                   MS. ZARENKO: Well, that was going  
17           to be my next question. If there were fuzzy  
18           lines that were hard to draw and somebody -- a  
19           service provider or whoever -- was doing their  
20           best to try to fit it into those three  
21           tranches, would there be any competitive  
22           reason in having any cost allocation go to one



1 of those categories over the other?

2 MR. ASHTON: Sure. I mean, you've  
3 probably heard as I've heard from plan  
4 sponsors, well gosh, we don't have to worry  
5 about that. That service is free. Well,  
6 nothing's free. I don't remember the last  
7 time I got something that was free. And  
8 nothing's free in this area by a long shot.

9 So yes, there could be competitive  
10 issues that come about, which suggest to me  
11 that people will be very careful to make sure  
12 they're getting stuff into the right category.

13 MS. ZARENKO: In the model format  
14 that you submitted as the attachment to your  
15 letter, I noticed that there's a section there  
16 for disclosure of employer-paid fees, which  
17 has been something we've heard a lot about in  
18 comments. And I know elsewhere in your  
19 letters, you say you do not think that  
20 employer-paid fees should be subject to the  
21 requirements of the regulations. So if I try  
22 to put myself into the shoes of plan sponsor,

1 I would certainly want to know what I was  
2 paying. So is it that that information is  
3 being disclosed? As a legal matter, you don't  
4 think that the disclosure of those fees should  
5 be subject to the requirements of our rule?

6 MR. ASHTON: I don't think they  
7 should be subject to the rule. I think they  
8 are probably being disclosed because the plan  
9 sponsor is going to write a check and they're  
10 going to want to know what kind of a check  
11 they're writing. So I think that the  
12 marketplace in fact does take care of that  
13 aspect of it.

14 But it doesn't seem to me that  
15 it's appropriate to be included in the  
16 proposed regulation. So yes, we would urge  
17 that plan sponsor-paid expenses and  
18 compensation not be covered by the proposed  
19 regulation.

20 MS. ZARENKO: Okay. And my final  
21 question is you requested clarification.  
22 Specifically, you said it would be helpful to

1 see a lot more examples of the kinds of  
2 relationships and arrangements that service  
3 providers have that would need to be disclosed  
4 to plan fiduciaries.

5 Can you just talk for a minute or  
6 two about what you think those relationships  
7 and arrangements are that would be relevant to  
8 a plan fiduciary?

9 MR. ASHTON: Well, let me first  
10 address what isn't clear to us. And that is  
11 the proposed regulation talks about referral  
12 relationships. I'm not quite sure what you're  
13 getting at. So it would be helpful to have  
14 some examples.

15 In other words -- and I'll just  
16 use my law firm as an example -- if I get  
17 substantial referrals from -- and we're not a  
18 covered service provider because we don't get  
19 any indirect compensation -- if my law firm  
20 were in that position and got lots of  
21 referrals from a specific third-party  
22 administrator or record keeper or

1 broker/dealer or investment advisor, but there  
2 was no economic relationship between us other  
3 than they refer us, where can we refer them  
4 work? And if we get the business, that's  
5 great. And we'll charge our clients  
6 appropriately. Always charge our clients  
7 appropriately. Is that a referral  
8 relationship that's material that would need  
9 to be disclosed? I don't know. Maybe yes.  
10 Maybe no.

11 So it's that kind of issue that I  
12 think is somewhat confusing in the current  
13 version of the regulation. And it would be  
14 helpful to have further clarification of  
15 what's meant by that.

16 MS. ZARENKO: Thank you.

17 MS. DWYER: Hi. My question goes  
18 to compensation and fees relating to mutual  
19 funds. What specific information do plan  
20 fiduciaries need that is not in the mutual  
21 funds' SEC disclosures? And why do they need  
22 it?

1           MR. ASHTON: Well, I think they  
2           need it because it does have an impact on the  
3           plan asset. That is, it impacts the net asset  
4           value of the mutual fund shares held by the  
5           plan either directly or indirectly. That  
6           impacts what the participant has at  
7           retirement.

8           Probably the information is in the  
9           prospectus. I'll grant you that. I don't  
10          know the last time you went and looked at a  
11          mutual fund prospectus. I'm a reasonably  
12          sophisticated lawyer, I think. I don't find  
13          mutual fund prospectuses particularly  
14          transparent. And I suspect that it is not  
15          useful as I said in my comments earlier -- as  
16          we've said in our written comments -- it is  
17          not particularly useful to hand a plan sponsor  
18          50 prospectuses if that's the number of  
19          investment options that are available and say  
20          here, you go figure it out. And it strikes us  
21          that it would be useful to have that  
22          information consolidated for the plan sponsor

1 so that they can make an informed decision.

2 MS. DWYER: Within that  
3 consolidation, do you contemplate that there  
4 would be additional information in that  
5 consolidated information that would  
6 substantively not be in the SEC disclosures?

7 MR. ASHTON: No.

8 MS. DWYER: Is anything new?

9 MR. ASHTON: No.

10 MS. DWYER: No. Thank you.

11 MR. CAMPAGNA: Your testimony is  
12 at odds with other commenters in the area of  
13 transaction costs and the need for disclosure  
14 regarding investment-related fees internal to  
15 the fund. And you believe it's important.

16 Could you elaborate on that,  
17 particularly in the area of these portfolio  
18 transaction -- portfolio brokerage fees? I  
19 think you're thinking that that also is an  
20 important part of information.

21 MR. ASHTON: Again, as I've said,  
22 the costs inside a mutual fund are material to

1 the net asset value of the mutual fund, and  
2 therefore have an impact on the plan's assets.

3 And if I'm a responsible fiduciary, I want to  
4 know is it appropriate to put this particular  
5 mutual fund on the list that I offer to my  
6 participants? Is that mutual fund being  
7 managed appropriately? Or is it not? Am I  
8 better off going to some other type of  
9 investment collective trust fund or an ETF or  
10 something else where the internal costs may be  
11 cheaper?

12 And maybe it's not appropriate.  
13 Maybe there are very good reasons for putting  
14 a particular mutual fund. I'm not bashing  
15 mutual funds by any means. I don't intend to.

16 But if the point is to provide information to  
17 the fiduciary so the fiduciary can make an  
18 informed decision, it seems to me that the  
19 fiduciary needs the information in order to be  
20 able to make the informed decision. And the  
21 costs borne by the fund itself are, we  
22 believe, material to that decision about the

1 fund.

2 MR. CAMPAGNA: Now, a model that  
3 you laid out in your comment letter was the  
4 record keeper maintaining a platform with  
5 unaffiliated funds -- be it mutual funds, be  
6 it other investment vehicles. And we asked a  
7 previous person what kind of screening process  
8 do you have.

9 How do you evaluate the particular  
10 funds that are going to be on your platform,  
11 particularly in the unaffiliated areas? How  
12 do you come to a determination who to put on  
13 your platform?

14 MR. ASHTON: Well, I think there's  
15 a couple of different models. In one model,  
16 which may be more typical of insurance  
17 companies than record keepers, but may not,  
18 the record keeper will -- the plan provider,  
19 if you will -- will do a screening process.  
20 And I have several clients that go through a  
21 very detailed screening process -- hopefully a  
22 fiduciarly-appropriate screening process --



1 to select a fund, to make sure they're  
2 suitable for retirement plans in general, and  
3 suitable for inclusion in 401(k) plans in  
4 particular. And so there is a screening  
5 process.

6 In the so-called open architecture  
7 arrangement, where essentially any investment  
8 that is compatible with the record keeper or  
9 service provider's platform can be included in  
10 the platform, the record keeper doesn't do a  
11 screening process other than to find out is it  
12 compatible versus the other financial advisors  
13 to the plan who would do that screening  
14 process to make recommendations for the  
15 inclusion of the thousands of funds that are  
16 otherwise available on that platform.

17 MR. CAMPAGNA: An earlier person  
18 who testified said that there could be  
19 agreements between the fund -- be it mutual  
20 fund or non-plan asset fund -- and the record  
21 keeper to provide some of this information  
22 through to the plan fiduciary.

1                   Do you see that as a possibility?

2                   Are there those types of agreements now? And  
3                   is there a way of coming to some kind of  
4                   standardization regarding a type of agreement  
5                   that could be reached?

6                   MR. ASHTON:       I think it is  
7                   certainly possible. I'm not personally aware  
8                   of any because I haven't seen any of those  
9                   agreements. But it wouldn't surprise me that  
10                  there are such agreements.

11                  And it strikes me that if the  
12                  regulation proceeds as we have suggested that  
13                  we will see those agreements. And I  
14                  anticipate that it will keep lawyers busy for  
15                  a little while, and then we'll have to move on  
16                  to something else.

17                  MR. CAMPAGNA:     In your comment  
18                  letter, you spoke about if one member of a  
19                  bundle is responsible for a disclosure  
20                  failure, then only that member should be  
21                  subject to the excise taxes associated with  
22                  it.

1                   How would that work, particularly  
2           in a bundled package where a plan deals  
3           directly with say, the record keeper up front,  
4           or a broker, or a TPA?

5                   MR. ASHTON: Well, clearly if it's  
6           the bundled provider that is the provider of  
7           the package of services that fails to make a  
8           disclosure, unless it can demonstrate that  
9           that failure was because it was not able to  
10          get information from a member of the bundle --  
11          if you will -- it strikes me that the bundled  
12          provider would be responsible.

13                   On the other hand, if it is one  
14          member of the group that failed to provide  
15          information that was material, the provider of  
16          the service acted to the best of its knowledge  
17          and should not be -- even under the regulation  
18          as currently proposed -- should not be  
19          subjected to penalties. It acted as the  
20          regulation says to the best of its knowledge.

21                   MR. CAMPAGNA: Thank you, Mr.  
22          Ashton.

1                   MR. PIACENTINI: Okay. I guess  
2 I'd like to finish by going back to the  
3 beginning.

4                   At the opening of your oral  
5 statement, you said that you thought a major  
6 -- maybe the major -- effect of this policy  
7 would be to shift responsibility for gathering  
8 and processing information from plan sponsors  
9 who might have some other expertise than that  
10 to service providers who are expert at that  
11 perhaps.

12                   So I guess a couple of parts to  
13 the question, when you say the responsibility  
14 would be shifted, do you also mean that the  
15 actual activity would be shifted? If the plan  
16 sponsor is legally responsible for that now,  
17 it still might be that somebody else is doing  
18 it for them for a fee. Or would the actual  
19 activity shift?

20                   MR. ASHTON: The shift that I'm  
21 talking about is the shift in responsibility  
22 to disclose the information as opposed to

1           ferret out the information. Under the Frost  
2           and Aetna Advisory Opinions, the Department  
3           makes it very clear that one responsibility of  
4           the fiduciaries is to know and understand.  
5           And there's been other materials published  
6           since then that makes it clear that it's the  
7           responsibility of the fiduciary to know and  
8           understand the costs and the compensation of  
9           service providers.

10                         In our view, what this regulation  
11           does -- in my view appropriately -- is to  
12           shift the burden of finding out the  
13           information onto the people that have the  
14           information, to disclose it the fiduciary. So  
15           now the fiduciary has it. They still have the  
16           responsibility to understand it and to make a  
17           decision with respect to the information, but  
18           at least now they've got it. So that's the  
19           shift that I was talking about.

20                         MR. PIACENTINI: So then in terms  
21           of downstream consequences, does that mean  
22           that then getting this information to the

1       fiduciary will be more expensive or less  
2       expensive than if the fiduciary were still  
3       responsible? And ultimately, would it be done  
4       more effectively or less effectively?

5               MR. ASHTON: Let me go to the  
6       second part first. I think it will be done  
7       more effectively. And I'll make the same  
8       distinction that many of the prior speakers  
9       have made.

10              In the very large plan market the  
11       fiduciaries have every bit of information they  
12       want. They've got experts in-house, and hired  
13       experts to help them get information that they  
14       don't know to ask for. That is trending  
15       downwards in the size of plans. But at the  
16       small plan market, it is still not typical  
17       that there is the type of voluntary disclosure  
18       of the type that is typical at the large plan.

19              So in terms of your question would  
20       it be more effective, yes, I think it would be  
21       more effective in the small- to mid-size parts  
22       of the marketplace.

1           Would it cost more?   Perhaps a little  
2 bit initially. But I think once procedures  
3 are in place to make the disclosures -- which  
4 after all, people at some level are already  
5 making in some parts of the marketplace -- I  
6 think that expense will be amortized over a  
7 large number of plans and won't be material in  
8 the long run.

9           MR. PIACENTINI: Thank you.

10          PANEL MEMBER CAMPAGNA: Okay.

11 That concludes our morning testimony.

12          We're about 15 minutes -- oh, no  
13 I'm sorry. We have one more. We have the  
14 American Council of Life Insurers.

15          MR. SZOSTEK: Thank you. Good  
16 morning. My name is Jim Szostek. I'm the  
17 Director of Pension Policy for the American  
18 Council of Life Insurers.

19          To my left is Jason Bortz from  
20 Davis and Harman. Davis and Harman has worked  
21 with us on these proposed regs.

22          ACLI very much appreciates the

1 Department's work in addressing issues  
2 regarding plan services and fees. The  
3 Department's fee disclosure initiatives  
4 reflect an enormous amount of hard work and  
5 thought. ACLI strongly supports the  
6 Department's work, and we share the  
7 Department's desire to enhance transparency in  
8 plan service arrangements.

9 The manner in which services are  
10 provided through ERISA has changed  
11 significantly over the years. ACLI agrees  
12 that it is appropriate to revisit 408(b)(2) to  
13 ensure that its regulatory requirements are  
14 reflective of those changes.

15 We are also mindful that the  
16 service arrangements are likely to continue to  
17 change in the future. Plan fiduciaries and  
18 plan service providers need a clear and  
19 concise regulatory framework that sets forth  
20 principles for disclosure. These principles  
21 should be readily understood and easily  
22 applied in the context of today's employee



1 benefit plans, the designs, and of those  
2 designs in the future. To those ends, we  
3 welcome the opportunity to present testimony  
4 to the Department.

5 Our comment letter details a  
6 number of suggestions for improving the  
7 regulation. My comments today focus on a few  
8 of these suggestions, namely the need to  
9 separately address the different types of  
10 plans, the unique considerations related to  
11 the multi-state regulatory system for  
12 insurance contracts, and the importance of  
13 providing for a smooth transition to new  
14 rules.

15 Regarding the role of insurers in  
16 ERISA plans, ACLI represents 373 member  
17 companies. These member companies account for  
18 93 percent of the life insurance industry's  
19 total assets in the U.S.

20 ACLI member companies began  
21 issuing group annuity contracts to employer-  
22 sponsored retirement plans as far back as the

1 early '20s. Today, group annuity and other  
2 forms of insurance contracts are used to fund  
3 and service a wide range of ERISA-covered  
4 plans, including defined contribution plans  
5 such as 401(k) and 403(b) plans. Insurance  
6 contracts hold a significant portion of all  
7 tax-qualified retirement plan assets.

8 In addition to retirement plans,  
9 ACLI member companies issue contracts to  
10 guarantee payments from and provide services  
11 to health plans, life insurance arrangements,  
12 long-term care programs and disability  
13 insurance plans. As employers, ACLI member  
14 companies also sponsor ERISA plans for their  
15 employees.

16 As for the scope of the  
17 regulations, this draft of the proposed  
18 regulations would apply broadly to individual  
19 account plans, defined benefit pension plans  
20 and health and welfare plans. We recognize  
21 the policy needs to provide rules under  
22 Section 408(b)(2) that apply to all employee

1 benefit plans. However, we urge the  
2 Department to reserve on the issuance of any  
3 of these final rules with respect to the  
4 defined benefit plans and health and welfare  
5 arrangements and instead consider first the  
6 individual account retirement plans such as  
7 401(k) plans.

8 Individual account plans have been  
9 the focus of public policy discussion for some  
10 time. Essentially the same level of  
11 discussion and analysis simply has not yet  
12 been undertaken with regard to the other types  
13 of employee benefit plans.

14 Our member companies have many new  
15 questions about the application of the  
16 proposed regulations to these other employee  
17 benefit plans. These questions concern the  
18 application of the principles and technical  
19 requirements in the proposed regulations to  
20 insurance contracts issued in connection with  
21 these plans, plans that have different  
22 purposes and different fee structures than

1 individual retirement accounts.

2 We believe the Department,  
3 employers and plan service providers need  
4 sufficient opportunity to focus on the unique  
5 characteristics of these plans and  
6 arrangements. Rather than delayed guidance  
7 for such efforts, we believe that the employee  
8 benefits community would best be served if the  
9 Department proceeded first with guidance  
10 exclusively on individual account retirement  
11 plans.

12 As for the multi-state regulatory  
13 system for insurance contracts, ACLI member  
14 companies are also concerned that the final  
15 regulations may require changes to the terms  
16 of insurance contracts. As you know, the  
17 insurance industry is a state-regulated  
18 industry, and the insurers have to obtain  
19 approval of their contracts from each state's  
20 insurance department. This approval is  
21 typically necessary on a state-by-state basis,  
22 and it is not unheard of for the approval

1 process for a single state to take up to a  
2 year. It is critical that the final  
3 regulations clarify that the disclosure rules  
4 may be satisfied without a need for changes to  
5 be made to insurance contracts.

6 More broadly, we urge the  
7 Department to reconsider the requirement in  
8 the proposed regulation that a contract  
9 between a service provider and a plan  
10 fiduciary itself include a provision requiring  
11 the service provider to make the required  
12 disclosures. As issuers of insurance  
13 contracts, ACLI members have significant  
14 concerns with the use of the term "contract."

15 Again, any changes in approved contracts must  
16 be resubmitted and re-approved by state  
17 regulators at a significant cost to both our  
18 member companies and the various states  
19 themselves.

20 In lieu of the contractual  
21 requirement, we urge that the final rules  
22 allow required disclosures to be made in the

1 form of a notice to the plan sponsor or  
2 appropriate fiduciary. Compliance should be  
3 determined on the basis of whether the  
4 requisite disclosures were actually made.  
5 ACLI members need the flexibility to satisfy  
6 the disclosure requirements without making  
7 modifications to the terms of the underlying  
8 state-approved insurance contracts. Any other  
9 rule would impose an unnecessary burden on  
10 insurers and slow implementation.

11 Lastly, on the transition to new  
12 rules, one of the most important issues for  
13 ACLI member companies is the proposed  
14 effective date of 90 days after the  
15 publication of final regulations. Service  
16 providers and plan fiduciaries need sufficient  
17 time to ensure that they fully understand and  
18 are capable to implement the new regulatory  
19 regime. An appropriate transition period is  
20 important as even an inadvertent violation of  
21 these rules would result in a prohibited  
22 transaction.

1           We recommend that the final  
2 regulations be effective no earlier than one  
3 year following the publication of final rules.

4       We suggest this time frame giving our member  
5 companies' knowledge both as a sponsor and as  
6 a service provider of the practicalities  
7 involves. Insuring that agreements and  
8 processes conform to the specifics of the new  
9 regulations will take time. Service providers  
10 and plan fiduciaries will wait for the final  
11 regulations before making changes to existing  
12 disclosures, modifying current processes and  
13 procedures, gathering new data elements,  
14 refining existing data elements, and investing  
15 in systems changes. Of course, these  
16 activities can be undertaken after they've had  
17 an opportunity to fully understand the final  
18 regulations, and determine an appropriate  
19 approach for implementation.

20           We note that if the Department  
21 does not adopt our comment regarding that the  
22 disclosure obligation be in the form of a

1 notice, ACLI member companies will need  
2 significantly more time to conform to the  
3 final rules.

4 We very much appreciate this  
5 opportunity to present our views on the need  
6 for separately addressing the various types of  
7 plans, the unique considerations related to  
8 the multi-state regulatory system for  
9 insurance contracts, and the importance of  
10 providing for a smooth transition to the new  
11 rules. And I would be happy to answer any  
12 questions.

13 MS. WIELOBOB: Hi, Jim.

14 Regarding the state insurance  
15 commission approval, you spoke a little bit  
16 about that, and I've read about it in some  
17 comment letters from other insurance entities.

18 When we're talking about you say  
19 perhaps a 12-month process in getting approval  
20 of any change in the contract language, are we  
21 talking about per insurance product that an  
22 insurance company would offer? I can't find



1 any detail on that. Are you talking contract-  
2 by-contract, customer-by-customer approval?

3 MR. SZOSTEK: They're typically on  
4 a form basis. So if you offer today 10  
5 different forms of insurance contract, each  
6 contract would then need to be re-filed with  
7 each state.

8 MS. WIELOBOB: And how often is  
9 that typically done in the normal course?

10 MR. SZOSTEK: It would typically  
11 only be done where a change was made to the  
12 contract itself. So you've got state approval  
13 to use the contract. You're at that point.  
14 You're fine to sell that contract. If you  
15 make a change to the contract, you'll need to  
16 file it for pre-approval.

17 MS. WIELOBOB: Okay. That was  
18 just sort of a simpler question I can't really  
19 find the answer to elsewhere.

20 Now, insurance contracts issued to  
21 health and welfare plans are different than  
22 those you say not issued to defined

1 contribution plans?

2 MR. SZOSTEK: In some respects,  
3 yes.

4 MS. WIELOBOB: And what would  
5 those be?

6 MR. SZOSTEK: It's a premium-based  
7 product where -- I mean, to say that they're  
8 different, they're different types of  
9 programs, if you will. So you're talking  
10 about for the most part a fully insured  
11 welfare plan where the plan no longer has  
12 liability for the payments. They've purchased  
13 the insurance contract, and the insurer will  
14 handle both the insurance aspect of the  
15 program and then the claims processing part of  
16 the program. There may be other things that  
17 the insurer's doing as well under that  
18 contract.

19 You may have situations in, say  
20 the 401(k) marketplace, where it's a contract  
21 that covers both -- in this respect they could  
22 be similar -- as a contract that covers both

1 investment, if you will, and other services  
2 that are provided to the plan sponsor.

3 I think our comment really is  
4 about the fact that the health and welfare  
5 community really hasn't been thinking about  
6 what do these rules mean to us. And the  
7 401(k) community has been spending quite a bit  
8 of time over the last year-plus thinking about  
9 disclosure, fees, compensation flows.

10 MS. WIELOBOB: Because the  
11 argument's been made that these rules are in  
12 opposition to the way sales of insurance  
13 products work. And I just haven't been able  
14 to get my arms around exactly why.

15 MR. SZOSTEK: I'm not sure what  
16 you mean by that.

17 MS. WIELOBOB: Apples and oranges.  
18 That insurance entities have made the  
19 argument that they're compensated in a manner  
20 which is so different than the way DC-side  
21 service providers are that really the regime  
22 doesn't work for welfare plan providers.

1                   MR. SZOSTEK:     I know that we  
2 haven't argued that it doesn't work. I think  
3 we just haven't had a chance to really kind of  
4 vet it out and think about it.

5                   MS. WIELOBOB:   Okay. I wanted to  
6 ask you a question about indirect service  
7 providers and disclosure there.

8                   In your comment letter, you  
9 suggested that there be a standard for  
10 disclosing indirect service provider  
11 compensation other than which is in the  
12 proposal. And I think one of the standards  
13 that you were concerned with was sort of the  
14 remoteness of indirect compensation, as are  
15 many commenters. And I think that you said  
16 the principle should be something along the  
17 lines of unless subcontractor fees are  
18 allocated to plan assets or are based on plan  
19 assets, they shouldn't have to be disclosed.

20                   MR. SZOSTEK:   Right. We looked at  
21 the bundled rule in the reg, and thought that  
22 that rule is a good rule and it could be

1 applied sort of across the board that unless  
2 there's some variation in the fee based upon  
3 plan assets that the fact that there's this  
4 indirect service provider that may be  
5 preparing benefit statements, for example,  
6 that there is no need to allocate indirect  
7 compensation to that provider.

8 In many cases, it's quantifiable,  
9 as was everything. It's quantifiable. But  
10 I'm not sure that it provides any benefit to  
11 the plan sponsors purchasing the product.  
12 They kind of know what they're paying overall  
13 for the product.

14 And then to go into and having us  
15 sort of de-construct products and show all  
16 these various arrangements and different  
17 compensations that are being paid, I'm not  
18 sure what benefit that has for the plan  
19 sponsor. And it is a bit of work. There's  
20 clearly a lot of work in some respects.

21 So we thought your bundled rule  
22 made sense to us, and that was a rule that

1           could apply generally.

2                       MS. WIELOBOB:   Okay.   Can we talk  
3           just one minute about how insurance brokers  
4           and agents are compensated?   Can you comment  
5           on how you see those forms of compensation  
6           fitting into this proposal?   I understand that  
7           there are fees.   There are commissions.   There  
8           are some incentive compensation.   Does ACLI  
9           have any position on that?

10                      MR. BORTZ:   I don't think that  
11           this is an issue we've focused on --  
12           representing insurers rather than the brokers  
13           --

14                      MS. WIELOBOB:   Right.

15                      MR. BORTZ:   -- and consultants.  
16           But certainly one thing to think about in this  
17           area is that there's sort of a robust history  
18           of class exemptions in the area of 84-24,  
19           which was referred to before.   And we just  
20           think it's important that the Department think  
21           about how these pieces all fit together.   And  
22           we haven't seen a lot of sort of how 408(b)(2)

1 can interact with 84-24 and the other  
2 exemptions.

3 MS. WIELOBOB: Okay. That's all I  
4 have. Thanks.

5 MS. ZARENKO: I just have one  
6 question.

7 It's kind of a scope issue. I  
8 think what we're hearing is a request for  
9 clarification about when is an insurance  
10 company just selling an insurance contract or  
11 product, and when is it a service provider.  
12 And I think it might be easy to spell that out  
13 in certain cases, but nowadays things are  
14 often packaged and lots of entities have  
15 affiliates. And so the distinction starts to  
16 blur.

17 I would just appreciate your  
18 comments on when does it rise to the level of  
19 being a service provider, and not just sale of  
20 a contractor product?

21 MR. SZOSTEK: Okay. I think that  
22 that's a question we have for the Department.

1                   When you read through the  
2                   regulation and think about its application to  
3                   various investment products, it's almost as if  
4                   the argument is an investment product is a  
5                   service product.

6                   If the insurance contract merely  
7                   provides for -- for example, if all the  
8                   insurance contract provides for is a rate of  
9                   return on monies that the plan invests, is  
10                  that a provision of services? That's a  
11                  question we would have for the Department.

12                  So we saw in the preamble sort of  
13                  a blanket statement about the fact that there  
14                  are these insurance contracts and that there  
15                  are no service provisions. But we're curious  
16                  as to where the Department wants to go with  
17                  that.

18                  MR. BORTZ: One way to think of it  
19                  is the 408(b)(2) reg doesn't apply to all  
20                  service arrangements. It only applies to  
21                  certain ones -- ones where you all think  
22                  disclosure of sort of indirect compensation



1 would be meaningful.

2 One way to look at the world of  
3 fully-insured arrangements is not to say are  
4 there really services here in addition to  
5 insurance, but really to ask are these the  
6 kind of arrangements where disclosure would be  
7 helpful -- so like a fully insured life plan.

8 Maybe it doesn't make any sense to  
9 have disclosure there where all you're doing  
10 is purchasing term life insurance. It may be  
11 easier to go at it through a scope reg than a  
12 sort of slice-by-slice service reg.

13 MS. ZARENKO: Would you make  
14 recommendations on how we would do that?

15 MR. BORTZ: No. No. That's all  
16 in your court.

17 MS. ZARENKO: Thank you.

18 MS. DWYER: I have no questions.

19 CHAIRMAN CAMPBELL: I guess one  
20 question I do have is looking at the  
21 perspective of a fiduciary who's going out to  
22 acquire some benefits -- provide some

1 benefits.

2 What would you say the distinction  
3 is and what's being looked at -- the types of  
4 issues they need to consider when looking to  
5 get a service performed in connection with the  
6 DC plan versus some sort of welfare benefit  
7 plan?

8 We've seen a lot of comments  
9 saying well, we're not sure that we're  
10 prepared to go down the road of having this be  
11 more broadly applicable. But we've not seen a  
12 lot of comments as to what the real  
13 distinctions would be, other than the  
14 assertion that they are. And I'm curious what  
15 from a fiduciary's perspective do you think  
16 some of those differences might be.

17 MR. BORTZ: Well, I think they're  
18 a lot. I mean, one of the goals of this reg  
19 is to identify the fees that are paid for  
20 services.

21 In fully-insured arrangements,  
22 there's typically a premium that's paid. Some

1 of the premium will go to insurance. Some of  
2 that will go to services. It's a big question  
3 under this reg how someone would identify what  
4 piece is allocable to what, and whether or not  
5 there would be any benefit to be gained from  
6 that kind of an exercise.

7 Similarly, in the health and  
8 welfare context, insurance typically provides  
9 both services and benefits. And again, it  
10 doesn't make sense to necessarily crack out  
11 which piece is what in an arbitrary way where  
12 there's sort of no market delineation.

13 So I think a lot of the issues are  
14 really about how you divide premiums, if you  
15 should, if it makes any sense to do that, and  
16 how you divide what's provided under the  
17 contract. And I think those are really the  
18 big distinguishing factors between insurance  
19 in general, and certainly insurance in the  
20 health and welfare context.

21 MR. CAMPAGNA: Just one question.

22 You mentioned the class exemptions that are

1 currently applicable to insurance and  
2 insurance brokers, et cetera.

3 Do you have any sense as to your  
4 position on the effect that 408(b)(2) should  
5 have on that, or whether it should have any  
6 effect?

7 MR. BORTZ: Well, I think one  
8 threshold question here is whether or not you  
9 all see issues that should be addressed in the  
10 context, or whether or not 84-24 has been  
11 serving the need to which it's been put since  
12 it was put out what -- I guess the predecessor  
13 to 84-24 was in '77 or '79 -- whether you all  
14 see a perceived need to sort of change the  
15 landscaping. Certainly our sense is that 84-  
16 24 has been doing a good job.

17 MR. CAMPAGNA: Okay.

18 MR. BORTZ: The other thing to say  
19 on the health and welfare context that's a  
20 tricky issue that we haven't heard vetted is  
21 this sort of, what is it, the '92 tech  
22 release, and this relief from the trust

1 requirement. It's one of the issues that you  
2 all are going to have to grapple with is are  
3 payments paid by an employer out of its  
4 general assets for services subject to the  
5 408(b)(2) disclosure regime.

6 Insurance, and particularly health  
7 and welfare plans, are often paid for out of  
8 the employer's general assets. And to the  
9 extent they're not, they're sort of paid out  
10 of this quasi-plan assets under the tech  
11 release. And I think that's just a whole set  
12 of issues that needs to be vetted here.

13 MS. WIELOBOB: You might see that  
14 in the self-insurance sort of discussion. But  
15 do you have any comments on that?

16 MR. BORTZ: I think the comment is  
17 that it needs to be thought about, and we need  
18 to gather information. We need to make sure  
19 the right people are thinking about these  
20 issues and getting the same kind of grappling  
21 that you've gotten in the individual account  
22 context.

1 MS. WIELOBOB: I think we really  
2 got one comment on that issue. So I'm glad  
3 you brought it up.

4 CHAIRMAN CAMPBELL: Okay. That  
5 does now conclude our morning testimony. And  
6 we're only five minutes behind. So if we  
7 could resume testimony now -- not gathering --  
8 just testimony at 1:05. Thank you.

9 (Whereupon, the above-entitled  
10 matter went off the record at 12:04 p.m. and  
11 resumed at 1:04 p.m.)

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A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

PANEL MEMBER CAMPAGNA: Our first party will be Express Scripts, Inc., for Pharmaceutical Care Management Association -- Bill Kilberg.

MR. KILBERG: Thank you very much.

Good afternoon. My name is William Kilberg. I'm appearing here today on behalf of Express Scripts, Inc., for the Pharmaceutical Care Management Association, which is a trade association of pharmacy benefit managers. The PCMA submitted comments in a letter dated February 22 from Barbara Levy, General Counsel of PCMA.

I am joined this afternoon by my colleague, Paul KILBERG.

Our purpose today is to expand a bit upon the central point that was made in PCMA's February 22 letter. The proposed rule should not be applied to pharmacy benefit managers, because PBMs simply do not present

1 the types of concerns targeted by this  
2 rulemaking.

3 As we understand it, the proposed  
4 rule would address the Department's central  
5 concern that plans and plan sponsors lack  
6 sufficient information about the fees and  
7 expenses being imposed on plans by service  
8 providers, because pricing structures used by  
9 those providers, particularly by bundled  
10 service providers, are too complex and opaque.

11 The proposed regulations are at  
12 least in substantial part a response to a  
13 report on plan fees and expenses issued by the  
14 Working Group of the Department's ERISA  
15 Advisory Council. That report focused on the  
16 lack of transparency in fees and expenses  
17 incurred by participants in 401(k) plans  
18 investing in pooled investment vehicles like  
19 mutual funds.

20 The Working Group emphasized that,  
21 with the emergence of the defined contribution  
22 plan as the dominant form of retirement plan,



1 a dramatic change has occurred in the way fees  
2 are charged. In particular, the Working  
3 Group's report emphasized that management fees  
4 and other expenses of mutual funds are levied  
5 at the fund level and not easily identifiable  
6 by plan fiduciaries and/or plan sponsors, and  
7 further, that the prevalence of bundled  
8 arrangements with plan providers with the  
9 costs of administration such as trustee or  
10 record keeping fees are offset by payment to  
11 those providers in the form of Rule 12(b)(1),  
12 sub-transfer agency, marketing or finders  
13 fees, or revenue sharing payments. And that  
14 this has complicated the ability of plans and  
15 plan sponsors to fully appreciate the fees  
16 being paid indirectly to providers.

17 It's consistent with the opening  
18 remarks of the Assistant Secretary this  
19 morning, where he explained that the purpose  
20 of this proposed regulation and this hearing  
21 was to deal with issues involving the  
22 financial services marketplace.

1                   The Working Group's report found  
2                   that perhaps 70 to 80 percent of plans and  
3                   plan sponsors were unaware that providers were  
4                   receiving these indirect payments. The PBM  
5                   business model, on the other hand, operates in  
6                   a far different manner. Here the FTC has  
7                   found that market forces have functioned to  
8                   provide a substantial amount of transparency  
9                   -- the very transparency that the Working  
10                  Group found absent on the retirement side.

11                  The PBM model is not difficult to  
12                  describe. PBM organizes retail, typically  
13                  brick-and-mortar pharmacies, into networks.  
14                  The PBM bargains with the retail pharmacy.  
15                  For each participant who fills a prescription  
16                  there, it will reimburse the pharmacy a set  
17                  amount. This amount is less than the pharmacy  
18                  otherwise would charge for the drug. But in  
19                  return for providing the discount, the  
20                  pharmacy expects to get an increased volume of  
21                  customers from the PBM.

22                  PBMs also generally operate their

1 own mail-order pharmacies. Here PBMs  
2 negotiate directly with pharmaceutical  
3 companies or with wholesalers. The companies  
4 provide drugs to the PBMs for a reduced price,  
5 again in return for expected increased volume  
6 of business from the PBMs. The PBMs then sell  
7 the drugs directly to the plan participants.

8 PBMs negotiate the terms of these  
9 purchases on its own behalf. PBMs also  
10 perform the claims administration process for  
11 plans, and often also perform a variety of  
12 other services for manufacturers.

13 This model is well known and well  
14 understood. Plans and plan sponsors are aware  
15 of how PBMs operate. PBM clients are often  
16 large, sophisticated companies that negotiate  
17 arrangements with PBMs with the assistance of  
18 consultants knowledgeable about the market for  
19 PBM services. Smaller companies often are  
20 represented in negotiations by third-party  
21 administrators, who act on behalf of a number  
22 of separate plans in order to enhance their

1 bargaining power.

2 Negotiations are hard-fought.  
3 Plan sponsors generally bid out contracts for  
4 PBM services, so that PBMs must compete with  
5 each other.

6 There are 40 to 50 PBMs in the  
7 United States. The FTC has found that this  
8 competition among PBMs is vigorous.  
9 Competition takes place on both price and non-  
10 price dimensions, including benefit design,  
11 size of network, quality of service.

12 In addition, different plan  
13 sponsors have different preferences for  
14 formulary design and pharmaceutical payment-  
15 sharing. With respect to pricing, PBMs and  
16 plans or plan sponsors negotiate extensively  
17 over the payments to be provided to the PBM,  
18 which take two basic forms -- flat fees for  
19 administrative processing services, and index-  
20 based pricing discounts on the pharmaceuticals  
21 the plan participants purchase.

22 The plan sponsor can negotiate to

1 pay a specific, index-based charge less a  
2 stated percentage amount for brand-name drugs  
3 and generic drugs. Alternatively, on the  
4 retail pharmacy side, plan sponsors can  
5 negotiate for pass-through pricing where  
6 savings extracted from the retail pharmacy are  
7 passed through to the plan.

8 Further, plan sponsors can and  
9 inevitably do negotiate for a share of the  
10 volume rebates that the drug manufacturers  
11 provide to the PBMs, which would otherwise  
12 reduce the PBM's cost of goods sold.

13 Because there's no free lunch,  
14 PBMs are likely to charge plans more for  
15 administrative services where the plan has  
16 negotiated either or both pass-through pricing  
17 and a share of volume rebate.

18 By using a PBM, everyone wins.  
19 Plans and plan sponsors gain access to  
20 discounts. Participants get cheaper co-pays  
21 or payroll reductions and get access to  
22 enhanced distribution channels. Retail

1           pharmacies and drug manufacturers get  
2           increased business. The PBM gets a reasonable  
3           process.

4                       The FTC has found that there do  
5           not appear to be any significant barriers to  
6           negotiation between health plan sponsors and  
7           PBMs over -- and I'm quoting -- all the terms  
8           of their agreement, including how PBMs are to  
9           be paid for their services and the disposition  
10          of any rebates.

11                      Furthermore, the FTC has found  
12          there is no indication that clients of PBMs  
13          lack accurate information on the price and  
14          quality of the service that they intend to  
15          purchase. Indeed, in the FTC's view, vigorous  
16          competition in the marketplace for PBMs is  
17          more likely to arrive at an optimal level of  
18          transparency than would regulation.

19                      Imposing the proposed disclosure  
20          regimes on PBMs is not neutral, but may well  
21          have substantial adverse effects. The FTC  
22          studies have expressed concern about tacit

1 collusion among manufacturers in the event  
2 that formal disclosure were mandated.

3 Because the FTC has  
4 comprehensively studied the PBM industry and  
5 has determined that extending additional  
6 disclosure mandates onto PBMs would have a net  
7 anti-competitive effect, the Department, which  
8 has not specifically studied PBMs but has  
9 instead focused on service providers to  
10 defined contribution plans, should defer to  
11 the FTC's determination, at least, unless and  
12 until the Department conducts its own  
13 investigation and determines otherwise.

14 I have left with you a copy of all  
15 of the FTC studies. There are a number of  
16 individual letters that the FTC has sent,  
17 which we've cited in our materials and Barbara  
18 Levy's letter of February 22, as well as some  
19 specific studies on the PBM industry.

20 I'm happy to answer any questions  
21 you may have about anything I've said here  
22 this afternoon, or about anything in Ms.

1 Levy's letter.

2 Thank you very much.

3 MR. CAMPAGNA: Let's start down  
4 there.

5 MS. WIELOBOB: Hi, there.

6 MR. KILBERG: Hi.

7 MS. WIELOBOB: I am familiar with  
8 the FTC study, and it's robustly cited in your  
9 comment letter.

10 As to the notion that disclosing,  
11 sort of, the behind the scenes the ways that  
12 PBMs do business -- disclosing rebates and so  
13 forth to plan sponsors -- I see the assertion  
14 in the FTC's conclusions, and one that, I  
15 think, that you echo that they would have  
16 anti-competitive effects. Can you tell me  
17 mechanically, why do you think that would be  
18 the case?

19 I'm not an economist. I'll leave  
20 that to others on the Panel. But I kind of  
21 understood sunshine is beneficial to the  
22 consumer. The more we know, the better



1 competition gets. So to hear that disclosure  
2 would lead to higher prices, I find it to be a  
3 little confusing. I'm supposing it's  
4 something that I've missed.

5 The other issue, I know the FTC  
6 actually used their words. They did say tacit  
7 collusion. That's something we can't disprove  
8 or prove. There could be collusion going on  
9 right now. And so I'm not sure how one could  
10 avoid that conclusion going either direction.

11 But if you could talk about the marketplace  
12 points a little bit, that'd be great.

13 MR. KILBERG: Sure. First, I  
14 think what's important to note is that the FTC  
15 has found that sunlight does exist now. Plan  
16 sponsors are well aware of rebates -- that the  
17 rebates are not a secret in the industry --  
18 and are able to negotiate for those rebates.  
19 In fact, many large employers simply get the  
20 entirety of the rebate passed through to them.

21 So the issue is not whether there  
22 is sunlight and whether participants -- or

1 more importantly plan sponsors -- are aware of  
2 the information they need to have. The bigger  
3 question is whether, if you formalize in a  
4 written document, information that would allow  
5 manufacturers to determine what rebates other  
6 manufacturers are giving on specific drugs.

7 Remember there's a big, vigorous  
8 competition, both with regard to brand-name  
9 drugs, because you have competing drugs by  
10 different manufacturers -- for example among  
11 the statin drugs -- but also because you have  
12 many, many producers of generic drugs, for  
13 which there's a very vigorous market. And  
14 indeed if you explore into this industry as  
15 the FTC has done, you'll learn that the way  
16 pricing goes, typically PBMs lose money on  
17 brand-name drugs and make their profit on  
18 generic drugs, because there is so much  
19 competition.

20 The concern is that, if any  
21 manufacturer knew what other manufacturers  
22 were discounting with regard to particular

1 drugs, they could then adjust their price  
2 accordingly. And the concerns are that this  
3 would result in higher pricing. It would be  
4 disadvantageous to participants and  
5 beneficiaries.

6 MS. WIELOBOB: The competition  
7 there wouldn't have the opposite effect?

8 MR. KILBERG: No. Because if you  
9 know that somebody else is discounting less  
10 than you are, you know that you can sell this  
11 drug at X pennies rather than Y pennies. And  
12 that's the concern that the FTC has.

13 The argument we're making to you  
14 is a very simple one. If it ain't broke,  
15 don't try to fix it. The burden should be on  
16 the regulator to show the need for regulation.

17 And if the FTC is right -- we believe they  
18 are right, and this is not something that they  
19 just came up with -- this is something  
20 resulting from years of study, both the FTC  
21 and jointly by the FTC and the Antitrust  
22 Section of the Department of Justice. Then,

1 let's not regulate it.

2 MS. WIELOBOB: Well, in fact,  
3 aren't a number of states actively considering  
4 -- I know you're here to talk about federal  
5 law -- but aren't a number of states now in  
6 the process of -- some have passed, and others  
7 are enacting or it's going through state  
8 legislatures -- regulation of PBMs?

9 MR. KILBERG: Considering it. And  
10 that's what a number of these FTC letters that  
11 we provided to you relate to. The FTC has  
12 been asking the states not to regulate in this  
13 area because they believe that regulation  
14 would in fact have an anti-competitive effect  
15 along the lines that I've just described.

16 MS. WIELOBOB: Okay. Now as to  
17 the trade secrets, you mentioned in your  
18 comment letter that trade secrets may be at  
19 issue.

20 If the 408(b)(2) disclosure regime  
21 was promulgated as is, what sorts of trade  
22 secrets are we talking about? Formularies?

1           Would it benefit companies -- the  
2           pharmaceuticals?

3                         MR. KILBERG:       There may be  
4           individual formularies that would be  
5           confidential. First and foremost, of course,  
6           would be the rebates themselves by drug. And  
7           that's much of the letter that Ms. Levy  
8           submitted on behalf of the PCMA is the result  
9           of a comment by a series of PBMs.

10                        So you've got people focusing on  
11           different parts of the regulation, or  
12           different aspects of the regulation, but  
13           really honing in on the same larger point,  
14           which is why I've chosen to focus on that  
15           larger point here. And that is that there is  
16           confidential information which can be worked  
17           out by plan sponsor by plan sponsor, but which  
18           should not be made generally public.

19                        MS. WIELOBOB:     Okay.     And you  
20           mentioned in assessing the quality of a  
21           variety of PBMs that customers may -- plan  
22           sponsors -- will look at a variety of things

1 --

2 MR. KILBERG: Yes.

3 MS. WIELOBOB: -- quality of  
4 services costs and so forth. And I think the  
5 FTC -- you're probably more familiar with  
6 this study than me -- but the focus on  
7 competition there seems to be on pricing?

8 MR. KILBERG: Yes.

9 MS. WIELOBOB: And the Department  
10 has said in our guidance -- you're probably  
11 familiar with it -- that cost is the only one  
12 aspect of a fiduciary's consideration in  
13 evaluating service providers.

14 MR. KILBERG: Right.

15 MS. WIELOBOB: So I believe the  
16 Department's position -- I don't want to  
17 misstate it -- is that the lowest cost  
18 provider is not always the most prudent  
19 choice. So if it's acceptable to view the  
20 FTC's conclusion in terms of economics --  
21 finance, that is, dollars -- the disclosure  
22 regime has other qualitative effects as well.

1           If we can set aside competition and dollars,  
2           how do you think the disclosure regime could  
3           harm other aspects of the quality of service  
4           presented by particular PBMs?

5                   MR. KILBERG: I don't know if it  
6           would harm it or not, quite frankly. But it  
7           goes back to the point that there's no  
8           evidence here, as the Working Group found,  
9           there was on the financial side -- on the  
10          retirement plan side -- that there is a lack  
11          of information or that anything is complex or  
12          opaque.

13                   I think in this industry,  
14          generally, the competition is understood. It  
15          is vigorous as the FTC found. And it occurs  
16          across a variety of service aspects, as well  
17          as price.

18                   MS. WIELOBOB: Okay. And one  
19          question -- just indulge me one more.

20                   I saw mention of some dated  
21          material on Medicaid. And I know Congress had  
22          a debate about whether -- what PBMs' role with

1           respect to Medicare, Medicaid would be. What  
2           is it? I didn't have time to look into that.

3           Do PBMs work for those programs?

4                       MR. KILBERG: Yes. And there is  
5           the same issue, or at least I know of this  
6           issue. I don't know if there were others.

7                       But in that context, there also  
8           was a question as to whether there should be  
9           more regulation. And the conclusion was not,  
10          that it would in fact be more anti-competitive  
11          than it would be pro-competitive.

12                      MS. WIELOBOB: Thank you,

13                      MS. ZARENKO: I just have a couple  
14          quick follow-ups.

15                      When I read your submission, what  
16          I thought the position was, was that there's  
17          sufficient transparency. There may be slip-  
18          ups here and there in the PBM marketplace, but  
19          that this regulation wasn't the way to solve  
20          that or go after those problems. But now I  
21          almost feel like what I'm hearing is, in your  
22          opinion, when we're talking about the ERISA



1 plan marketplace, there are no issues with  
2 transparency in the information that's  
3 provided from PBMs to the plan clients?

4 MR. KILBERG: We're not aware of  
5 any issues that would look to regulation to  
6 fix them.

7 The point of a letter was just  
8 that. That was the first section. We then go  
9 on to say but if you want to do something,  
10 then here are a whole bunch of other issues,  
11 but they really go to very much the same  
12 point, which is that regulation might have an  
13 anti-competitive effect insofar as it would  
14 seek to regulate and disclose individual  
15 rebates.

16 MS. ZARENKO: As you probably  
17 know, the definition of a fiduciary under  
18 ERISA is a functional definition. You either  
19 are or you aren't, based on what you're doing.

20 MR. KILBERG: Right.

21 MS. ZARENKO: And I know contracts  
22 sometimes spell out that you are one or not.

1 MR. KILBERG: Right.

2 MS. ZARENKO: But I would just  
3 appreciate your practical viewpoints on the  
4 extent to which PBMs consider themselves to be  
5 fiduciaries to their ERISA plan clients.

6 MR. KILBERG: Generally they do  
7 not consider themselves to be fiduciaries,  
8 because generally they are not dealing with a  
9 plan or providing services to the plan. They  
10 are providing services to the plan sponsor to  
11 the employer. And there are no plan assets  
12 involved. There are strictly payments from  
13 the employer to the PBM.

14 There are instances, as we  
15 indicate in our letter, where PBMs have agreed  
16 to provide claims services where they in fact  
17 may make claim determinations. That's quite  
18 rare in my experience. But it does happen.  
19 In those instances they would be functional  
20 fiduciaries, and sometimes they agree to be a  
21 named fiduciary for that purpose.

22 MS. ZARENKO: Do you think plan

1 sponsors have the same view, or do you think  
2 there might be instances where a plan sponsor  
3 does think of a PBM as a fiduciary service  
4 provider?

5 MR. KILBERG: I'm not prepared to  
6 answer that question.

7 MS. ZARENKO: I didn't know if you  
8 would have a view or not. Thank you. That's  
9 all I have.

10 MS. DWYER: I believe you're  
11 saying that this proposed regulation merely  
12 formalizes disclosure that's already there on  
13 an informal basis, and that the formalization  
14 would have an anti-competitive effect. Why is  
15 that? Why turning this disclosure into a  
16 written document -- why is that going to  
17 increase the chances that the information is  
18 going to be out there more than it is now?

19 MR. KILBERG: Well, a few points  
20 along the lines of my prior answers.

21 If there's no need for the  
22 regulation, why engage in it? If you don't

1 have the problem, why regulate?

2 Secondly, the disclosure that  
3 you've got is going to be on a per plan basis.

4 There's going to be an amalgamation of  
5 information with regard to rebates for  
6 example, that will refer to the rebates for a  
7 particular plan based upon its usage so that  
8 you can calculate -- the PBM can calculate for  
9 any particular employer the drugs that were  
10 purchased and the rebates that are owed with  
11 regard to those drugs and the quantities that  
12 were purchased by participants in that plan.

13 What we're concerned about is  
14 putting that information out generally into  
15 the marketplace, so that someone can unravel  
16 it and make determinations as to which  
17 manufacturers are providing, or which  
18 wholesalers are providing what kind of rebate  
19 on which drugs. The more you formalize it,  
20 the more you put the information out into the  
21 marketplace, the greater the risk that that  
22 information will be used for purposes that are

1 anti-competitive rather than competitive. And  
2 if you don't need to regulate, and you don't  
3 need to run that risk, why do it?

4 MS. DWYER: Another question I  
5 have is that the information now that's being  
6 disclosed will be disclosed after the fact.  
7 Am I correct on that?

8 MR. KILBERG: Generally, the  
9 negotiations that will take place will take  
10 place before the fact. The negotiations that  
11 will take place will say that you will provide  
12 us with all of the rebates or some percentage  
13 of the rebates. You will provide us with all  
14 of the pass-through or some percentage of the  
15 pass-through in exchange for which  
16 administrative fees will be leveled at this  
17 level or that level. That's the nature of the  
18 financial negotiation that takes place.

19 The dollar amounts will only be  
20 determined after the fact because they're  
21 usually determined based upon the  
22 prescriptions that were actually written

1           during the period in question.

2                   MS. DWYER:   And substantively, do  
3           you see a difference of the information that  
4           would be disclosed formally through the  
5           proposed regulation, as opposed to what's  
6           being disclosed now voluntarily?

7                   MR. KILBERG:   Well, a good portion  
8           of our letter deals with the issue of the  
9           definition of compensation in an effort to  
10          avoid getting into some of these traps and  
11          providing information that would taint the  
12          process.

13                   But again, I'd come back to the  
14          initial point, which is that, given the  
15          studies that have been done by a sister agency  
16          that have said that none of the problems which  
17          allegedly exist on the retirement plan side  
18          exist over here, why would you want to include  
19          this in a regulatory framework?

20                   MS. DWYER:   Thank you.

21                   CHAIRMAN   CAMPBELL:   Let's say  
22          hypothetically that our investigations that we

1           conducted on an ongoing basis do show a trend  
2           that causes us to have a concern for  
3           absentees, that there is an informal  
4           disclosure going on and that there are rebates  
5           that aren't being passed through in any shape  
6           or form. Is it your view then that the  
7           structure of this regulation just  
8           fundamentally is at odds with the business  
9           model for this industry, such that even in  
10          that circumstance this would not be an  
11          appropriate response?

12                       MR. KILBERG: The regulation as  
13          presently structured, yes, is in competition  
14          with the business model. The definition of  
15          compensation as we point out is one that would  
16          be very difficult for us to live with, and we  
17          would suggest that compensation ought to be  
18          defined in its usual business sense as  
19          payments received in return for goods or  
20          services provided, rather than payments  
21          received in connection with or -- we're almost  
22          into the preemption language in relationship

1 to -- we think it's too broad, too vague. And  
2 if you were to regulate, you should regulate  
3 differently.

4 But we would also say, before you  
5 regulate, we would prefer that you adopt the  
6 position of the FTC. If you choose not to  
7 adopt the position of the FTC, then we would  
8 urge you to do more homework, get more  
9 knowledgeable about the industry before you  
10 conclude that there's a need for this kind of  
11 regulatory approach.

12 CHAIRMAN CAMPBELL: Do you think  
13 the situation facing pharmacy benefit managers  
14 is different than that facing other forms of -  
15 - I guess you wouldn't say they are service  
16 provider plans -- but other types of service  
17 providers? Or is this a problem that we would  
18 anticipate seeing in other areas?

19 MR. KILBERG: Well, I think the  
20 problems that you've got on the retirement  
21 side are quite different, as a general  
22 proposition, than issues on the welfare plan



1 side.

2 I think that on the retirement  
3 side, you have third party payments that are  
4 very different than what you have in this  
5 program, or typically in the welfare plan side  
6 where third-party payments go to cost of goods  
7 sold, not to actual compensation. You're  
8 dealing with a very different kind of  
9 structure. Furthermore, I don't think you've  
10 got the kind of opaqueness -- as the  
11 Department refers to it -- on the welfare plan  
12 side that you have on the retirement plan  
13 side.

14 So as a general proposition, I  
15 would urge the Department to give some more  
16 thought to the issues before it regulates. I  
17 believe that you simply lack the kind of  
18 information and in the kind of depth that you  
19 should have it in order to provide a  
20 disclosure regulation of this breadth on the  
21 welfare plan side as a general proposition,  
22 and certainly with regard to PBMs.

1                   CHAIRMAN CAMPBELL:   Okay.  Do you  
2                   have a question?

3                   MR. CAMPAGNA:   My question is, how  
4                   do small employers figure into this business  
5                   model.  Are they provided the same kind of  
6                   transparency and in your experience, are they  
7                   able to judge the information that they're  
8                   given regarding the rebates and the  
9                   information regarding the compensation or  
10                  rebate systems that PBMs negotiate?

11                  MR. KILBERG:   Typically, small  
12                  employers are represented by third-party  
13                  administrators.  They may use a different  
14                  consulting arrangement than you see large  
15                  employers making.  They usually come in groups  
16                  through a TPA and negotiate on that basis.

17                  You also see more smaller  
18                  employers on the insurance side where the  
19                  insurer is in fact negotiating for them and  
20                  providing the PBM services.

21                  So it's somewhat of a different  
22                  structure either in terms of the negotiations

1 or sometimes in terms of the program itself  
2 when it's done through the insurance  
3 mechanism.

4 MR. CAMPAGNA: Thank you.

5 MR. BUTIKOFER: You've talked  
6 about this tacit collusion and the problem  
7 that comes if we disclose the rebates. But  
8 what disclosures that are required by the  
9 proposed regulation could actually be  
10 disclosed, and not harm or cause this tacit  
11 collusion?

12 MR. KILBERG: I haven't tried to  
13 look at it from that perspective.

14 Part of our problem is that the  
15 definition of compensation seems to be so  
16 broad that I'm not sure where you're drawing  
17 the line.

18 MR. BUTIKOFER: All right.

19 MR. KILBERG: It's hard to see  
20 what it is -- a) we don't have a problem to  
21 regulate; b) the regulation itself is so broad  
22 as to be uncertain as to where you're drawing

1 the line.

2 In our letter, we tried to provide  
3 you with our expressed concerns, both as a  
4 general proposition, and secondly, if you were  
5 to go ahead with the regulation, with  
6 specifics in the regulation. But I don't know  
7 that I could draft for you a regulatory  
8 structure that would work.

9 The FTC has looked at various  
10 disclosure regimes. As indicated, the states  
11 have had a number of proposals floating about.

12 And they've looked at the Medicaid approach.

13 And they found all of them wanting. So I  
14 don't know where you -- how you draw the line.

15 MR. BUTIKOFER: All right.  
16 Thanks.

17 MR. WILLIAMS: How in your mind do  
18 plan fiduciaries currently meet their  
19 fiduciary duties for welfare plans, their  
20 holding plan assets, and have to comply with  
21 the 408(b)(2) regulation?

22 MR. KILBERG: I can speak best to

1 PBMs and again, the disclosure is broad.

2 Where you might have the plan  
3 assets, for example, in the case of a Taft-  
4 Hartley plan, and I could debate that. But  
5 let's assume for the moment at least that  
6 there, you have plan assets. I would think  
7 that they'd be able to meet their obligations  
8 quite easily because there is as much  
9 transparency and competition. And typically,  
10 they would engage in a bidding process and sit  
11 down and negotiate with a variety of PBMs,  
12 usually with a consultant in tow.

13 MR. WILLIAMS: So they can get  
14 enough information to meet their fiduciary  
15 duties to determine whether the PBM will get  
16 reasonable compensation for the service?

17 MR. KILBERG: Absolutely.

18 CHAIRMAN CAMPBELL: All right.

19 Thank you, sir.

20 MR. KILBERG: Thank you.

21 MR. CAMPAGNA: Next is WellPoint.

22 MS. LANGER: Good afternoon.

1                   Thank you for allowing me the  
2                   opportunity to appear before you today and to  
3                   provide input.

4                   My name is Judith Langer, and I'm  
5                   Public Policy Manager for WellPoint, Inc. I'm  
6                   joined today by Matt Haddad, Senior Counsel at  
7                   WellPoint.

8                   WellPoint is the health benefits  
9                   company with the largest commercial membership  
10                  in the United States. Many of WellPoint's  
11                  business units and subsidiaries function as  
12                  service providers to ERISA health and welfare  
13                  plans, furnishing third-party administration,  
14                  wellness programs, pharmacy benefits  
15                  management, and many other types of services  
16                  to ERISA health and welfare plans.

17                  In evaluating these proposed  
18                  rules, we have worked with our trade  
19                  associations, America's health insurance  
20                  plans, the BlueCross/BlueShield Association,  
21                  and the Pharmaceutical Care Management  
22                  Association. And we fully support their

1           comments and testimony on this rule. However,  
2           we feel so strongly about these issues that we  
3           felt it would be important to testify and  
4           express our concerns about the proposed rule.

5                        We should start out by saying that  
6           we do support the goals of the proposed rule  
7           to increase transparency of compensation and  
8           relationships of service providers. However,  
9           we believe the proposed rule as drafted will  
10          create, rather than ameliorate, problems in  
11          the health and welfare benefits industry.

12                      First of all, we urge the  
13          Department to withdraw the proposed rule, or  
14          to delay finalization of the final rule with  
15          respect to health and welfare plans, and to  
16          conduct a comprehensive study of the health  
17          and welfare benefits plan industry to  
18          determine whether there are in fact problems  
19          in the industry that need to be addressed by  
20          guidance or by a proposed rule.

21                      As others have mentioned, the  
22          studies done by the Department and the

1 concerns that have been raised by Congress  
2 over the past several years focus on financial  
3 service providers, such as investment  
4 management companies and pension consultants,  
5 that provide services to traditional defined  
6 contribution or defined benefit plans.

7 It is evident from the preamble to  
8 this rule and from the rule itself as drafted,  
9 that this rule is primarily intended to target  
10 problematic issues concerning financial  
11 services providers in the pension industry.

12 To the best of our knowledge, these same  
13 concerns have not been shown to extend to the  
14 health and welfare benefits industry.

15 Therefore, we believe that this proposed rule  
16 as drafted is simply not a good fit for health  
17 and welfare benefit plans and their service  
18 providers. We encourage the Department to  
19 study the health and welfare benefits industry  
20 and to tailor any proposed rule to any  
21 specific existing concerns about service  
22 providers to health and welfare plans.



1                   However, if the Department  
2 declines to withdraw their proposed rule or to  
3 delay issuing a final rule, we strongly urge  
4 the Department to grant affected entities in  
5 the health and welfare benefits industry an  
6 extended period of time within which to comply  
7 with the final rule. As has been mentioned  
8 before, it will be extremely difficult for  
9 plans and service providers to comply with the  
10 final rule within 90 days after it is issued.

11                   We are concerned, and very  
12 concerned, that a too-short compliance  
13 timeframe will significantly stress and  
14 disrupt the normal business activities of  
15 ERISA plans and service providers subject to  
16 the rule. This is particularly true for  
17 health and welfare plans and their service  
18 providers, as we are struggling to understand  
19 how the proposed rule impacts all parts of our  
20 industry.

21                   As drafted, the proposed rule will  
22 require health and welfare service providers

1 to make substantial changes in their business  
2 practice and information systems. This rule  
3 represents a major paradigm shift in the  
4 health and welfare benefit plan industry.

5 The change represented by the  
6 detailed disclosure requirements in the  
7 proposed rule is analogous to the one that  
8 occurred when the HIPAA privacy rules were  
9 issued where existing general privacy law was  
10 replaced by a very detailed, complex and  
11 completely new regulatory scheme. Such a  
12 substantial change in business practice  
13 requires a substantial period of time for  
14 plans and service providers to fully analyze  
15 and understand the rule, work with others in  
16 the industry to create a common understanding  
17 on how to comply with this rule, perform a  
18 GAAP analysis, modify information systems,  
19 create new work flows and information-  
20 gathering procedures, train personnel, create  
21 and implement policies and procedures, and  
22 amend contracts.

1                   When the HIPAA privacy rules were  
2 promulgated, covered entities were given 24  
3 months to comply and were assisted every step  
4 of the way by the Department of Health and  
5 Human Services Office of Civil Rights.  
6 Assistance from the regulatory agency  
7 permitted affected parties to achieve  
8 compliance. We suggest that the Department  
9 look to HHS' experience with HIPAA privacy  
10 rules compliance in creating a similar  
11 timeframe for compliance in similar but  
12 compliance assistance for affected entities.

13                   We also strongly encourage the  
14 Department to develop compliance assistance to  
15 assist plans and service providers in  
16 complying with the final rule. Based on  
17 preliminary discussions of the proposed rule  
18 within the health and welfare benefits plan  
19 industry, it is clear to us that different  
20 stakeholders already have different  
21 interpretations of what types of compensation  
22 and what relationships that may constitute

1 conflicts of interest will have to be  
2 disclosed under the rule.

3 Similar questions about how to  
4 interpret the regulations arose in HIPAA  
5 privacy rules compliance process. And in that  
6 case, covered entities greatly appreciated  
7 HHS' compliance guidance consisting of FAQs,  
8 informal guidance, model forms, educational  
9 teleconferences and presentations and the  
10 like.

11 Now we understand that the  
12 Department of Labor has conducted many  
13 compliance assistance workshops on laws and  
14 issues within its jurisdiction, and those have  
15 been very helpful. However, in this situation  
16 we suggest that the Department allocate  
17 resources to holding workshops before the  
18 compliance date of any final rule in addition  
19 to after the date compliance is required.  
20 Compliance guidance will assure that both  
21 plans and service providers are aware of the  
22 Department's interpretation of terms and

1 practices in the final rule so that the  
2 industry will have similar interpretations of  
3 what the final rule requires and will  
4 experience less confusion about how to comply.

5 Additionally, working with the  
6 health and welfare benefits industry, the  
7 Department should develop model forms for  
8 compensation disclosure as well as for  
9 disclosure of relationships that would  
10 constitute what the proposed rule calls a  
11 conflict of interest. And we do note that the  
12 Department has done this before. The  
13 Department has developed a form to assist  
14 fiduciaries of individual account pension  
15 plans. Use of model forms within the health  
16 and welfare benefits industry will ensure that  
17 all affected entities have a common  
18 understanding of what disclosures these rules  
19 require.

20 Now all of these compliance  
21 activities will take time. Therefore, we  
22 strongly urge the Department to give health

1 and welfare plans and their service providers  
2 two full plan years after the final rule is  
3 issued until January 1, 2011, assuming the  
4 final rule is issued this year to comply.

5 We also believe that this proposed  
6 rule is not a good fit for health and welfare  
7 service providers, which is evident by the  
8 definition of compensation, which again  
9 appears to be designed primarily to apply the  
10 financial service providers. As applied to  
11 health and welfare service providers, the  
12 definition of compensation is overbroad. We  
13 don't believe that it will result in the  
14 disclosure of additional practical information  
15 over and above what plan fiduciaries already  
16 receive designed to permit plan fiduciaries to  
17 assess the reasonableness of their contracts  
18 for service providers. We do believe that it  
19 will generate much information of no practical  
20 use to plan fiduciaries in making their  
21 decisions.

22 We do have additional concerns

1 about the definition of compensation as  
2 applied in the context of PBMs. Due to  
3 variations in plans' sponsor requirements. In  
4 the PBM industry, the definition of  
5 compensation differs from one plan to another.

6 Thus there is no common definition of what  
7 constitutes compensation to a PBM. We  
8 encourage the Department to work with the PBM  
9 industry in establishing clearly defined and  
10 consistent benchmarks for compensation within  
11 the PBM industry so that there is a level  
12 playing field in which plan fiduciaries can  
13 obtain the same information from each PBM with  
14 which they contract.

15 We are also concerned about the  
16 conflict-of-interest provisions in the  
17 proposed rule. The requirement that service  
18 providers disclose potential conflicts of  
19 interest is vague, subjective and open to  
20 misinterpretation. The requirement that  
21 service providers disclose potential conflicts  
22 of interest puts service providers in the

1           difficult position of trying to identify which  
2           of its relationships with other entities may  
3           in the future become a conflict of interest  
4           for the plan.     This is unrealistic and  
5           unworkable.  It also leaves service providers  
6           open to unintentionally committing compliance  
7           violations.

8                         We suggest that the Department  
9           modify the proposed rule to require service  
10          providers to disclose only actual existing  
11          relationships with entities, leaving it to  
12          plan fiduciaries to decide whether or not  
13          those relationships constitute conflicts of  
14          interest, and we suggest that the Department  
15          give further study to the issue of potential  
16          conflicts of interest.

17                        Finally, the proposed rules  
18          requirement that a service provider identify  
19          and disclose to the plan its relationship with  
20          another of the plan service providers creates  
21          a very difficult standard for service  
22          providers to meet.  A service provider's



1 ability to meet the standard completely  
2 depends on the plan disclosing to the service  
3 provider about all of its other service  
4 providers. A plan's inadvertent failure to  
5 disclose all the service providers may cause  
6 the new service provider to unknowingly  
7 violate the rule, with consequent penalties.  
8 We do not believe that it is the Department's  
9 intent to penalize service providers in this  
10 manner. We believe this provision should be  
11 omitted from the final rule.

12 As has been stated previously by  
13 other testifiers, we're very concerned that  
14 the compensation disclosure requirement under  
15 the proposed rule will have an anti-  
16 competitive effect in the health and welfare  
17 benefits marketplace. When the proprietary  
18 compensation of the service provider becomes  
19 available to its competitors, as it inevitably  
20 will, prices charged by service providers will  
21 smooth out as tacit collusion occurs amongst  
22 service providers. The highest price charged

1 by a service provider will then become the  
2 norm, as the ones who are choosing to charge  
3 lower prices will realize that the market  
4 bears a higher price. Plan fiduciaries will  
5 then no longer be able to get the best price  
6 from service providers competing against each  
7 other for business. This will ultimately harm  
8 plan participants and beneficiaries.

9 Disclosure of indirect  
10 compensation such as pharmaceutical rebates  
11 will similarly have an anti-competitive effect  
12 on the industry as the Federal Trade  
13 Commission found in its study of the PBM  
14 industry. As the FTC has said, pharmaceutical  
15 manufacturers' knowledge of their rivals'  
16 prices can dilute incentives to bid  
17 aggressively and facilitate tacit collusion  
18 which ultimately raises prices for plan  
19 sponsors and plan participants.

20 We submit that the Department  
21 should narrow the proposed rule to eliminate  
22 the requirement that service providers

1 disclose indirect compensation, or at the very  
2 least tailor it to require disclosure only on  
3 indirect compensation that is directly related  
4 to the plan.

5 In conclusion, WellPoint believes  
6 that the proposed rule does not address any  
7 demonstrable problems in the health and  
8 welfare benefits industry. As the FTC has  
9 stated regarding the PBM industry, there is no  
10 reason to suppose that competition is less  
11 likely than government regulation to produce  
12 efficient levels of information disclosure.

13 Before this detailed, burdensome  
14 regulatory procedure is implemented for health  
15 and welfare plans and their service providers,  
16 we strongly urge the Department to perform  
17 further study of the health and welfare  
18 benefits industry so that any future  
19 regulation, if such regulation is even  
20 necessary, can be more closely tailored to  
21 evident problems in our industry.

22 Thank you for your time, and we

1 will be happy to answer any questions you may  
2 have.

3 CHAIRMAN CAMPBELL: Okay. Why  
4 don't we start down here this time?

5 MR. BUTIKOFER: You've listed off  
6 some challenges that are unique to health and  
7 welfare. But is there something else inside  
8 that, that would be especially challenging for  
9 the small business, especially the independent  
10 brokers to deal with?

11 MS. LANGER: Well -- and Matt,  
12 please chime in if you need to.

13 Small businesses by and large have  
14 insured plans, and they do not always and  
15 typically use service providers. So the  
16 relationship would be between the health  
17 insurer and the small business to provide the  
18 health insurance.

19 Premium quotes are given, of  
20 course, before a small employer decides to buy  
21 that particular plan. So there is already by  
22 state insurance regulation a requirement that

1 the health insurer disclose what the premium  
2 costs will be per employee and for dependents  
3 for that small employer.

4 MR. BUTIKOFER: So you're saying  
5 it's actually a smaller burden for the small  
6 ones because of these prepackaged --

7 MS. LANGER: Yes. And we do not  
8 believe that they would have service providers  
9 that would be subject to this rule, and that,  
10 if they would, it would be the exception  
11 rather than the norm.

12 MR. CAMPAGNA: The point of the  
13 408(b)(2) regs was for fiduciaries to know  
14 about indirect compensation, so that they  
15 could judge the reasonableness of the  
16 compensation they're paying directly to their  
17 service provider.

18 I'm still struggling with how --  
19 and I could have asked this question to Mr.  
20 Kilberg as well -- I'm still struggling to  
21 understand how the PBMs obtain rebates from  
22 the drug manufacturers. Isn't it an important

1 part for plan sponsors to understand the  
2 reasonableness of compensation that they give  
3 and pay to the PBMs directly as an effect on  
4 that reasonableness?

5 MS. LANGER: Well, I'll try to  
6 address that. But I'm not a representative of  
7 the PBM industry.

8 But it is my understanding that a  
9 PBM would have an arrangement with a  
10 pharmaceutical manufacturer to get a rebate  
11 for a certain, particular drug. And the  
12 rebates would be at a certain percentage  
13 depending on market share. And it can be a  
14 very detailed program. It can be very simple.

15 But when a PBM is supplying  
16 information on a pre-contract basis to a plan  
17 sponsor, this usually happens in the manner of  
18 negotiating the formulary, so that if a  
19 particular drug is placed on a -- let's say  
20 it's a generic drug, and it's placed in the  
21 most preferable place in the formulary -- the  
22 plan sponsor would already know that they

1           could be getting some of that rebate passed  
2           through to them.

3                       MR. CAMPAGNA:   Okay.   Thank you.

4                       CHAIRMAN CAMPBELL:   Okay.   You've  
5           commented as have several other folks, in the  
6           context of welfare plans, that the disclosures  
7           there would somehow be different -- that there  
8           are different issues to consider.   We've had a  
9           lot of comments to that effect, as I said  
10          earlier, but not a lot of detail as to exactly  
11          what those differences might be and sort of  
12          evidence and examples to back up that  
13          assertion.

14                      So I was just trying in my own  
15          mind to think of an example.   Take for  
16          example, you as a fiduciary were trying to  
17          hire a TPA for your self-insured plan --  
18          welfare plan -- health benefits plan.   How is  
19          that really different in terms of what you're  
20          evaluating and looking at than hiring, say, a  
21          record keeping platform in your DC plan.   From  
22          the fiduciary perspective, what are the real

1 differences that I'm looking at? What is the  
2 nature of that distinction?

3 MS. LANGER: Well, again, I'm  
4 going to not speak at all to the defined  
5 contribution or defined benefits industry. I  
6 don't know anything about it.

7 But from a health and welfare plan  
8 perspective, the third-party administrator  
9 would provide a quote to the plan sponsor.  
10 Usually the price is on a per member, per  
11 month basis. So if there are 500 employees in  
12 the plan, it would be whatever charge it is  
13 per member per month, and the employers can  
14 fluctuate.

15 The third-party administrator  
16 might provide a lot of different types of  
17 services, all of which would have a price tag,  
18 which would be disclosed up front before the  
19 contract is signed to the plan sponsor. So  
20 for instance, the third party administrator  
21 might process claims. They might have a  
22 disease management program for chronic



1 diseases. They might have an employee  
2 assistance program. All of these come with a  
3 price tag. And up front, the plan sponsor and  
4 plan fiduciary will know, here are the various  
5 services, and they will choose which ones they  
6 want. And so there is a lot of negotiation  
7 that goes on up front.

8 CHAIRMAN CAMPBELL: And I guess  
9 where I'm having trouble is seeing how that's  
10 necessarily different than what occurs in the  
11 DC context where you would be talking to a  
12 particular record keeper about what additional  
13 services might be provided as part of the  
14 bundled or unbundled arrangement.

15 MS. LANGER: Okay.

16 CHAIRMAN CAMPBELL: Again, you  
17 don't have knowledge of the DC side, so it's  
18 hard to do a direct comparison. I'm just  
19 having trouble understanding why, from the  
20 fiduciary's perspective, the analysis that  
21 they go through, the information they need to  
22 make the decision is so fundamentally

1 different.

2 MS. LANGER: Well, that I can't  
3 speak to. But I can say that as far as we are  
4 aware -- and again, we are the largest health  
5 plan with the largest commercial membership in  
6 the United States -- we do not know of any  
7 problems that plan sponsors have with the  
8 information disclosed by third-party  
9 administrators, at least the ones under our  
10 control.

11 And again, as Mr. Kilberg  
12 eloquently said, if it ain't broke, don't fix  
13 it.

14 CHAIRMAN CAMPBELL: Well, the  
15 reason I ask again is just looking at your  
16 other comments, they seem to be comments that  
17 were perhaps more broadly applicable crossing  
18 various types of benefits -- questions about  
19 the conflict of interest, questions about what  
20 compensation means, how far down you go. It  
21 seems to be comments that we've heard in other  
22 than just the welfare context. So I'm kind of

1           wondering what there is uniquely to welfare  
2           other than those issues.

3                       MS. LANGER: Well, and again, our  
4           bottom line is we do not think that this  
5           regulation is a good fit for health and  
6           welfare benefit plans. But if the Department  
7           decides to proceed with it, there are broader  
8           concerns that we have about conflict of  
9           interest and compensation, and you enumerated  
10          the other ones.

11                      MR. WILLIAMS: I have another  
12          question before we move on. Sorry.

13                      I assume you would agree with the  
14          general proposition that if a TPA firm was to  
15          charge a fee for a service that that fee  
16          should have been disclosed.

17                      MS. LANGER: Yes.

18                      MR. WILLIAMS: Okay. So for  
19          instance, if they were going to terminate the  
20          contract, and they were going to charge them a  
21          fee for moving the records to another TPA  
22          firm, that that should have been disclosed to

1 the plan fiduciary?

2 MS. LANGER: Yes. And there is a  
3 very detailed contract between the plan  
4 sponsor or the plan and the TPA that specifies  
5 all of the consequences of contract  
6 termination.

7 MR. WILLIAMS: So currently, there  
8 are contracts -- written contracts -- that  
9 provide fee disclosures to plan fiduciaries  
10 for that service provider charged those fees?

11 MS. LANGER: Absolutely. Whatever  
12 service the TPA is going to provide.

13 MR. WILLIAMS: So when you say you  
14 don't see any problems, or you don't hear  
15 about any problems, you're saying, well, these  
16 contracts are working then. Right?

17 MS. LANGER: Yes. As far as we  
18 are aware, yes.

19 MR. WILLIAMS: But they do require  
20 disclosures of fees that are going to be  
21 charged because that's just good business.  
22 Right?

1 MS. LANGER: Absolutely.

2 MS. DWYER: I have no questions.

3 MS. WIELOBOB: Actually I want to  
4 follow up Fil's question.

5 What sort of information is  
6 currently provided on the welfare plan side?  
7 You've got these disclosures and contracts.

8 MS. LANGER: Well, based on my  
9 knowledge -- and please Matt, chime in. He's  
10 our primary attorney.

11 Let's take a large firm of 1,000  
12 or more employees. They or their consultants  
13 will send out an RFP, a request for proposal,  
14 to a number of different health plans. Now,  
15 these are very voluminous documents, and they  
16 don't talk about just price. They talk about  
17 do you comply with the HIPAA privacy rules?  
18 Do you comply with the Department of Labor?  
19 Do you comply with COBRA? How do you handle  
20 this? They're very voluminous. And believe  
21 me, our marketing area spends a lot of time in  
22 responding to these RFPs as we bid on the

1 business.

2 MS. WIELOBOB: Okay. In your  
3 comment letter you indicate there's a whole  
4 variety of types of services you all provide,  
5 from dental to standard medical. You have  
6 almost everything on the welfare plan side.  
7 Yet in your letter, I think a lot of your  
8 discussion -- really the centerpiece is that  
9 FTC study.

10 MS. LANGER: With respect to the  
11 PBM.

12 MS. WIELOBOB: Right. With  
13 respect to the PBM.

14 So what portion of your business  
15 is PBM?

16 MS. LANGER: We do have the fourth  
17 largest PBM in the United States. And I can't  
18 tell you what percentage of business that is.

19 MS. WIELOBOB: Are you saying that  
20 the rationales articulated by the FTC in their  
21 study really apply to all the other aspects of  
22 your business as well?

1 MS. LANGER: Yes.

2 MS. WIELOBOB: For the same  
3 reasons?

4 MS. LANGER: Absolutely.  
5 Absolutely.

6 And on the insurer side, in  
7 particular, antitrust is a huge concern,  
8 because rating formulae, for instance, are  
9 proprietary. So whenever we as an insurer  
10 have to disclose rating information such as a  
11 rate filing to a state insurance regulator,  
12 that is held as proprietary information by the  
13 regulator.

14 And again, it is a competitive  
15 business, and you don't want your competitor  
16 to know what price you're charging so that  
17 they could undercut you or find out your  
18 secret actuarial formulae for rating a  
19 particular block of business.

20 MS. WIELOBOB: So one of your  
21 remarks was that the compensation that would  
22 be required to be disclosed, you think, is

1 sort of a better description would be indirect  
2 compensation directly related to the plan?

3 MS. LANGER: Well, if the  
4 Department decides to go and proceed with this  
5 rule and keep compensation in there, then at  
6 least that would be an element that would tie  
7 it directly to the plan.

8 MS. WIELOBOB: Can you give me an  
9 example of indirect compensation directly  
10 related to the plan in the welfare setting?

11 MS. LANGER: I'm just trying to  
12 think.

13 MS. WIELOBOB: I'm just trying to  
14 get my brain around what she's --

15 MR. HADDAD: Would that be related  
16 to the plan?

17 MS. WIELOBOB: Well, she said  
18 indirect compensation -- if -- yes. Go ahead.

19 MR. HADDAD: Well, I guess the  
20 concern we have from sort of a broad  
21 perspective is the rule isn't very clear to us  
22 about what is compensation, what's not



1 compensation.

2 MS. WIELOBOB: Sure.

3 MR. HADDAD: Part of our business  
4 is that we contract with healthcare providers  
5 for discounts. Those discounts are  
6 negotiated. They would apply to -- all for  
7 booking business. And theoretically, I guess  
8 if we're insuring group A and we are paying  
9 claims at a contracted rate that is something  
10 less than fair market value, have we received  
11 compensation, which is the difference between  
12 the charge and the rate? I don't think we  
13 have. I don't think the rule is clear that  
14 that is a compensation to us. It's a  
15 difference, but I'm not sure it is  
16 compensation.

17 There are a lot of sort of  
18 instances in the rule that I don't think are  
19 very clear.

20 MS. WIELOBOB: Yes. I've seen  
21 other commenters have provided illustration in  
22 their written comments. I just wanted to know

1           what you all meant on your side of things.

2                       MS. LANGER: Well -- and it is  
3           very difficult to think of such an incidence  
4           of indirect compensation. My gut reaction is  
5           that it's very, very rare.

6                       But again, until the health and  
7           welfare benefits industry understands the full  
8           impact of the rule and we have a chance to  
9           analyze it and do a GAAP analysis, we can't  
10          really come up with some of these examples.

11                      MS. WIELOBOB: Do you think plan  
12          fiduciaries are getting good information now?

13                      MS. LANGER: Yes.

14                      MR. HADDAD: I think in the  
15          welfare, especially on the health side, you  
16          have sort of the mega-employers who have  
17          consultants. They are fully engaged in the  
18          process. They have tons of information. And  
19          sort of as you move down into the smaller  
20          groups, you have insured plans where the rates  
21          that are charged are regulated. So it's a  
22          little different.

1 MS. WIELOBOB: Thank you.

2 CHAIRMAN CAMPBELL: All right.

3 Thank you very much.

4 How are you?

5 MS. KANWIT: Good afternoon.

6 Good afternoon. My name is  
7 Stephanie Kanwit. I'm Special Counsel for  
8 America's Health Insurance Plans, better known  
9 by the acronym AHIP.

10 As many of you know, AHIP is a  
11 national association representing nearly 1300  
12 health insurance plans in the United States,  
13 providing coverage to over 200 million  
14 Americans. We're here to express our concerns  
15 regarding the proposed rule.

16 I have here with me today Mr. Bill  
17 Kowalski, who's an in-house attorney for  
18 Aetna. And Bill has been with Aetna for eight  
19 years as head of National Accounts, and I  
20 thought it would be useful to have him here  
21 today to answer some of the specific questions  
22 this Panel has proposed to date.

1                   Also in the front row, we have Mr.  
2 Tom Wilder from AHIP, who's are Senior  
3 Regulatory Counsel.

4                   I wanted to assure everyone on  
5 this Panel that AHIP is truly on the cutting  
6 edge of this whole concept of transparency.  
7 We're working right now with government  
8 agencies, physician groups and members to  
9 assure both quality and price transparency in  
10 the area of medical services. Transparency is  
11 very, very critical to us.

12                  We believe this rule has a lot of  
13 purpose. But we also believe that it's ill  
14 suited -- as you just heard from Ms. Langer  
15 and Mr. Kilberg -- to the health and welfare  
16 area, and Mr. Kilberg's testimony on the PBM  
17 area. We believe it must be withdrawn and  
18 revised to more accurately assess and address  
19 the specific needs of health and welfare plan  
20 fiduciaries.

21                  And there are two key issues here  
22 -- just in a nutshell -- because we have

1 submitted very extensive comments to all of  
2 you and thank you for reading those.

3           Number one, we believe it attempts  
4 to fix a nonexistent problem for health and  
5 welfare plan fiduciaries. The question was  
6 just asked, do they have information. The  
7 answer is yes. They already receive or can  
8 request from service providers a comprehensive  
9 laundry list of information related not only  
10 to the type but the quality and cost of  
11 services.

12           Number two, even if this rule were  
13 deemed necessary, would the current disclosure  
14 requirements contained in the proposed rule  
15 accomplish what the laudable object is, which  
16 is transparency. And we say no. We say that  
17 the disclosure requirements in their current  
18 form will impose additional costs on health  
19 plans and their service providers and at the  
20 same time fail to provide additional material  
21 information that will be useful to the health  
22 and welfare plan sponsors. And simultaneously

1 -- we had a lot of questions about this issue  
2 -- creating the risk of disrupting what we  
3 believe is a highly competitive marketplace.

4 My point number one, it's fixing a  
5 nonexistent problem here. There is no  
6 evidence in the record that plan sponsors of  
7 health and welfare benefits are somehow  
8 lacking material information. So our question  
9 would be why propose such sweeping and truly  
10 revolutionary regulations without any evidence  
11 that they're needed to correct some well-  
12 documented problems of some sort here.

13 Again, our extensive comments go  
14 into this in great detail. But we believe  
15 that plan sponsors obtain an enormous amount  
16 of information right now about services and  
17 prices at multiple stages of the contracting  
18 process: in response to RFPs, as part of  
19 contract negotiations and services, contract  
20 documents in post-contracting, reporting and  
21 auditing requirements that are included in  
22 many of these agreements -- extensive auditing

1 reporting.

2 In addition, the contracts are  
3 typically renewed on an annual basis, giving  
4 fiduciaries -- giving the plan sponsors -- the  
5 ability to change service providers should the  
6 cost and quality not meet the needs of the  
7 plan and the beneficiaries.

8 Secondly, and this is critical,  
9 and Mr. Kowalski from Aetna can back me up on  
10 this, the plan sponsor is always free to  
11 obtain and request additional information from  
12 the health insurer as the contract is ongoing,  
13 and will provide -- always provide -- they  
14 want to keep the customer happy -- sufficient  
15 information to allow a fiduciary to determine  
16 for example whether a service provider's  
17 compensation or fees are reasonable for  
18 services performed. And the only exception to  
19 that rule, and this has come up a couple of  
20 times this morning, of items that health plans  
21 do not routinely share are sensitive or  
22 proprietary information. And the example I

1 give in my short paper is rates paid to  
2 physicians and other health care providers.

3 Aetna does not want to reveal to  
4 everyone in the State of Illinois what it is  
5 paying providers in Chicago for specific  
6 procedures. And the reason is, as we've just  
7 discussed a little bit in the questioning, is  
8 because that proprietary information first of  
9 all isn't needed by the sponsor to evaluate  
10 reasonableness, and secondly, public  
11 disclosure of that information would be  
12 anticompetitive and ultimately result in  
13 higher costs for everybody.

14 And as you just heard from the  
15 testimony of Ms. Langer and Mr. Kilberg,  
16 that's why we all have blind bidding. That's  
17 why RFPs go out. That's why we don't want to  
18 share information in responses to RFPs with  
19 all your favorite competitors out there in the  
20 market.

21 The market works. We believe that  
22 the market needs to maintain flexibility to



1 allow parties to contracts to create terms  
2 that meet their needs and to meet the needs of  
3 their particular cohort of beneficiaries and  
4 participants. What we don't want to do by  
5 excessive regulation -- especially regulation  
6 that hasn't been demonstrated to address a  
7 specific problem -- is calcify that  
8 marketplace to the detriment of everybody.

9 What we believe is missing from  
10 the proposed rule is the recognition of the  
11 enormous power -- I call it empowerment in my  
12 written testimony here -- but the enormous  
13 power that plan sponsors have to work with  
14 their service providers to get the very best  
15 cost and terms that they possibly can.

16 My second point -- general point  
17 -- is that the proposed rule will impose  
18 additional costs on health plans and at the  
19 same time disrupt the system rather than add  
20 benefit to the system. As I just noted, we  
21 believe -- and we can answer questions on this  
22 as we go forward -- that the current system

1 works well, that plan sponsors are able to  
2 access exactly the kind of information they  
3 need when they need it from their service  
4 providers.

5 The breadth of the language in the  
6 proposed rule -- and you've had a couple of  
7 examples just addressed here -- and the  
8 inapplicability of certain sections to health  
9 and welfare plans will impose unnecessary and  
10 sometimes costly administrative burdens on our  
11 members, on the health insurance plans, which  
12 service these ERISA plans. And those costs  
13 are ultimately going to be passed on to plan  
14 sponsors.

15 We're very concerned that the  
16 information required here would require plan  
17 fiduciaries to demand reams of information  
18 from their service providers because of the  
19 penalties, and for our plans to submit that  
20 information -- even information that the  
21 service providers do not need or want -- and  
22 that the result will be there will be a sea of

1 information with no benefit down the road  
2 here.

3 One quick example -- and we go  
4 into detail on this -- is the application of  
5 the proposed rule to the insurance products.  
6 We feel that that's absolutely unnecessary.  
7 There's full risk out there already on the  
8 insured products.

9 Secondly, as you all know in the  
10 McCarran-Ferguson Act, those products are  
11 heavily regulated by state insurance  
12 departments, which by the way have  
13 inconsistent and conflicting rules already  
14 that many of our insured members have to deal  
15 with on a day-to-day basis. This would add an  
16 additional unnecessary layer of regulation and  
17 rules.

18 Long and short of it -- it's  
19 telling me to sum up here -- we support the  
20 principle of transparency, but we'd like you  
21 this Panel to do three specific things here.

22 Number one, determine whether

1 specific issues exist with respect to the  
2 adequacy of disclosures made to health and  
3 welfare plan fiduciaries.

4 Number two, determine whether  
5 there are gaps in existing requirements. And  
6 I'm particularly referring to ERISA disclosure  
7 requirements such as the Form 5500.

8 And number three -- and here's the  
9 key and the difficult question -- how  
10 meaningful transparency of material  
11 information useful to those plan sponsors can  
12 best be provided to them without, at the same  
13 time, requiring disclosure of competitively  
14 sensitive information that will just raise  
15 costs for all.

16 Thanks very much.

17 CHAIRMAN CAMPBELL: Let's start on  
18 this side.

19 MS. WIELOBOB: Okay. I guess this  
20 is something you might be better equipped to  
21 answer -- or maybe both of you.

22 How often are the policies

1 renegotiated or the contracts -- typically?

2 MR. KOWALSKI: I think it depends  
3 on the employer or the plan sponsor.

4 Typically, in the national  
5 accounts self-funded marketplace, which is the  
6 marketplace at Aetna that I'm employed in in  
7 addressing, it can vary anywhere from three  
8 years, five years. Many of the contracts are  
9 evergreen so that if the plan sponsor is  
10 satisfied with the terms of the contract -- if  
11 it's meeting their needs -- what ends up  
12 happening every year is a renegotiation over  
13 the fees and a renegotiation over things like  
14 the performance guarantees. So the basic  
15 terms of the contract remain.

16 They can be amended if necessary  
17 -- an addition of services, a change in the  
18 way a particular service is provided. But I  
19 would say on average, large plan sponsors  
20 don't go in every year. It's multi-year  
21 contracting.

22 MS. KANWIT: But there's

1 consistent give and take. Am I right?

2 MR. KOWALSKI: Yes.

3 MS. KANWIT: Between the plan  
4 sponsor and Aetna, say, in a self-funded  
5 context?

6 MS. WIELOBOB: In what sense give  
7 and take?

8 MR. KOWALSKI: Well again, every  
9 year at the time of fee negotiation, there may  
10 be inquiry around a particular product.  
11 There's an audit -- typically a claim audit --  
12 every year, every couple of years. There may  
13 be an implementation audit at the beginning of  
14 the process. So there's inquiry around  
15 overpayments to the extent that if there's  
16 overpayment made, there's an investigation and  
17 a discussion with the plan sponsors.

18 Plan sponsors are also examining  
19 other aspects of the services with their  
20 consultants. Again in the national accounts  
21 arena, most plan sponsors have multiple  
22 consultants who are also advocating their

1 interests.

2 So the give and take is ongoing.  
3 The contracting process is more formalized on  
4 a plan-year basis.

5 MS. WIELOBOB: Well, today we  
6 talked a lot about negotiation on the part of  
7 plan fiduciaries. What do we really mean?  
8 Most contracts these days seem to me to be  
9 contracts of adhesion. You're talking about  
10 plan fiduciaries' ability to negotiate. What  
11 are they able to do? How deep does it go?

12 MR. KOWALSKI: You mean adhesion  
13 on the part of the plan sponsor, or the TPA?

14 MS. WIELOBOB: The TPA.

15 MR. KOWALSKI: I would disagree  
16 with that statement. I think quite frankly  
17 it's a very -- at least again in the large  
18 national accounts arena -- at Aetna defined as  
19 3,000 lives or more, multiple jurisdictions --  
20 it's a very sophisticated marketplace. And  
21 quite honestly, I think the business people --  
22 if you have business people from the industry

1 here -- might view it as a contract of  
2 adhesion in the other direction.

3 MS. WIELOBOB: Direction? Yes.

4 MR. KOWALSKI: It is a robust  
5 marketplace. The demands that plan sponsors  
6 place on TPAs for individualized, unique  
7 arrangements specific to that particular plan  
8 sponsor -- fee concessions.

9 MS. WIELOBOB: So it's all on the  
10 table?

11 MR. KOWALSKI: It's all  
12 negotiable.

13 MS. WIELOBOB: Okay. I'll have to  
14 switch gears for a moment.

15 On disclosure and education, one  
16 of the things in your written comments you  
17 suggest that perhaps there are alternative  
18 means by which the Department could pursue  
19 educating plan fiduciaries -- getting them  
20 information to assist their decision making.  
21 And I asked this question earlier this morning  
22 to another witness.



1           One of the things that you cite to  
2           is the 5500. Now some might say that's after-  
3           the-fact information. That's not really going  
4           to be useful to fiduciaries. Can you react to  
5           that notion?

6           MR. KOWALSKI: I'd make maybe a  
7           tangential comment, but I think it ultimately  
8           gets to your point.

9           The way the draft regs can be  
10          interpreted today is to say that every service  
11          provider is required to disclose all of its  
12          relationships -- its potential conflicts --  
13          whatever term, both of them bandied about  
14          today -- with all of the other service  
15          providers that may be serving a particular  
16          plan sponsor, as well as all of its  
17          subcontractors and third parties. And this  
18          may go to your point as to how this  
19          marketplace is unique from other service  
20          providers.

21          And like everyone else on this  
22          side of the industry, I can't speak to the

1           specifics of the pension industry or the  
2           finance industry, but what I can tell you is  
3           the modern health benefits industry requires a  
4           significant cast of players to provide health  
5           benefits.

6                           And yesterday on the computer I  
7           just sat down and started to type out in an  
8           average national account how many different  
9           types of plan service providers there might  
10          be. And I came up with a list of 20, which I  
11          can read you if you like -- everything from a  
12          managed care, product provider, fully-insured  
13          indemnity plan, insured PPO product purveyor,  
14          an HRA, an HSA, consumer-directed health plan,  
15          administrator in the executive med program, a  
16          med sup plan, a pharmacy benefit, a stop-loss  
17          policy, a subrogation vendor. It goes on and  
18          on. The way the regs are drafted today, you  
19          could argue that Aetna would be responsible  
20          and some poor plan sponsor -- particularly a  
21          less sophisticated plan sponsor -- would be  
22          responsible for reviewing all of those

1 relationships with all of those parties and  
2 all of their subcontractors, and trying to  
3 determine if there is an actionable conflict  
4 of interest there.

5 So I know the Department had said  
6 in the draft regulations that they anticipated  
7 1,018,000 service contracts would be impacted  
8 by the regulations. I think that was part of  
9 the evaluation of the impact. If that's the  
10 case, and if you're looking at, for example,  
11 this hypothetical plan sponsor who's got 20  
12 service providers on the health care side of  
13 their benefits administration, and those 20  
14 vendors -- or those 20 contracts -- those 20  
15 services are all out to bid say to three  
16 competitors, you now have 60 parties who may  
17 feel the need to submit lists of all of their  
18 subcontractors and their vendors and their  
19 relationships with each other as part of an  
20 RFP, for example. It can be a massive amount  
21 of information, and as some of the other  
22 witnesses had indicated, potentially a massive

1 amount of information that's not necessarily  
2 relevant to the determination of whether or  
3 not this is a reasonable agreement that's  
4 being entered into.

5 So I think one way that this  
6 industry may be unique is that it is multi-  
7 faceted to a fair degree. And there are a  
8 significant number of players involved in  
9 providing basic health care services today.  
10 And I think if you do move forward with the  
11 regulations, you've got to find a way unique  
12 to the health benefits industry to eliminate  
13 that deluge of information because your  
14 1,000,000 contracts -- your 1,018,000  
15 contracts in the draft regulations can -- if  
16 everyone's got 20 different contracts being  
17 put out to bid to three vendors for each  
18 contract, you end up with 600 million pages of  
19 information. Is that really what you want in  
20 this industry?

21 And I think -- do you want my  
22 suggestion, for what it's worth? If you

1 clarify that whatever documentation, whatever  
2 information is required to be provided, post-  
3 award of the business, but prior to signing  
4 the contract, you then winnow down that  
5 massive deluge of information to one service  
6 provider's submission -- one service  
7 provider's disclosure. And it becomes the  
8 last step in due diligence as opposed to what  
9 may be a pro forma piece of an RFP.

10 I have to tell you, last week I  
11 received an RFP -- Aetna receive an RFP --  
12 from a large national company -- international  
13 company -- in which in the RFP they cut and  
14 pasted part of your proposed rule around  
15 conflicts of interest. Now at some level,  
16 that's terrific. They're aware of what's  
17 going on. But that may be the canary in the  
18 coal mine. That may be an indication that  
19 every RFP is going to contain this information  
20 because plan sponsors are going to be afraid  
21 that if they don't do that, the DOL will find  
22 them out of compliance. And that just starts

1 this massive wall of paper.

2 MS. WIELOBOB: Okay. I have one  
3 more quick question, and I hope we have time  
4 for it.

5 We've heard health and welfare  
6 folks today -- and others -- but really I'm  
7 focused on you all -- deferring to state  
8 regulators. Transparency is there because  
9 we're already subject to regulations. Someone  
10 else is doing it.

11 What is that accomplishing? And I  
12 really am asking. I just don't know. What is  
13 that accomplishing if your plan fiduciary --  
14 what transparency through that means? I mean,  
15 the way it's been talked about is if it's  
16 meeting our interests in this regulation but  
17 just in a different way, how is it doing that?

18 MS. KANWIT: What we're saying is  
19 we don't really have a choice in complying  
20 with that -- that the state regulators are  
21 very jealous of their prerogatives. How do I  
22 put this? The NAIC monitors it carefully.

1           That many states have exhaustive requirements  
2           about how, when and where you disclose A, B, C  
3           and D.

4                   MS.   WIELOBOB:           So   they're  
5           regulating how plan fiduciaries get --

6                   MS.   KANWIT:           They're regulating  
7           insured ERISA products.   Yes.

8                   MS.   WIELOBOB:           And information  
9           getting to fiduciaries?

10                   MS.   KANWIT:           And information on --  
11           and it fits in with the concept of what is the  
12           business of insurance within the meaning of  
13           the McCarran-Ferguson Act.   They've been  
14           extremely aggressive.

15                           Right now we're dealing with the  
16           issue of discretionary clauses.   How much does  
17           a state have a right to even discuss what the  
18           measure is when an issue comes to the court  
19           system?   So the states are inching into areas  
20           that some of us would argue are the Department  
21           of Labor's responsibility.

22                           But what we don't want to have to

1 deal with in the health insurance industry  
2 with 1300 of our members is figuring the how,  
3 what and where, and have an additional layer  
4 of duplicative and perhaps unnecessary  
5 "disclosure regulations" imposed on us when we  
6 already have the state regulators to deal  
7 with. As Bill can attest, it's a problem.

8 MS. WIELOBOB: Thank you.

9 MS. ZARENKO: I just have one  
10 question.

11 A lot of the discussion on the  
12 health and welfare side today has focused on  
13 the contractor arrangement between the service  
14 provider and the plans. But I'm just  
15 wondering, apart from that flow of information  
16 and all the paper we're talking about and the  
17 information that has to be disclosed and the  
18 questions about what exactly is required to be  
19 disclosed, does anything about the proposed  
20 rule if it was finalized as it is go so far,  
21 in your opinion, to actually affect the way  
22 services will be provided in the future, or



1           affect the way benefits, participants and  
2           beneficiaries will be provided?

3                       MS. KANWIT:       We'd be guessing.  
4           Right, Bill?

5                       MR. KOWALSKI:   Obviously, there's  
6           the issue of costs.

7                       And again, looking to the proposed  
8           regulations in the December 13 Federal  
9           Register, there's some reference to the  
10          Department's assumption that for plans this  
11          would take a half an hour of service for a  
12          certain segment of the plans to update their  
13          disclosure information. And for those larger  
14          TPAs making in excess of \$1,000,000 a year,  
15          there was another calculation of an hour of  
16          time or something to that effect. I may be  
17          having the dollar amounts wrong. I'm not  
18          citing them precisely. But I can tell you it  
19          was vastly, vastly underestimated as to what  
20          would be required to implement these regs if  
21          they're promulgated and applied to the health  
22          insurance industry.

1           I can just tell you the amount of  
2           time we've already spent in analyzing this,  
3           talking to our business people, talking to the  
4           trade associations, probably exceeds the  
5           estimates of the Department in those draft  
6           regs.

7           So this type of information, with  
8           this many participants, and then the  
9           allocation -- the determination of an accurate  
10          allocation of costs that are at this point  
11          potentially across the book of business,  
12          applied, calculated down to the specific plan  
13          sponsor for thousands of plan sponsors with  
14          potentially hundreds of different vendors who  
15          each have their own stables of subcontractors  
16          is extremely difficult -- verging on  
17          impossible -- to do with precision the way  
18          it's drafted today. The burden I think is too  
19          onerous on this particular type of industry.  
20          They're just too many players, and too much  
21          detail would be required.

22                   MS. ZARENKO:       Okay.       Otherwise

1           since the proposal came out you haven't been  
2           hearing from other associations or members --  
3           providers going back and saying wow, this is  
4           just going to change the way I do business, or  
5           this is going to change the way that we deal  
6           with plans apart from what has to be in our  
7           contract and how that has to be --

8                       MS. KANWIT: No, but we've heard  
9           mostly negative comments from everybody. They  
10          basically want to be left alone to have the  
11          flexibility they have now to make the  
12          disclosures that the customers -- the plan  
13          sponsors -- want made. The plan sponsors have  
14          enormous power in this particular marketplace  
15          and can call the shots -- can get this kind of  
16          information if they need it, including, as I  
17          mentioned in my testimony, proprietary  
18          information at least in selected areas.

19                      For example, for an audit, Aetna  
20          and many of the health plans will give them  
21          selected proprietary information. So their  
22          auditors at KPMG, for example, can ascertain

1 if exactly the terms of the contracts are  
2 being met.

3 Am I correct, Bill?

4 MR. KOWALSKI: This is on the  
5 provider contracts?

6 MS. KANWIT: Yes.

7 MR. KOWALSKI: Right.

8 MS. KANWIT: Yes.

9 MR. KOWALSKI: Yes, I just think  
10 you need to do an industry specific cost  
11 benefit analysis because I think the onus of  
12 compliance both by us and by the plan sponsor  
13 in this particular industry may be greater  
14 just because of the way the industry is  
15 structured than it is on the pension side.  
16 You've got to do that comparison because we  
17 don't know the pension industry.

18 But it seems to me, again from the  
19 list of parties who would be involved, it's a  
20 massive amount of information that would have  
21 to be digested, disseminated, and then re-  
22 digested by the plan sponsor for fear that

1           they might miss something.

2                           And maybe one point more on that,  
3           the unanticipated consequence of being deluged  
4           with that information may be leading a plan  
5           sponsor unintentionally to just choose the  
6           service provider with the smallest amount of  
7           information that they are disseminating as  
8           part of their disclosure, because it's the  
9           path of least resistance or it appears they  
10          have less potential conflicts. And that may  
11          be entirely the opposite case in a given  
12          situation. So you may be motivating plan  
13          sponsors to make the wrong decision in an  
14          attempt to have fulsome or too fulsome  
15          disclosure, and just motivating them to choose  
16          the easiest document to digest.

17                        MS. DWYER: I have no questions.

18                        CHAIRMAN CAMPBELL: I just want to  
19          say it's not the position of the Department of  
20          Labor that your contracts are contracts of  
21          adhesion.

22                        MR. KOWALSKI: Okay. I'm glad to

1           hear that.

2                           MS. KANWIT: Thank you.

3                           (Laughter.)

4                           MR. CAMPAGNA: My question is two  
5 parts.

6                           How do plan sponsors and  
7 fiduciaries become aware of particular plans  
8 that may be available to them? Do they get  
9 those through brokers or otherwise? And do  
10 any of these plans have any particular  
11 arrangements with the brokers regarding who is  
12 going to be recommended to a particular plan?

13                          And could you tell me a little bit about  
14 that?

15                          MS. KANWIT: Bill?

16                          MR. KOWALSKI: I know that that  
17 was a topic of investigation from various  
18 attorneys general over the past few years --  
19 around potential marketing abuses. And for  
20 the record, I think we've come through that  
21 without problem. But I can't speak to what  
22 other plans do.

1           Generally, I can tell you that  
2           most large plan sponsors hire consultants --  
3           the Hewitts, the Mercers of the world -- who,  
4           as Stephanie was saying earlier, submit RFPs,  
5           R5s, RFPs and put them out in the marketplace,  
6           and plans provide responses to that. And as  
7           Stephanie indicated, they're massive  
8           documents. They go into not just rates, but  
9           services, geographic areas of coverage, plan  
10          designs, options, et cetera.

11          So how a particular plan broker  
12          determines which TPAs to provide the service  
13          to, I can't speak to that specifically, but I  
14          can tell you that from what I know, it's a  
15          marketplace that benefits the plan sponsor  
16          with more competitors. So the more TPAs that  
17          know about a particular RFP -- and we want to  
18          know about those RFPs so that we can place the  
19          business or try to place the business -- the  
20          more favorable the result typically for the  
21          plan sponsor.

22          But as a general rule, brokers

1 represent plan sponsors. They're retained by,  
2 paid for by the self-funded plans. Agents  
3 represent and work on commissions mostly for  
4 fully insured products -- work for the  
5 insurance companies.

6 MR. CAMPAGNA: Are you aware of  
7 any types of arrangements between the brokers  
8 and the plans so that they're maybe first on  
9 the platform or first to be recommended in the  
10 particular menu that's being offered to the  
11 plan?

12 MR. KOWALSKI: I'm not.

13 MS. KANWIT: I'm not either.

14 MR. CAMPAGNA: Okay. Thank you.

15 MR. BUTIKOFER: So you mentioned  
16 information upon request. Is there certain  
17 information that's normally put in that  
18 information upon request? What is it? And  
19 then who is it that's typically accessing this  
20 additional information? Is it these large  
21 plans that are on top of things? Or is it  
22 information that these smaller fiduciaries are



1           trying to access as well?

2                       MR. KOWALSKI: I guess I would say  
3           virtually any information is available. And  
4           we get a myriad of requests for information  
5           from plan sponsors from every aspect of the  
6           plan's operation.

7                       To Stephanie's point, I think most  
8           plans are particularly sensitive around  
9           sharing their network negotiated rates with  
10          their providers for obvious reasons. That's  
11          what we compete with our competitors with  
12          primarily -- our network discounts.

13                      I would say larger plans are more  
14          sophisticated than smaller plans in terms of  
15          what they ask. I would also say they can  
16          afford to analyze and pay for consultants to  
17          analyze a greater amount of information -- a  
18          greater depth of information.

19                      So like your SPD regulations, you  
20          potentially have got the opportunity or the  
21          obligation -- however you see it -- to  
22          structure any disclosure requirements to suit

1 the sophistication of the particular market  
2 because the information available -- to use a  
3 prior statement's example -- the  
4 sophistication of an IDM is going to be  
5 greater than of 100-person machine shop. And  
6 so to the extent that we inundate the IDMs  
7 with a massive disclosure, you can be sure  
8 we're going to inundate the machine shop if  
9 that's what's mandated.

10 MS. KANWIT: But if their  
11 accountants -- the machine shop's accountants  
12 came to you, Bill, on the product and said we  
13 need X, Y and Z, there's no reason not to  
14 release it.

15 And the difference between that  
16 and the questions that were asked about  
17 proprietary information is that oftentimes  
18 that information -- for example in an audit --  
19 is given subject to confidentiality  
20 strictures. So Aetna would only give pieces  
21 of that information to company A, but  
22 sufficient for company A's accountants to

1 understand how the product was priced and  
2 where the money went and how -- so that they  
3 could audit and do their due diligence, but at  
4 the same time not violate what we keep talking  
5 about which is this proprietary information  
6 problem.

7 MR. BUTIKOFER: We've talked about  
8 that these large plans can take care of  
9 themselves. But is there any kind of  
10 educational -- I guess you could say  
11 information -- that you're passing to these  
12 small plan fiduciaries that provides helpful  
13 information to them in trying to understand  
14 this information being given?

15 MR. KOWALSKI: I'd say most  
16 medium-size plants -- for lack of a better  
17 term -- also use brokers. They also buy less  
18 pedestrian plans. So the wellness benefits,  
19 the top-hat plan, the MEDSA plan, may not be  
20 something that's affordable by a medium-sized  
21 or a smaller sized plan sponsor fiduciary. So  
22 by definition, they're going to be buying the

1 less sophisticated product with less bells and  
2 whistles and I think less information  
3 potentially that needs to be provided.

4 But I think our marketing folks  
5 would be more than happy to give a plan  
6 sponsor anything that they're looking for in  
7 an attempt to sell them on the Aetna product.

8 MR. BUTIKOFER: All right. You  
9 also had a list of your 20 service providers.

10 Is that typical, or is that kind of an  
11 extreme end?

12 MR. KOWALSKI: I'd say it's  
13 typical for again this segment of the  
14 marketplace -- the larger national account  
15 plan sponsors.

16 And you may have variation. There  
17 may be multiple services here provided by one  
18 TPA. You may have every service provided by a  
19 different TPA. It will vary. There may be  
20 three bidders per service contract. There may  
21 be 15 bidders per contract. It varies, but I  
22 would say it's not an extreme example in this

1 marketplace.

2 MR. BUTIKOFER: Thanks.

3 CHAIRMAN CAMPBELL: All right.

4 Well, thank you very much. We will take our  
5 break now. We'll probably be back around 10  
6 to 3:00. It'll give us time while still  
7 keeping us close to being on schedule. Thank  
8 you.

9 (Whereupon, the above-entitled  
10 matter went off the record at 2:37 p.m. and  
11 resumed at 2:51 p.m.)

12 MR. WILLIAMS: We're going to  
13 start.

14 Before we introduce the next  
15 speaker, let me just announce a point of  
16 procedure. If anybody has written testimony,  
17 could you make sure I get a copy so that we  
18 can have it all in one place? Thank you.

19 MR. CAMPAGNA: Next person to  
20 testify -- Self-Insurance Institute of  
21 America.

22 MR. GILLIHAN: Good afternoon.

1 MR. CAMPAGNA: Thank you.

2 MR. GILLIHAN: My name is Ashley  
3 Gillihan. I'm here on behalf of the Self-  
4 Insurance Institute of America obviously to  
5 submit comments on the proposed compensation  
6 and fee disclosure regulations.

7 I want to first thank you for  
8 being receptive to allow us to come here today  
9 and to make those comments.

10 Let me first give you a quick  
11 overview of the Self-Insurance Institute of  
12 America so that you can better understand our  
13 audience.

14 Self-Insurance Institute of  
15 America is the only national association  
16 dedicated exclusively to protecting and  
17 promoting the self-insurance and alternative  
18 risk transfer industry such as stop-loss.  
19 Since its founding in 1981, the Association  
20 has grown significantly and now includes  
21 members from across the nation and several  
22 countries around the world.

1 Major membership constituencies  
2 include self-insured employers, group self-  
3 insured workers compensation funds, third-  
4 party administrators, managing general  
5 underwriters, excess stop-loss insurance  
6 cares, and a variety of other companies that  
7 are involved in self-insurance in the  
8 alternative risk transfer business.

9 First let me say that our members  
10 generally view the proposed regs as consistent  
11 with their interpretation of the statutory  
12 requirements, as well as the preceding  
13 regulations. But in response to the request  
14 for comments, we are here today to express a  
15 desire for additional clarification, in  
16 particular regarding the application of the  
17 rules relating to compensation received by  
18 individuals who assist plans and plan sponsors  
19 with the placement or purchase of insurance,  
20 such as insurance agents and brokers.

21 It is our view that in order for  
22 plan fiduciaries to make informed decisions to

1 best protect plan participants, it is  
2 important that the playing field between  
3 providers of self-insured plans and providers  
4 of fully insured plans have a level playing  
5 field.

6 As you know, an insurance broker  
7 or an agent to a fully-insured plan will often  
8 receive his or her compensation in the form of  
9 commissions from an insurance carrier. Those  
10 commissions are typically a percentage of the  
11 premiums that are paid by the plan or plan  
12 sponsor to the insurance carrier, but  
13 oftentimes they are a volume of overall sales  
14 of that particular carrier's insurance product  
15 or just an overall sales closed by the service  
16 provider. We often refer to those as  
17 contingent commissions.

18 Historically, disclosure of  
19 commissions regardless of how characterized --  
20 whether they're characterized as contingent  
21 commissions, specific sale commissions which  
22 are the percentage of premiums paid to the



1 plan -- has been problematic. Anecdotal  
2 evidence from our members has suggested that  
3 disclosure is still somewhat problematic.

4 For example, contingent  
5 commissions were the focus of the Department's  
6 Advisory Opinion 2005-02A, in which the  
7 Department clarified -- as you know -- that  
8 the portion of any contingent commissions  
9 earned by a broker or agent that are  
10 attributable to a plan must be reported on the  
11 plan's Form 5500 Schedule A.

12 While it seems clear to Self-  
13 Insurance Institute of America and its members  
14 that the Department does not intend to include  
15 premiums paid to an insurance carrier in the  
16 definition of compensation and fees that are  
17 subject to these regulations, we do believe it  
18 is the intent of the Department to require  
19 individuals such as insurance brokers and  
20 agents or any other individuals who assist  
21 plans and plan sponsors with the purchase of  
22 insurance that they disclose any and all

1 compensation related to the placement or  
2 purchase of that insurance. Nevertheless,  
3 despite the breadth of the regs, we have some  
4 concerns that the current language does not  
5 effectively convey this intent for the reasons  
6 that I will discuss in a moment.

7 Consequently, we respectively  
8 request that the Department consider to attach  
9 the proposals that we've submitted to the  
10 proposed regulations that we believe will  
11 clarify that intent and further solidify those  
12 who assist with the placement of insurance or  
13 purchase of insurance are also subject to  
14 these regulations. And again, let me  
15 reiterate, our concern is that plan  
16 fiduciaries and that plan participants be  
17 protected by being able to make a reasonably  
18 informed decision by having all the  
19 information.

20 As you know, the definition of  
21 compensation and fees set forth in the regs is  
22 very broad, and would seem to encompass any

1 and all compensation received by a service  
2 provider with respect to the services it  
3 provides for the plan or plan sponsor. There  
4 does not appear to be a distinction or any  
5 differential treatment for self-insured versus  
6 fully-insured plan service providers.

7 Although broad in scope, the  
8 proposed regulations do not identify specific  
9 types of compensation other than to identify  
10 certain types of non-monetary compensation.  
11 As many of us do in that situation, we often  
12 look to the preamble for clarification. And  
13 there is in particular one particular  
14 statement that we believe may result in an  
15 erroneous conclusion or misconstruing the  
16 interpretation of the Department.

17 In the preamble, the Department  
18 notes that "The purchase of insurance is not  
19 in and of itself compensation to a service  
20 provider for purposes of these regulations."  
21 We fear that such a statement may lead service  
22 providers of fully-insured plans to

1           erroneously conclude or misconstrue the regs  
2           such that compensation received by individuals  
3           who assist in the placement of insurance and  
4           who receive these fees from insurance carriers  
5           or other third parties will not disclose that  
6           compensation.

7                         Similarly, we fear that service  
8           providers of fully-insured plans may view  
9           contingent commissions -- those that are based  
10          on the volume of sales for a particular  
11          insurance carrier -- they may view those  
12          payments as made as a result of the service  
13          provider's relationship to the carrier, and  
14          not with respect to its relationship to the  
15          plan.

16                        Last, we also have concerns that  
17          plan fiduciaries who engage individuals to  
18          assist in the placement of fully-insured  
19          products or fully-insured and self-insured  
20          administration will be unable to identify any  
21          conflicts of interest unless such individuals  
22          are required to disclose not only the

1 compensation they will actually receive with  
2 respect to the insurance contract chosen but  
3 also the compensation that they would have  
4 received if the other insurance products  
5 brought to the plan fiduciary would have been  
6 chosen.

7 Again, we believe that these  
8 issues can be resolved by revising the  
9 definition of compensation and fees as we have  
10 set forth in the attached exhibit that we  
11 previously provided.

12 On behalf of the Self-Insurance  
13 Institute of America, I would like to thank  
14 you for allowing me this opportunity today.  
15 And I'll open it up for questions.

16 CHAIRMAN CAMPBELL: Great. Let's  
17 start down there.

18 MR. CAMPAGNA: I'm just trying to  
19 understand your comment regarding the purchase  
20 of insurance, and why you find that confusing.

21 Is it that we don't make a distinction  
22 between the payment of premiums associated

1 with the purchase of insurance versus the  
2 brokerage commissions that would be received  
3 in connection with the purchase of that  
4 insurance? Is that kind of the issue that you  
5 see?

6 MR. GILLIHAN: Well, I think  
7 that's part of it. I don't think that  
8 distinction is made in the preamble or in the  
9 proposed regulations.

10 But if you look at it, it's a  
11 fairly broad statement. I know you guys know  
12 what it is. We do not believe that the  
13 purchase of insurance is not in and of itself  
14 compensation to the service provider. And our  
15 fear is that that is a fairly broad statement  
16 and will allow service providers of fully-  
17 insured plans to construe any payment that  
18 they receive that's related to the purchase of  
19 insurance as being outside of these  
20 regulations. And without that distinction in  
21 the preamble, we feel that that further  
22 supports their argument that it would not be

1 included.

2 MR. CAMPAGNA: So you do see a  
3 distinction between a broker selling the  
4 insurance product and the provider of  
5 insurance providing insurance?

6 MR. GILLIHAN: Yes.

7 MR. CAMPAGNA: So that the broker  
8 is a separate service provider in your mind  
9 who should be disclosing the commissions that  
10 they receive as well as anything else they  
11 receive from the carrier such as these  
12 contingent commissions?

13 MR. GILLIHAN: That's correct.

14 MR. CAMPAGNA: Okay. Could you go  
15 into that a little bit more about what other  
16 potential payments that that broker may be  
17 receiving in connection with the purchase of  
18 insurance so that we can make sure that we  
19 would capture that idea?

20 MR. GILLIHAN: Sure. Sure.

21 There are bonuses that are often  
22 based not only on the volume of sales of a

1 particular insurance contract, but you might  
2 also have bonuses related to the purchase of a  
3 contract by a particular entity. For example,  
4 in a small area, you may have the purchase of  
5 insurance by a major hospital in that area for  
6 its employees. And that might result in a  
7 bonus, obviously the contingent commissions  
8 that are the volume sales.

9 Just for clarification, when I say  
10 contingent commissions, what I mean by that  
11 are those commissions that would be paid to  
12 me. Say I was selling insurance carrier X's  
13 policy, and I sold X amount during the year --  
14 or over X amount. Then I might receive an  
15 additional commission because I sold over X  
16 amount of volume commission.

17 The other, the most simple one, is  
18 a specific sale commission. That's a straight  
19 commission that is a percentage of the  
20 premiums paid to the plan.

21 And if you've not reviewed the  
22 language then, I'd be glad to go over that



1 here. The language that we've suggested would  
2 result in the disclosure of any compensation  
3 received that's directly or indirectly related  
4 to the purchase of insurance.

5 MR. CAMPAGNA: Now, are you aware  
6 of any other types of payments that brokers  
7 may receive in connection with sales of  
8 insurance? Anything other than commissions,  
9 any to be on the platform say of a particular  
10 broker and their recommendations to a plan?  
11 Is there anything else that we should be aware  
12 of?

13 MR. GILLIHAN: Well, and actually  
14 some of these were addressed in 2005-02A.  
15 Oftentimes you have someone who manages an  
16 agency and they might receive service fees or  
17 some type of managing fee for managing that  
18 agency. And if you recall from that Advisory  
19 Opinion, those were not considered to be  
20 commissions and not includable on the Schedule  
21 **A.**

22 **Outside of those general**

1 categories that I provided to you, I'm not  
2 aware of any other general categories. They  
3 may be characterized differently. But I think  
4 those categories encompass most of the  
5 compensation.

6 MR. CAMPAGNA: In connection with  
7 the provision of insurance itself, how would  
8 you draw the line between what is actually  
9 being provided under the policy and services  
10 that may be provided to a particular plan such  
11 as participant communication information  
12 regarding the policies -- those kinds of  
13 things? Would you draw that distinction? How  
14 would you kind of set that up?

15 MR. GILLIHAN: Well, let me step  
16 back even a step further if you don't mind.

17 I view that statement in the  
18 preamble, and perhaps I've misconstrued it  
19 maybe, or members have misconstrued it, as  
20 referring to the premiums and only the  
21 premiums that a plan sponsor or plan might pay  
22 to an insurance carrier. And so it seems to

1 me that we would not be including that in the  
2 definition of compensation and fees.

3           However, anything else paid by an  
4 insurance carrier or through a third party to  
5 an individual that relates to the purchase of  
6 that insurance should be disclosed. So I  
7 wouldn't draw the line in terms of -- perhaps  
8 the line is drawn between whether the  
9 insurance carrier provides it itself, or  
10 perhaps that might be where it's viewed where  
11 the insurance carrier provides those services  
12 itself as a result of that premium, or whether  
13 it's paid to an independent third party. I  
14 believe the idea that we had in mind when we  
15 submitted these comments were the independent  
16 agents and brokers that receive something from  
17 the insurance carrier.

18           MR. CAMPAGNA: Okay. Thank you.

19           MR. WILLIAMS: So are these  
20 disclosures currently being made -- the ones  
21 that you're proposing? You seemed  
22 enthusiastic about it. I'm just curious.

1 MR. GILLIHAN: I'm just a hyper  
2 guy.

3 The anecdotal evidence -- and I'll  
4 leave it at that -- from our members suggests  
5 that they are not being disclosed. I do not  
6 have statistics to give to you today. And I  
7 do not have personal observation of that. I  
8 just know that our members who are out in the  
9 field issuing self-insured administrative  
10 services-only agreements, the anecdotal  
11 evidence they've provided to us is that  
12 they're not being disclosed.

13 MR. WILLIAMS: So you favor more  
14 disclosure than is currently being provided in  
15 the interests of --

16 MR. GILLIHAN: I favor more  
17 disclosure than what is being provided in the  
18 market today consistent with what you've put  
19 in the proposed regs. Yes.

20 MR. WILLIAMS: In many cases,  
21 you're talking about agents who are not  
22 fiduciaries. I take it they're service

1 providers?

2 MR. GILLIHAN: That's correct.

3 MR. WILLIAMS: Okay. Thank you.

4 CHAIRMAN CAMPBELL: Were you here  
5 for the previous series of testimony from some  
6 of the other groups addressing welfare plan?

7 MR. GILLIHAN: I was here for the  
8 last about an hour and a half.

9 CHAIRMAN CAMPBELL: Okay. I was  
10 just wondering if you might have a reaction to  
11 some of the testimony we heard previously  
12 regarding the burden that the regulation might  
13 present to welfare plans and whether the  
14 welfare plan area is suited for this  
15 regulation.

16 MR. GILLIHAN: I think that health  
17 and welfare plans often do not -- they're not  
18 funded plans. And therefore, you don't have  
19 the direct correlation between plan assets  
20 being used to pay service provider fees in the  
21 same manner that you do with pension plans.  
22 Pension plans almost all -- all are funded

1 through a trust. Plan assets from the trust  
2 are used to administrative fees. You don't  
3 have that as often. Rarely do you have that  
4 in the health and welfare field.

5 I think that makes it perhaps more  
6 difficult for health and welfare plans.  
7 Obviously these regs are not limited to  
8 payments that directly correlate with plan  
9 assets. But I do think that could put an  
10 additional burden on health and welfare plans  
11 to have to disclose those fees or have to deal  
12 with those fees when oftentimes they're coming  
13 straight from the plan sponsor.

14 So do I think it could add  
15 additional burden? Yes. How significant is  
16 that burden? I don't know. We've spent  
17 several of those last few years advising  
18 clients to disclose compensation when it was  
19 received by them with respect to services  
20 provided by the plan. So I think it can be  
21 done obviously. But yes, I do think health  
22 and welfare plans may have a greater burden

1 than pension plans.

2 MS. DWYER: But following up on  
3 Mr. Campbell's question, do you see any  
4 regulation with regard to health and welfare  
5 plans?

6 MR. GILLIHAN: Do I see any  
7 regulation?

8 MS. DWYER: Yes. Do you see a  
9 need for regulation? You've given us a  
10 revision that you would propose in the  
11 regulation, but would you prefer we just don't  
12 do the regulation for health and welfare  
13 plans, or just delay it? What is it that you  
14 want?

15 MR. GILLIHAN: Well, I would have  
16 a lot less work to do if we didn't have it on  
17 the health and welfare side. That doesn't  
18 count for anything I'm sure.

19 But I think I see a general need  
20 for that. Sure.

21 MS. DWYER: I guess my question  
22 would be better put saying do you think

1           there's adequate transparency in the health  
2           and welfare arena at the moment? Obviously  
3           you've given the one piece that you don't  
4           think is transparent. But what about other  
5           areas?

6                           MR. GILLIHAN: Other than this one  
7           piece, I think you have a lot less indirect  
8           compensation than what you have on the  
9           retirement plan side. And that would go back  
10          to Mr. Campbell's comment and when I talked  
11          about the pension plans. Those pension plans  
12          are funded through a trust. Those trust funds  
13          are invested. You get the investment fees.  
14          You don't have that in the health and welfare  
15          arena.

16                           Oftentimes, it's a direct payment  
17          from a plan sponsor and the plan sponsor's  
18          general assets to the service provider, and  
19          you have less of the indirect compensation.  
20          And I view these regulations as being at least  
21          slanted toward the indirect compensation  
22          that's received. I think that's a fair



1 statement. And I think you have less than  
2 that in the health and welfare world.

3 So is there a need for these types  
4 of regulations for the health and welfare  
5 plans? Conceptually, yes. Less of a need?  
6 Yes.

7 MS. DWYER: Thank you.

8 CHAIRMAN CAMPBELL: Just to follow  
9 up one more time.

10 So unlike some of the other  
11 witnesses, your view is is not that it ain't  
12 broke, so don't fix it, but it might be just  
13 slightly bent? Is that kind of where you're  
14 --

15 MR. GILLIHAN: Slightly what?

16 (Laughter.)

17 CHAIRMAN CAMPBELL: Putting in a  
18 slightly colloquial way, you're saying it's  
19 slight bent, but not broken?

20 MR. GILLIHAN: Yes. Correct.

21 CHAIRMAN CAMPBELL: Okay.

22 MS. WIELOBOB: All right. My

1 questions kind of go to the practicalities  
2 of -- I'm sorry. She's passed. She didn't  
3 tell you that. But she told me she didn't  
4 have any questions.

5 MR. GILLIHAN: That's okay. I was  
6 going to stare at her until you --

7 MS. WIELOBOB: Until I got the  
8 point?

9 (Laughter.)

10 MS. WIELOBOB: Reporting these  
11 compensation arrangements or commissions. I  
12 understand that the commission paid to -- and  
13 I understand your position. You just want the  
14 level playing field for self-insureds and you  
15 think that this modification to their  
16 clarification that the definition of  
17 compensation would capture some compensation  
18 that the fully-insureds get. Is that correct?

19 MR. GILLIHAN: Correct. Can I  
20 tweak that slightly?

21 MS. WIELOBOB: Sure.

22 MR. GILLIHAN: It is a level

1 playing field. But it's in an effort to  
2 ensure that the plan fiduciaries have all of  
3 the information that they need.

4 Our concern is not so much for the  
5 self-insurers -- I mean, these clearly apply  
6 to self-insured --

7 MS. WIELOBOB: Right.

8 MR. GILLIHAN: -- service  
9 providers. If they're making the disclosure  
10 about the compensation fees they're receiving  
11 -- both direct and indirect -- and it's not  
12 happening on the fully-insured side because  
13 they're able to take advantage of a somewhat  
14 ambiguous provision in the preamble, then they  
15 don't have all the information that they need  
16 to make an informed decision.

17 MS. WIELOBOB: Okay. So as a  
18 practical matter, I understand that some  
19 commissions are maybe always, sometimes based  
20 on what the premiums ultimately are and then  
21 the take-up rates. Is that right? Some can  
22 be, or some form of overcompensation?

1 MR. GILLIHAN: I think it varies.

2 Sure.

3 MS. WIELOBOB: Okay. So that  
4 varies.

5 MR. GILLIHAN: The standard is a  
6 percentage of the premiums paid to the plan  
7 and then there are variations from that.

8 MS. WIELOBOB: Okay.

9 MR. GILLIHAN: Resulting in  
10 contingent or volume-type commissions is, I  
11 would say, the end of the reins on that in  
12 bonuses and what have you.

13 MS. WIELOBOB: So how would those  
14 be made known to a plan fiduciary in a  
15 meaningful way in that they are really after  
16 the fact? Some commenters say we realize that  
17 contingent commissions are after the fact.  
18 Really we would recommend that incentive  
19 compensation is disclosed categorically just  
20 to let plan fiduciaries know --

21 MR. GILLIHAN: In other words, you  
22 mean that we get contingent commissions and

1           that would be it?

2                       MS. WIELOBOB:   And this is the  
3           base for it.  I mean, would that --

4                       MR. GILLIHAN:     Not to I guess  
5           sound like I'm brown-nosing -- for lack of a  
6           better legal term -- but you guys did give a  
7           nice provision for formulas when you don't  
8           know the amount in advance.  And I think that  
9           these types of -- the specific sale  
10          commissions, obviously that's just a  
11          percentage at the bottom-line.

12                      As you go up, I don't know that  
13          it's any more difficult to provide a formula  
14          for the variations from what I would call  
15          specific sale -- the variations up from that.

16          And then it is for any of these other  
17          situations on the pension side for investment  
18          fees or 401(k) fees, or any of those where  
19          it's fairly complicated where I have to  
20          provide something in advance -- a formula in  
21          advance.  It gives you some idea, I think,  
22          that it can be done here as well just as

1 practically.

2 MS. WIELOBOB: One of the  
3 arguments you see is that wouldn't just be  
4 meaningful because it's just a formula. It's  
5 not a hard and fast number. But you're saying  
6 that that would be possible?

7 MR. GILLIHAN: Yes. I think it  
8 would be. I think it would be possible to  
9 make that a meaningful disclosure. It all  
10 depends on obviously how this ends up in the  
11 final regs and whether there's any more detail  
12 required when you provide a formula.

13 But the regs currently say a  
14 formula has to be provided that will allow the  
15 plan fiduciary within some reasonable  
16 certainty to determine whether those fees are  
17 reasonable or not.

18 And to be honest with you, I think  
19 almost any disclosure of -- not just  
20 contingent commissions, but anything that  
21 might give me some idea about what that's  
22 going to be -- would be meaningful.

1 MS. WIELOBOB: Thank you.

2 CHAIRMAN CAMPBELL: All right.

3 Thank you very much.

4 MR. GILLIHAN: Thank you.

5 CHAIRMAN CAMPBELL: And next up is  
6 the Chamber of Commerce.

7 MR. JOHNSON: Well, unlike the  
8 prior speaker, we're glad to brown-nose any  
9 time.

10 (Laughter.)

11 MR. JOHNSON: Well, thank you for  
12 the opportunity to testify before you today.

13 I am Randy Johnson. I'm Vice  
14 President of Labor, Immigration and Employee  
15 Benefits for the U.S. Chamber. And I'm  
16 accompanied by Aliya Wong who is the true  
17 expert in this area but is the pension policy  
18 for the Chamber.

19 And we appreciate the concern for  
20 greater transparency and plan fees and the  
21 effort to address these concerns embodied in  
22 the regulation. And we support full

1 transparency up to the level of what's  
2 practical. And of course, like everyone else  
3 who's testified today, we know there's a  
4 difficult balance to be struck between full  
5 disclosure and what plan sponsors and  
6 providers can actually do in the real world.

7 Now we have submitted comments  
8 with a variety of other groups for the record.

9 And we all realize I think as other ones have  
10 noticed, as more workers become dependent on  
11 individual account plans for retirement, it  
12 obviously becomes increasingly important to  
13 provide participants with information that  
14 would allow them to make well informed  
15 decisions.

16 Just as importantly, employers  
17 must be aware of fees associated with the  
18 plans they're sponsoring in order to fulfill  
19 their fiduciary duties. But given the very  
20 complicated nature of plan fee arrangements --  
21 and they become more complicated the more I  
22 dig into this reg and talk to Aliya and our



1 members -- it's not a simple task obviously to  
2 discern what information and what format will  
3 prove most meaningful to either employers or  
4 participants.

5 And so, in our view it's going to  
6 take more input and dialogue from all these  
7 different parties and experts. And as such,  
8 our primary recommendation today is that EBSA  
9 gather further information to respond to  
10 questions and concerns that were made.

11 I want to emphasize here that  
12 while we appreciate this hearing and we  
13 appreciate all the work that's gone prior to  
14 this hearing with the ERISA Advisory Council  
15 going back to 2004 and this opportunity to  
16 submit comments, we do sincerely believe that  
17 the process would be immeasurably helped if  
18 the Agency would hold more informal round  
19 table-like discussions with those to be  
20 governed by this regulation.

21 Comments in hearings are useful,  
22 but certainly at least in my experience as the

1 Special Assistant for Regulatory Affairs here  
2 at the Department of Labor back in the mid-80s  
3 and other employment, there is much to be  
4 gained and much to be learned by the  
5 regulators in really a more informal give-and-  
6 take about what are the real world problems  
7 that those who are to be regulated face when  
8 attempting to comply with a new government  
9 mandate.

10 Now let me emphasize to you that  
11 contrary to what many may think, the  
12 Administrative Procedure Act does not prohibit  
13 these kinds of informal gatherings. And of  
14 course, ERISA provides for informal rule  
15 making under Section 505 as distinguished from  
16 formal adjudications or formal rule makings.

17 Now forums need not be public such  
18 as this, nor everyone involved be invited to  
19 every meeting and every discussion. The  
20 Agency has broad discretion to structure these  
21 meetings to gather input as it sees fit.  
22 Indeed the courts have not just allowed these

1 kinds of meetings to occur, but they've in  
2 fact encouraged them. And in the case of  
3 Sierra Club v. Costle, the court noted by  
4 reversing the earlier Home Box Office decision  
5 which went the wrong way on this APA issue, it  
6 noted that ex parte communications could be  
7 considered in many instances to be beneficial  
8 when an agency issues a proposed rule.

9 I do want to take one second here  
10 to quote from the court. "Oral face-to-face  
11 discussions are not prohibited anywhere,  
12 anytime in the Act. Under our system of  
13 government, the very legitimacy of general  
14 policy making performed by unelected  
15 administrators depends in no small part upon  
16 the openness, accessibility, and amenability  
17 of these officials" -- you guys -- "to the  
18 needs and ideas of the public from which their  
19 ultimate authority derives, and upon whom  
20 their commands must fall." That would be us.

21 "Informal contacts may enable the agency to  
22 win support for its program, reduce future

1 enforcement requirements by helping those  
2 regulated to anticipate and shape their plans  
3 for the future and spur their provision for  
4 information which the agency needs." And  
5 that's of course out of the D.C. Circuit.

6 In the same vein, let me just  
7 quote from a recent analysis from an expert in  
8 the area, which I'll be glad to submit for the  
9 record. "Thus the APA prohibits ex parte  
10 communications in only two types of  
11 proceedings: formal adjudications and formal  
12 rulemakings. The APA does not, however,  
13 extend that ban to informal adjudications or  
14 informal rulemakings. It would be" -- and I  
15 think this is key. "It would be no more  
16 appropriate to ban agency decisionmaking from  
17 engaging in ex parte communications in  
18 informal rulemakings than to ban Members of  
19 Congress from engaging in off the record  
20 conversations with constituents who are  
21 interested in a legislator proposal pending  
22 before Congress."

1                   And I think we all know and are  
2 familiar with the informal give-and-take that  
3 occurs between Members of Congress and their  
4 constituents when they come in. And not all  
5 parties are represented at those kinds of  
6 meetings.

7                   The           Employment           Standards  
8 Administration recently held many in-depth,  
9 informal stakeholder meetings in its  
10 development of its recently issued proposed  
11 family medically-backed regulations. While  
12 these meetings occurred prior to issuance of  
13 the proposed reg, this model is still useful  
14 to consider following here we believe.

15                   And in conclusion, we recommend  
16 similar outreach in meetings with plan  
17 sponsors, mutual fund companies, third-party  
18 administrators,           investment           management  
19 companies, and in-house service providers  
20 whether together, separately or at times both  
21 and at times separate, to name a few examples.

22           We believe these kinds of meetings will go a

1 long way along with the kinds of forums you're  
2 holding today to provide information to you  
3 with regard to how a rule can be even more  
4 appropriately structured.

5 I think the summation of that is  
6 -- before I turn it over to Aliya -- is that  
7 I think we all know that if you close the  
8 doors and get behind a table and put pen to  
9 paper and you don't let people out of the room  
10 for five or six hours, you can get a lot done.

11 That doesn't mean it's closed or it's private  
12 or anything wrong is going on. The courts  
13 have said that's okay. You still have to  
14 issue a rule. It'll still be challenged in  
15 court. Well, maybe it won't be challenged in  
16 court. You did such a great job.

17 But this is the kind of give and  
18 take I think in my experience -- at least at  
19 the Department of Labor -- that you really can  
20 get a lot done in addition to these kinds of  
21 forums. And so we would recommend, and we've  
22 heard it from members who would like that kind

1 of opportunity to come in and meet with you on  
2 a more informal basis than I believe they've  
3 already had.

4 With that, I'll turn it over to  
5 Aliya who will go into some more substantive  
6 issues with regard to the regulation.

7 MS. WONG: I'd like to talk to you  
8 today about some of the things we've mentioned  
9 in our written comments that we think would be  
10 particularly useful to have as a round table  
11 discussion, or these informal conversations  
12 with.

13 As you're aware, we've supported  
14 the regulatory process in terms of providing  
15 guidance for plan fee disclosure. While  
16 statutory changes may later need to be made,  
17 we believe that the regulatory process  
18 provides a critical opportunity for comment  
19 and discussion that cannot be matched in the  
20 statutory process. And even with the amount  
21 of comment and discussion that has occurred  
22 thus far, there still remains significant

1 questions and concerns that our members  
2 continue to bring up with us, and that we  
3 think need to be addressed by the Agency.

4 Our written comments suggest that  
5 the Department should establish a de minimis  
6 amount expressed as a percentage of assets for  
7 the reporting of investment-related fees, and  
8 a materiality threshold for reporting plan  
9 services. The regulation as written could  
10 lead to situations that require the disclosure  
11 of a large number of service providers that  
12 receive compensation as a result of their  
13 relationship with a primary service provider.

14 Informal meetings between service  
15 providers and plan sponsors could be used to  
16 determine and clarify the appropriate level of  
17 disclosure. And this has been brought up by a  
18 couple of people earlier today in terms of  
19 what level of disclosure needs to be provided.

20 Our next recommendation involves  
21 the manner of the disclosure between service  
22 providers and plan sponsors. And again, this



1 is something that other commenters have  
2 mentioned during the day and there have been  
3 questions about during the hearing today.

4 In our written comments, we state  
5 that we don't believe the provision of  
6 disclosures from separate documents from  
7 separate sources is adequate for plan  
8 sponsors. And we do recommend that, to the  
9 extent a service provider is able to obtain  
10 information, that they do put that information  
11 into one single document. However, we realize  
12 that there are serious concerns about that.

13 And here's another area where we think it  
14 would be very useful to have a round table or  
15 informal meetings between service providers,  
16 plan sponsors and with the Agency to really  
17 develop the manner of disclosure that would be  
18 useful for all parties in this situation.

19 Finally, we recommend further  
20 discussions concerning the term material  
21 relationships. And again, this is an issue  
22 that we've heard about several times today.

1           The requirement to disclose material  
2 relationships is undefined and the source a  
3 significant concern in the retirement plan  
4 community. Convening a round table of  
5 interested stakeholders to vet concerns and  
6 possible solutions would contribute  
7 significantly to finding a working solution.

8           In addition to these specific  
9 areas we mention in our written comments, I  
10 think there are other areas such as discussing  
11 the relationships between mutual funds and the  
12 plan itself and the disclosures that may be  
13 necessary there. A conversation concerning  
14 the disclosures required under the Form 5500  
15 and the disclosures required under this  
16 regulation here -- 408(b)(2) -- and whether  
17 there are similarities or there are additional  
18 issues that need to be addressed, and finally,  
19 looking at the make up of the expense ratio  
20 and whether or not that provides enough  
21 information for a fiduciary to determine if  
22 the fees are reasonable.

1           I think all of you realize these  
2           issues have been raised today in various  
3           forms, and so we believe give the comments  
4           that have been made here today and from  
5           talking to our membership, there is good  
6           opportunity for parties to come together as  
7           Randy has mentioned either separately or  
8           together to discuss these issues further and  
9           hopefully come up with viable solutions.

10           On behalf of the U.S. Chamber,  
11           Randy and I thank you for the opportunity to  
12           provide you with these comments. And we are  
13           happy to answer any questions that you may  
14           have.

15           MR. CAMPAGNA: So you do believe  
16           there's a need for disclosure to the plan  
17           sponsor of some sort. It's just that we  
18           should talk more on an informal basis to  
19           stakeholders. Is that kind of the general  
20           idea?

21           MS. WONG: Well, of course we  
22           support disclosure.

1                   MR. JOHNSON: Well, coming over  
2 here I said to Aliya, I said now is the U.S.  
3 Chamber supporting a new mandate here? Let me  
4 get this straight. And I guess the answer is  
5 we are.

6                   We believe there is room for  
7 regulatory things in this area and the need  
8 for greater disclosure. Where that balance is  
9 struck, I --

10                  MS. WONG: And we'd like to point  
11 out, one of the parties that we submitted our  
12 comments jointly with was the Profit Sharing  
13 Council of America that testified earlier this  
14 morning. And just to echo their comment that  
15 while we do support disclosure, we think it's  
16 really important that plan sponsors also get  
17 the tools that are necessary to make sure that  
18 they can get the information that they need to  
19 make this determination and get the  
20 information that is put out in regulatory.

21                  MR. CAMPAGNA: An earlier  
22 commenter made the statement that it was very

1           difficult to come up with this unified form  
2           because of all the different types of  
3           industries out there.     Say insurance is  
4           different than mutual funds.   So the breakdown  
5           of fees -- insurance products are basically  
6           inherent in the rate of return as opposed to  
7           disclosed separately.   Do you see that as an  
8           obstacle to this uniformity reform?

9                         MS. WONG:   I think that's one of  
10           the reasons we encourage the use of a round  
11           table or informal discussion.   I think when  
12           parties come to you one on one, you get one  
13           aspect of the conversation as opposed to  
14           having a group in the room, and as Randy  
15           alluded to, hashing it out all together.

16                        MR. JOHNSON:   And we have service  
17           providers as members of the Chamber, and we  
18           also have plan sponsors.   And we tend to get  
19           more from the plan sponsors on our employee  
20           benefits committee.

21                        But my sense of this issue is if  
22           you've got these two parties together in a

1 room along with your experts, and there's  
2 probably some role in there for groups that  
3 represent participants, because obviously  
4 there's a separate rulemaking going on for  
5 participant disclosure. And you hash out what  
6 kind of form is doable that meets -- maybe  
7 it's not perfect, but it's the best one we can  
8 come up with -- rather than kind of, as Aliya  
9 said, going back and forth with these groups  
10 separately.

11 MR. CAMPAGNA: Thank you.

12 MR. WILLIAMS: Do you have a  
13 particular view about where disclosure  
14 mandates would best be suited to the current  
15 marketplace?

16 MS. WONG: In terms of a  
17 particular --

18 MR. WILLIAMS: Types of plans.

19 MS. WONG: In our comments, we did  
20 state that we -- as has been stated earlier by  
21 other groups -- that we think that  
22 particularly this regulation should be applied

1 first to defined contribution plans, that it  
2 should be considered in the defined benefit  
3 context. And we did not state that it  
4 shouldn't be applied, but that it should be  
5 given further consideration for defined  
6 benefit plans, and that we do think there are  
7 issues that need to be addressed as others  
8 have mentioned when it comes to health and  
9 welfare plans.

10 Does that answer your question?

11 MR. WILLIAMS: Yes. So within the  
12 context of this regulation, or in some  
13 separate proceeding, do you have a view on  
14 that?

15 MS. WONG: We made the comments in  
16 the context of this particular regulation.

17 From our membership, I think there  
18 was general surprise that the regulation  
19 extended to health and welfare plans. There  
20 wasn't the sense that there needed to be a  
21 regulatory discussion about disclosures there.

22 MR. WILLIAMS: Okay. So you see

1 the most immediate need as being in the  
2 defined contribution plan arena. And I would  
3 assume with the indirect compensation where  
4 there is less disclosure than the direct  
5 compensation?

6 MS. WONG: Right.

7 MR. WILLIAMS: And if you could  
8 summarize your particular approach to the  
9 indirect compensation of method, you're saying  
10 it would be better if you could have it all in  
11 one place, in one document that would be  
12 understandable to the plan fiduciaries of say  
13 a small business?

14 MS. WONG: Right. Our concern is  
15 that the disclosures that are required for  
16 plan sponsors to look over be helpful for all  
17 plan sponsors regardless of their level of  
18 sophistication.

19 And again, as others have  
20 mentioned, particularly for the small- and  
21 medium-sized employers, we don't want them to  
22 be overwhelmed or look at this as yet another



1           burden they have to face. So to the extent we  
2           can get this information simplified for them,  
3           and not only simplified but uniform so that  
4           they can compare it, we think that would be  
5           the best.

6                       MR. WILLIAMS: Okay. Thank you.

7                       CHAIRMAN    CAMPBELL:           Roughly  
8           speaking, what proportion of your members are  
9           sort of small- and mid-size businesses? What  
10          I'm going to do is I'm just trying to get a  
11          sense --

12                      MR. JOHNSON: Right. Right.

13                      CHAIRMAN    CAMPBELL:           I assume  
14          you're primarily speaking as a voice of small-  
15          and mid-size business plan sponsors and their  
16          interests here. Not exclusively, obviously.  
17          Your membership is diverse.

18                      MR. JOHNSON: Right. About 90  
19          percent of our membership is 100 or less  
20          employees. But I wouldn't say the dues  
21          structure reflects that breakdown. The dues  
22          structure tends to be -- we have a lot of

1 bigger members who pay us a disproportionate  
2 amount than smaller members. And one of the  
3 realities of trade association work as you  
4 know is it tends to be the bigger members that  
5 can send representatives to meetings. But we  
6 try and keep in mind the small businesses'  
7 needs and figure out what they are just as  
8 good staff. We have some very vociferous  
9 members in the small business community, and  
10 they certainly speak up when they have to be  
11 represented.

12 So as far as our dues base, it  
13 tends to come from bigger members. But our  
14 membership is comprised largely of smaller  
15 members if you define it 100 or less employees  
16 as distinguished from the level of 10 or less  
17 employees.

18 CHAIRMAN CAMPBELL: Well, I wasn't  
19 trying to inquire on your dues structure. I  
20 was just trying to get the perspective that  
21 you're bringing that I assume has a certain  
22 degree of small- and mid-size plan sponsor

1 interest in it.

2 And I'm curious in your  
3 communications with your members who are sort  
4 of in that category. How much are they  
5 telling you that they're having difficulty  
6 getting the information they feel that they  
7 need to carry out their fiduciary duty?

8 MS. WONG: We do hear from some  
9 that they would like to be able to get more  
10 information, more clarification.

11 I think what we hear more than the  
12 disclosure of information is that they have a  
13 tougher time negotiating their fees, and  
14 negotiating just generally for their  
15 contracts, so that one concern is that even if  
16 they're getting that information, what then  
17 becomes their responsibility once they have it  
18 if they can't negotiate for anything  
19 differently. So that's really the tension  
20 that we hear primarily from them.

21 CHAIRMAN CAMPBELL: Do you think  
22 the additional information that this

1 regulation might require should it be  
2 promulgated much as it is now, provide them  
3 that information would be useful in those  
4 negotiations in perhaps achieving better  
5 terms?

6 MS. WONG: It's hard to say. What  
7 I think the concern is that it won't make  
8 negotiations any easier, and then they're  
9 stuck with information saying that their plan  
10 fees are unreasonable because they are a  
11 smaller employer without the kind of  
12 understanding that they don't have the  
13 opportunity -- or not that they don't have the  
14 opportunity, but that's the way the  
15 marketplace has created those fees.

16 So the concern and the caution is  
17 that along with making this information  
18 available, there also needs to be education.  
19 And the concern really comes out in the  
20 participant disclosure side that once  
21 participants find out this information,  
22 they're looking at their plan which happens to

1           be a very small plan with high fees, and they  
2           compare that to a large plan that has smaller  
3           fees. If they don't understand really the  
4           market differences between those two, then  
5           that small employer might find itself subject  
6           to litigation or other liabilities that have  
7           arisen from trying to do something good.

8                         CHAIRMAN CAMPBELL: And is that an  
9           issue you think could be or should be  
10          addressed in this regulation?

11                        MS. WONG: To the extent it can  
12          be, I think it should.

13                        CHAIRMAN CAMPBELL: Do you have  
14          any thoughts on how someone might do that?

15                        MS. WONG: I'd like to get back to  
16          you on that, because I think that's something  
17          we can explore with our membership and  
18          definitely get you more ideas.

19                        MR. JOHNSON: In an informal give  
20          and take process.

21                        (Laughter.)

22                        CHAIRMAN CAMPBELL: I have no

1 further questions. Thank you.

2 MS. DWYER: Just one question for  
3 Mr. Johnson.

4 Would you repeat for us the name  
5 of the case that discusses the Administrative  
6 Procedure Act?

7 MR. JOHNSON: Yes. It's the  
8 Sierra v. Costle. That was in the D.C.  
9 Circuit, and it's famous because it reversed  
10 quickly the so-called Home Box Office case  
11 that was a few years before that held that ex  
12 parte communications were in fact prohibited.

13 And in fact, it's at 657 Fed. 2nd 298, 1981.

14 But if you look in Davis, it's the case and  
15 it's still good law. Great, great, great  
16 decision. It's by Judge Walt.

17 MS. DWYER: Thank you.

18 MS. ZARENKO: I just want to  
19 follow up on it sounds like you were touching  
20 on some scope issues. As you know in the  
21 proposed rule, the way we went about defining  
22 which service contracts and arrangements are

1 subject to the requirements of the proposal it  
2 was by categories and service providers. And  
3 it seems like you prefer more to go to a  
4 quantitative approach. Was that the plan  
5 asset threshold you were talking about, rather  
6 than the way we did it?

7 MS. WONG: I think within the  
8 context of the way you did it, there seemed to  
9 be a breadth there that might be even more  
10 than what was anticipated in writing the rule.

11 And so our concern or what we would like to  
12 see in terms of conversation is really talking  
13 about the limit of that.

14 So in one example when we're  
15 talking about disclosing material -- when  
16 you're talking about disclosing all of the  
17 service providers involved, if there's a  
18 percentage amount for the assets there. So if  
19 you're talking about someone who gets \$1 out  
20 of what's paid out of the \$10 million that's  
21 paid, do you have to go all the way down to  
22 that \$1? So I think within the scope of what

1           you have, looking at that to impose limits on  
2           that.

3                       MS. ZARENKO:   So it's no question  
4           that all of the compensation that's paid from  
5           the plan or compensation issues have to be  
6           disclosed, you're more looking to some of  
7           these indirect compensation and how far down  
8           the line are we --

9                       MS. WONG:   Right.

10                      MS. ZARENKO:   -- in terms of who  
11           we're considering to be a service provider?

12                      MS. WONG:   Right.

13                      MS. ZARENKO:   Okay.  So it's not  
14           that you want to do away with our scope  
15           provision and replace it with just a straight  
16           percentage of plan assets threshold?

17                      MS. WONG:   No.

18                      MS. ZARENKO:   Okay.

19                      MS. WIELOBOB:    She asked my  
20           questions.

21                      CHAIRMAN  CAMPBELL:   All right.

22           Well, thank you very much.



1 MS. WONG: Thank you.

2 MR. JOHNSON: Thank you.

3 CHAIRMAN CAMPBELL: And next up is  
4 Hewitt Associates.

5 MS. BORLAND: Good afternoon. My  
6 name is Allison Borland.

7 On behalf of my colleague, Cindy  
8 Milstead, and Hewitt Associates, we thank you  
9 for the time you're taking today to listen to  
10 us.

11 I lead our defined contribution  
12 consulting practice. I'm not a lawyer.

13 Cindy is a Senior Benefits  
14 Attorney in our Office of General Counsel.

15 For more than 65 years, Hewitt has  
16 provided best-in-class HR administration and  
17 consulting services to large organizations.  
18 As a market leader in benefits administration,  
19 we deliver benefit programs to millions of  
20 participants and retirees on behalf of  
21 hundreds of organizations worldwide.

22 As the largest independent record

1       keeper not affiliated with any investment  
2       management firm, we have a unique perspective  
3       to share on these proposed rules. We'd like  
4       to focus on three areas of the proposed  
5       regulations: the uniform fee disclosure,  
6       conflicts of interest, and the time line for  
7       compliance.

8               So we'll start with the uniform  
9       fee disclosure. Hewitt absolutely supports  
10      thorough fee disclosure to plan fiduciaries,  
11      and we always have, but provisions to the  
12      proposed rules are required so that  
13      fiduciaries can fulfill their responsibilities  
14      with respect to plan fees.

15             Disclosure of plan fees is  
16      critical for two reasons. First, to enable  
17      fiduciaries to determine whether the fees  
18      constitute reasonable compensation, thus  
19      satisfying the requirements for the prohibited  
20      transaction exemption under Section 408(b)(2)  
21      of ERISA; and second, to provide information  
22      needed for fiduciaries to act prudently and

1 solely in the best interests of plan  
2 participants and beneficiaries, as required by  
3 Section 404(a) of ERISA.

4 The proposed disclosure rules fail  
5 to support the two stated goals for two  
6 reasons. Number one, they fail to facilitate  
7 meaningful comparison of costs across plan  
8 providers because of different levels of  
9 disclosure for bundled and unbundled service  
10 providers. Plan fiduciaries will be unable to  
11 make apples-to-apples comparisons.

12 Second, they fail to provide  
13 sufficient information for fiduciaries to  
14 fully understand reasonable changes and plan  
15 expenses over time. This is because of the  
16 lack of disclosure of fees in bundled  
17 arrangements that vary by the number of  
18 participants compared to those that vary by  
19 asset size. To determine the reasonability of  
20 costs, fiduciaries must understand the major  
21 components of plan expenses regardless of the  
22 packaging, whether bundled or unbundled, as

1 well as the services provided by those costs.

2 Consider the two primary

3 components of services needed for an

4 individual account plan, which generally add

5 up to more than 90 percent of total plan

6 costs. First, investment management fees.

7 These vary, depending on the size of the

8 assets. These generally comprise the majority

9 of plan costs. Second, administrative fees.

10 This includes record keeping, communication

11 and education. These vary. The costs for

12 providing these vary by the number of

13 participants, not the asset size. This is a

14 key difference.

15 If you think about it, if your

16 record keeping account balance is \$1, it's the

17 same amount of effort to record-keep a balance

18 that's \$1 million. The asset size doesn't

19 matter.

20 Bundled providers generally build

21 all of these fees into the basis point charge

22 -- the asset base charge -- so that the fees

1 are paid as a percentage of assets each year.

2 While we don't argue this approach is  
3 unreasonable, the lack of disclosure of  
4 underlying expenses is a problem.

5 I'd like to walk through a simple  
6 example to illustrate what can happen if the  
7 underlying component costs included in the  
8 bundled basis point charge are not disclosed  
9 to and monitored by the plan fiduciary.

10 Consider a plan with \$100 million  
11 in assets and 3,000 participants. The total  
12 fee charged and disclosed is 90 basis points.

13 This covers 60 basis points required for  
14 investment management fees. It also includes  
15 30 basis points for non-asset-related costs --  
16 administration, record keeping, et cetera.  
17 This totals to \$100 per participant. However,  
18 only the 90 aggregate basis points is  
19 disclosed.

20 Over a period of three years,  
21 assets increased to \$300 million through  
22 contributions, roll-overs and investment

1 return. The participant count increases from  
2 3,000 to 4,000. Total fees remain 90 basis  
3 points. They're the same. There's no reason  
4 to trigger any concern on the part of the plan  
5 fiduciary.

6 However, with the growth of the  
7 assets, the fees for the administration and  
8 non-asset-related costs have now grown to  
9 \$900,000 from \$300,000. Per participant, they  
10 have grown from \$100 to \$225. The per-  
11 participant fee has more than doubled,  
12 although the services provided that vary by  
13 the participant count have not changed.

14 Looking at this example, it is  
15 impossible to argue that paying more than  
16 twice the per-person administrative fee over a  
17 three-year period is reasonable. If the plan  
18 sponsor was aware of this increase, it could  
19 use this information to consider alternate  
20 providers or to negotiate with the current  
21 provider and, potentially, either receive the  
22 same services at a lower cost or receive

1 additional services for the same cost.

2 Under the proposed rules with a  
3 bundled fee arrangement and a lack of  
4 disclosure of the costs of the underlying  
5 services, a plan fiduciary would never have  
6 the knowledge needed to identify the issue  
7 described in this example. The result is that  
8 plan participants are paying significantly  
9 more than needed for the services provided,  
10 which erodes the value of their retirement  
11 nest egg.

12 Ultimately, much of the problem  
13 here resides in the fact that a significant  
14 portion of plan costs are not dependent on  
15 asset size but on the number of participants.

16 When all costs are bundled into the asset-  
17 based fee, it is critical that the underlying  
18 components be fully disclosed in order for a  
19 fiduciary to make an informed and prudent  
20 decision.

21 Further, the example I just  
22 outlined reflects just one facet of the

1           problem although arguably the most common one.  
2           Similar issues arise in other instances when  
3           various changes occur within the plan, such as  
4           changing out funds, shifting asset allocation,  
5           and bearing investment performance.

6                         Consequently, because of the  
7           importance of complete disclosure, in order  
8           for fiduciaries to make prudent decisions  
9           about the reasonability of fees, we  
10          respectfully request that the final rules  
11          require the disclosure of the allocation of  
12          fees to affiliates and subcontractors in a  
13          bundled fee arrangement to promote uniform  
14          disclosure and a better understanding of plan  
15          fees.

16                        Next we'd like to talk about the  
17          conflicts-of-interest provision.         The  
18          conflicts-of-interest disclosure provision  
19          should be omitted from the final regulations.

20          If not omitted, this provision needs to be  
21          tightened up with additional detail and  
22          examples.       Existing law in the other



1 provisions of the proposed regulations should  
2 provide employers with sufficient information  
3 to judge whether any other business  
4 relationship of a service provider will  
5 compromise its performance under a contract.  
6 Both fiduciaries and service providers have  
7 always had to be alert to possible conflicts  
8 caused by other business relationships that  
9 might result in a prohibited transaction.

10 Moreover, prudent business  
11 practices dictate that clients should be made  
12 aware of any outside relationship that might  
13 appear to compromise the relationship in  
14 question. Therefore, the conflicts-of-  
15 interest requirements are duplicative and  
16 unnecessary.

17 If the conflict-of-interest  
18 provision is not omitted from the final rules,  
19 then it needs to be clarified. The provision  
20 requires a service provider to disclose any  
21 relationship with any entity that creates or  
22 may create a conflict of interest in

1 performing services under the contract. This  
2 requirement could be interpreted to encompass  
3 almost any business relationship the service  
4 provider may have. Given that the  
5 consequences of noncompliance may include the  
6 cancellation of service contracts, loss of  
7 business relationships and prohibited  
8 transaction penalties, most service providers  
9 may be inclined to interpret this too  
10 conservatively and overdisclose.

11 For example, Hewitt has over 5,500  
12 different U.S. business relationships.  
13 Accordingly, for some services, it is possible  
14 that we will have business relationships with  
15 several hundred different business entities.  
16 Most of these entities will not be related to  
17 the provision of our services for a specific  
18 client.

19 However, given that our business  
20 relationships relate to the same type of  
21 service, we may be inclined, based on the  
22 current language, to overdisclose. Our

1 clients would then have to perform due  
2 diligence and evaluate each such relationship  
3 as a potential conflict of interest, which  
4 could be a significant and unnecessary burden  
5 and also a deterrent to doing business with a  
6 large firm, which we do not believe is the  
7 intent of the regulations.

8 The time, effort and cost of this  
9 provision to all parties would be  
10 unjustifiably burdensome. We therefore  
11 request that this provision be omitted from  
12 the final regulations or at least better  
13 defined.

14 Finally, we'd like to talk about  
15 the timing of compliance. The preamble to the  
16 proposed regulations indicates that the  
17 regulations will be effective 90 days after  
18 publication. Given the amount of work that  
19 will be necessary in order to comply with  
20 these regulations, we request that service  
21 providers should be required to make a good  
22 faith effort to comply with these regulations,

1 but these regulations are not effective for at  
2 least one year after publication.

3           Additionally, the proposed rules  
4 are not specific regarding the treatment of  
5 existing contracts or arrangements. For large  
6 service providers such as Hewitt, there are  
7 several thousands of contracts. If the intent  
8 of the proposed regulations is that service  
9 providers must also provide required  
10 disclosure for existing contracts on the  
11 effective date, it would be impossible to  
12 comply within a 90-day window. We therefore  
13 request that for at least one year after the  
14 effective date of the final rules, service  
15 providers will be deemed compliant as long as  
16 they make the required disclosures by the end  
17 of the transition period.

18           We also request that the  
19 Department provide clarification that existing  
20 contracts do not have to be amended, rather  
21 service providers may meet these requirements  
22 by providing the required disclosures only

1 outside of the contract.

2 With that, we thank you again and  
3 we'll be happy to answer your questions.

4 CHAIRMAN CAMPBELL: Great. Start  
5 down here.

6 MS. WIELOBOB: I don't have any.

7 MS. ZARENKO: First, I want to  
8 follow up on that conflict-of-interest  
9 question.

10 Some of the other commenters have  
11 suggested that, instead of constructing it the  
12 way we did, we should just require that a  
13 service provider list all the companies with  
14 which it's affiliated. And I'm just -- in  
15 listening to your testimony, I'm thinking of  
16 well, that still could be a very large number.

17 Would that list be helpful to a  
18 plan fiduciary? Are we then shifting the  
19 responsibility and expecting the plan  
20 fiduciary to have to go research all 200 of  
21 those affiliated companies and determine if  
22 there is or isn't a conflict? I just want to

1           hear what your thoughts are on that as a  
2           suggestion to deal with the conflict-of-  
3           interest provisions.

4                       MS. MILSTEAD: Well, I think that  
5           that's exactly our concern that, if we give  
6           you a list of just the relationships for which  
7           we're getting compensation, that's fine. We  
8           do that pretty much now. But if it's anyone  
9           who might somehow be associated with the  
10          service we're providing and so that  
11          relationship -- because we have a relationship  
12          and we use another company to provide similar  
13          services for someone else -- if that is  
14          something that might have to be disclosed  
15          also, then you're getting into the  
16          overdisclosure.

17                      We would like more detail, so we  
18          know where to stop, so we don't have problems  
19          disclosing the relationships we have under the  
20          existing contract. Again, we should do that,  
21          and we do do that. But it's all of the  
22          tangential relationships we have.

1 MS. ZARENKO: Okay. A couple  
2 questions on bundling and allocation of  
3 compensation.

4 You mentioned in your comment  
5 letter that some bundled providers may refuse  
6 to disclose allocation information. We  
7 typically hear about this with smaller plans.

8 How often is that true first of all? And  
9 second, how often do you find that to be the  
10 case?

11 MS. BORLAND: Yes. Excellent  
12 question.

13 So we've heard several commenters  
14 today talk about the fact that large plan  
15 providers are extremely sophisticated. They  
16 get everything they need. Everybody discloses  
17 everything to large plan providers. And that  
18 has not been our experience. Sometimes that  
19 is true -- absolutely that's the case. Other  
20 times it's not at all true. Some providers do  
21 fail to provide additional disclosure into the  
22 depths of the different allocations.

1                   We did a survey last year and we  
2                   asked large companies whether they had even  
3                   calculated the total plan costs of their plan.

4                   So had they even pulled together all the  
5                   numbers regarding what fees and expenses were  
6                   going toward their plan? Sixty percent of  
7                   them said yes, which is up from 30 percent six  
8                   years ago. But that still leaves 40 percent  
9                   who haven't even done that. So I'd say maybe  
10                  greater than 50 percent of the time, service  
11                  providers provide complete and thorough  
12                  disclosure, but nothing close to 100 percent  
13                  of the time, even with large employers.

14                  MS. ZARENKO: When you're saying  
15                  complete and full disclosure, is that  
16                  consistent with the kind of disclosures we're  
17                  asking for in our rule? Or what's the  
18                  standard by which you're saying complete and  
19                  full disclosure?

20                  MS. ZARENKO: So if we talk about  
21                  a bundled service provider in the total  
22                  aggregate basis point fee for example, that's



1 absolutely provided every single time.

2 If an organization is trying to  
3 determine the amount that's attributable to  
4 record keeping versus the amount that's  
5 attributable to investment management, that is  
6 sometimes, but not always, disclosed. Now  
7 that's not required in your regulation. So  
8 our concern is that if the regulation goes  
9 through as currently written, that will then  
10 reinforce the bundle provider's ability to  
11 refuse additional disclosures about the  
12 details.

13 Now other types of disclosures  
14 like indirect compensation, typically, that is  
15 provided when asked, but it's not provided on  
16 a voluntary basis. And plan sponsors do not  
17 always know the right questions to ask to get  
18 that information.

19 MS. ZARENKO: Okay. In your  
20 comment letter, you generally support  
21 requiring a service provider to allocate the  
22 compensation or fees, but I didn't see any

1 limits on that. So are you talking every  
2 penny? Or it seems like today you're talking  
3 a lot about at least the record keeping versus  
4 the investment. Could you comment on that?

5 MS. BORLAND: Yes. We do  
6 absolutely support a materiality threshold,  
7 whether it's one basis point -- something to  
8 that nature. We do not want to get down to  
9 talking about number of postage stamps and  
10 number of soft drinks served at meetings. So  
11 only material components of costs, I think we  
12 would ask to be included.

13 MS. ZARENKO: And what's your  
14 reaction to the comments that we hear that  
15 when we're talking about affiliated service  
16 groups -- these allocation numbers don't  
17 really reflect the value of the services? We  
18 do it for tax reasons. We do it for other  
19 business record keeping reasons so that it  
20 would just further confuse a fiduciary, or not  
21 really educate them. I would just enjoy  
22 hearing your response to that.

1 MS. BORLAND: Sure. Well, so  
2 first we disagree.

3 MS. ZARENKO: Okay.

4 MS. BORLAND: I think when you are  
5 delivering services such as record keeping and  
6 administration, the cost -- what it takes to  
7 provide that service -- doesn't depend on the  
8 size of the assets. It depends on the number  
9 of people for whom you're providing that  
10 service -- the number of account balances.

11 Now there are other factors like  
12 the complexity of the plan, maybe the number  
13 of loans -- other things that may impact that  
14 as well. But again, that's going to be  
15 somewhat related to the number of plan  
16 participants.

17 An organization knows the general  
18 costs of providing two very different types of  
19 services within its own structure. So again,  
20 we just disagree.

21 MS. ZARENKO: Noted.

22 One more question. You also

1           mention in your letter that plan fiduciaries  
2           sometimes perceive services as being free.

3                       MS. BORLAND:   Yes.

4                       MS. ZARENKO:   It seems like there  
5           would be a competitive edge in educating plan  
6           fiduciaries that that's not the case and  
7           saying well, you might think that's free but  
8           it's not. And here's how it really works in  
9           here. Here's how those services are being  
10          paid for.

11                      Are efforts to try to educate plan  
12          fiduciaries about how that works just  
13          ineffective or you never get the opportunity?

14                      MS. BORLAND:   We do have the  
15          opportunity. And we've been fighting that  
16          battle for many years.

17                      Looking at things through that  
18          lens is more complicated. It's harder. It  
19          requires a higher level of sophistication to  
20          understand the full picture. Organizations  
21          who do look at it that way, we work with them  
22          just great, and we enjoy our relationships

1 with them. Other very large organizations  
2 aren't interested. That's been our  
3 experience.

4 MS. ZARENKO: Thank you.

5 MS. DWYER: You clearly want to  
6 break up the bundle and have the fees  
7 allocated within the bundle. Can you give  
8 more real-world examples of what information  
9 would be found if we do that, and how it would  
10 benefit plans?

11 MS. BORLAND: I think, as  
12 illustrated by the example, the biggest impact  
13 is that if a plan fiduciary understands the  
14 fees that vary by asset size, by participant,  
15 and also by transaction, the plan fiduciary  
16 can then understand reasonable changes in  
17 compensation over time. So if they switch out  
18 and add target maturity funds that have  
19 different fee structures, the plan sponsor can  
20 understand what would be reasonable for asset-  
21 based versus per-participant charges. It  
22 gives the plan fiduciary adequate information

1 to understand the nature of the fees and how  
2 they should change over time, so that, in  
3 order to be prudent, they don't have to go out  
4 to bid every single year because something in  
5 their plan has changed and they're no longer  
6 certain that that 90-basis points is  
7 reasonable given changes that have occurred  
8 within their plan. I think that's the biggest  
9 reason.

10 MS. DWYER: Thank you.

11 CHAIRMAN CAMPBELL: I guess one of  
12 the concerns that we've heard expressed to us  
13 on the bundling versus unbundling issue is, to  
14 what extent we are favoring a particular  
15 business model, and at the end of the day how  
16 much of a difference is there between them to  
17 the fiduciary who is evaluating what's coming.

18 The argument on one side is that, well, this  
19 one is providing three services for \$100, this  
20 one's providing five for \$110. As you  
21 evaluate all your RFPs, you can determine  
22 which one's the best deal by evaluating what

1           you need and what it costs, even if some were  
2           packaged and some were unpackaged -- bundled  
3           or unbundled?

4                         You've indicated an answer to some  
5           of that already.     But how do you really  
6           respond to that argument, especially to the  
7           extent that folks on the other side say, well,  
8           even if we did unpackage it, you would find  
9           that some of our charges are unrelated to the  
10          costs of the services but are allocated among  
11          affiliates for tax reasons or all sorts of,  
12          sort of, non-service provider issues?

13                        MS. BORLAND:   Well, I think some  
14          of that is important because if you're  
15          evaluating a fund's performance and the cost  
16          of the fees related to the fund performance,  
17          if you can't carve out the part of the cost  
18          that's specifically related to the investment  
19          management fees, it's harder to evaluate the  
20          quality of the fund and the services that  
21          you're getting for those dollars.

22                        In addition, when you're comparing

1 -- as someone mentioned earlier, Hewitt puts  
2 out RFPs that are hundreds and hundreds of  
3 pages. We also answer RFPs that are hundreds  
4 and hundreds of pages. It's not quite as  
5 simple as putting things on one page on a  
6 spreadsheet and comparing the two. You have  
7 to look at the scope of services being  
8 provided for the different fees. And when you  
9 can't break out the fees to compare the scope  
10 versus the fee, it becomes very difficult.

11 If the fund line-up was exactly  
12 the same for example, it would make it much,  
13 much easier. But the fund line-ups themselves  
14 are always different, unless the plan sponsor  
15 specifically requests a bid on a set line-up,  
16 which does occur sometimes. But that's the  
17 minority of cases.

18 CHAIRMAN CAMPBELL: Okay.

19 MS. BORLAND: Does that help?

20 CHAIRMAN CAMPBELL: That does. I  
21 guess the example that someone had used -- I  
22 very much hesitate to throw another car



1 example into this debate because it's always  
2 rife with too many -- but one of the examples  
3 that someone had used was well, when you go  
4 and buy car X versus car Y, and car Y is  
5 advertising that we have a bumper-to-bumper  
6 four-year warranty that covers wiper blades on  
7 down, you're not getting that for free.  
8 You're paying it, built into the price of car  
9 Y. And you as a consumer are able to make  
10 these decisions every day.

11 Why in this context is that  
12 different for fiduciaries of plans when it's  
13 appropriate for consumers of automobiles?  
14 Again, I recognize this is a ridiculous  
15 comparison, but indulge me nonetheless.

16 MS. BORLAND: When I shop for a  
17 car, I do want to know the difference between  
18 the premium package and the regular package --

19 CHAIRMAN CAMPBELL: Right.

20 MS. BORLAND: -- and whether or  
21 not leather seats comes with it, whether  
22 there's a fancy steering wheel. And I also

1 want to know the incremental costs of those  
2 additional features so I can decide what suits  
3 me best, and if it's worthwhile to go with the  
4 full bundle and get the price reduction, or  
5 buy a reduced bundle and add up features. So  
6 I argue that analogy is at least somewhat  
7 relevant, and works on our side as well.

8 CHAIRMAN CAMPBELL: Well, I should  
9 have wasted all our time with that, because  
10 this analogy --

11 (Laughter.)

12 CHAIRMAN CAMPBELL: -- is so  
13 flexible that's everyone's used it for all  
14 sides of every debate.

15 MS. BORLAND: That's right.

16 CHAIRMAN CAMPBELL: And with that,  
17 I think I'll stop talking.

18 MS. BORLAND: Okay.

19 MR. CAMPAGNA: Going back to your  
20 idea of uniform disclosure, and the need for  
21 apples-and apples-comparison, I go back again  
22 to a commenter that said that can't be done

1           because there are different products. You can  
2           compare insurance to mutual funds. A lot of  
3           the fees that are based in the insurance  
4           products are basically inherent in the rate of  
5           return that they're given, so it's impossible  
6           to break it out.

7                         So how do you compare apples-to-  
8           apples when there's apples and oranges? How  
9           would we go about doing that?

10                        MS. BORLAND:       That's a good  
11           question. And I've also heard a lot of talk  
12           today about a standard -- almost spreadsheet  
13           -- that could be used in all cases. And I'm  
14           not sure that's the right answer.

15                        I     do     think     more     specific  
16           guidelines about exactly the types of fees  
17           that need to be broken out or disclosed would  
18           be helpful. I think sample disclosures, so  
19           sample forms that could be used would also be  
20           helpful. I think there has to be the ability  
21           to customize and flexibility in there for  
22           different fee structures, different business

1 models, insurance versus mutual funds.

2 We're typically in a market where  
3 we don't see insurance providers on the record  
4 keeping side. So I'm not quite as familiar  
5 with their products as service providers in  
6 the aggregate, but I do think there needs to  
7 be a balance between flexibility and enough  
8 information to be able to perform an adequate  
9 comparison even if it's not exactly the same.

10 MR. CAMPAGNA: Okay. Going back  
11 -- not to belabor this bundling/unbundling  
12 business -- but in the 5500 project, we heard  
13 from the affiliates who like the bundled rule  
14 -- wanted a bundled rule -- and said that  
15 basically breaking it out really was kind of  
16 meaningless for them especially, because it's  
17 not really based on anything other than kind  
18 of a record keeping system on an in-house  
19 basis.

20 What basis would you use to  
21 approach affiliates for this kind of breakout?

22 Would it be a cost basis? What basis would

1           you use to break out those fees?

2                       MS. BORLAND:       That's a good  
3           question. And I'm not sure I have a firm  
4           answer.

5                       I do believe it's important to  
6           have assets that vary by -- costs that vary by  
7           asset size separate from costs that vary by  
8           participant count, separate from costs that  
9           vary by transaction. So there's three  
10          categories that work very differently in the  
11          cost change over time.

12                      With respect to affiliates, I  
13          think there's probably some flexibility there.

14                      I think the service provider would have to  
15          come up with the most meaningful way to do it  
16          within their business model, which would put  
17          them in the best competitive position compared  
18          to other organizations.

19                      So I don't know that you can  
20          mandate the internal allocation methodology in  
21          a lot of detail.

22                      MR. CAMPAGNA:   Okay. And then --

1 MS. MILSTEAD: And also --

2 MR. CAMPAGNA: I'm sorry. Go  
3 ahead.

4 MS. MILSTEAD: I'll also note that  
5 for 5500 purposes, that is as someone said  
6 earlier, an after-the-fact situation. And for  
7 this purpose. we're talking more about the  
8 before-the-fact and the disclosures at the  
9 time of the contract. So there's some  
10 differences.

11 MR. CAMPAGNA: Okay. And the  
12 conflict provisions, you object to our  
13 language. It should be omitted or tightened  
14 up. I'm really interested in what you believe  
15 would be acceptable for this purpose.

16 You mentioned the idea of  
17 potential versus actual conflicts, or whether  
18 the service has to relate actually -- or the  
19 conflict has to relate to the plan service. I  
20 think you read our regulation to say that it  
21 could include things other than relating to  
22 the plan service. I just want your reaction

1 on why you think that, and really basically  
2 what would be acceptable for this provision.

3 MS. MILSTEAD: We're still  
4 thinking about that, too.

5 But again, what would be  
6 acceptable would be relationships that exist  
7 that are related to the services provided as  
8 opposed to relationships that exist but have  
9 nothing to do with the specific contract  
10 provided. And maybe it's not that we wouldn't  
11 have any disclosure, but maybe it's saying we  
12 would make some more types of general  
13 disclosures such as Hewitt has revenue-sharing  
14 contracts with basically any number of fund  
15 families, but not with every single one,  
16 because it has nothing to do with the services  
17 we're providing to that particular client at  
18 the time. We would tell them specifically as  
19 we do now what our relationships are with the  
20 funds they have.

21 MR. CAMPAGNA: Okay. And lastly,  
22 I'm interested in that statistic you quoted

1           about 60 percent of even large employers  
2           receive full disclosure and 40 percent don't.

3           Where does this information come from? And  
4           how did you come up with this?

5                       MS. BORLAND: Let me clarify. We  
6           conduct a bi-annual 401(k) survey called  
7           Trends and Experience in 401(k) Plans. I  
8           actually have a copy in my bag, and I'm happy  
9           to leave it with you.

10                      We asked a question, how many plan  
11           sponsors have themselves calculated or  
12           attempted to calculate the total cost of their  
13           plan. So it's not focusing on full disclosure  
14           versus incomplete disclosure. It's focusing  
15           on the plan sponsor's calculation of the total  
16           cost of the plan. Sixty percent said yes.

17                      We do this every other year, so  
18           back in 2001 that number was only 30 percent.

19           So the trend is steeply increasing up, but  
20           that still means 40 percent of plan sponsors  
21           answered no.

22                      MR. CAMPAGNA: Okay.



1 MS. BORLAND: And by large  
2 companies for the survey purposes, that's  
3 typically employers with more than 1,000  
4 employees.

5 MR. CAMPAGNA: Thank you.

6 MR. BUTIKOFER: Okay. Going back  
7 to your bundled example, you want to break it  
8 out into these three different types of costs.

9 And my question, though, is if we break the  
10 bundle up and want them to separately  
11 disclose, are we really fixing the problem  
12 because we're breaking up the bundle? What we  
13 are really trying to get is we want them to,  
14 if it's asset-based, it should be disclosed as  
15 asset-based versus if it's a head, then it  
16 should be disclosed by a head. Because if you  
17 unbundle but they still disclose it as an  
18 asset-based fee, you're never going to pick up  
19 the difference. And if you don't change that  
20 basis-point fee to an actual dollar amount,  
21 you still will never make the comparison and  
22 figure out you're paying too much.

1 MS. BORLAND: I agree with you.

2 Our model is to use the per participant fee  
3 approach. We believe that is the best and  
4 most equitable model for plan participants.

5 However, that is a significant  
6 change from the way things are performed  
7 today, and we figure that was too much to hope  
8 for and too much to ask for. But in a perfect  
9 world, we think that's the right answer.

10 MR. BUTIKOFER: So are we really  
11 talking about unbundled, or do we want an  
12 actual dollar disclosure is what really is the  
13 solution?

14 MS. BORLAND: I'm not exactly sure  
15 I understand your question, because any basis  
16 point fee can be converted to a dollar number.  
17 Right?

18 MR. BUTIKOFER: True. And so in  
19 the example you're giving, it seems to me you  
20 were saying that they were not making that  
21 calculation?

22 MS. BORLAND: Correct. It wasn't

1 being provided. That's right.

2 MR. BUTIKOFER: But they should be  
3 able to make it on their own, should they not?

4 MS. BORLAND: Only if they know  
5 the basis points allocated to the record  
6 keeping and per-head costs.

7 In my example, only the 90-basis  
8 point aggregate fee was disclosed. The 30  
9 versus 60 split between investment management  
10 and per-participant administration costs was  
11 not disclosed in my example.

12 So we did the underlying  
13 calculation, but the plan sponsor did not have  
14 the information needed to perform that  
15 calculation. So we're suggesting it's  
16 important for the plan sponsor to at least  
17 have that information so that they can perform  
18 the calculation and recognize when there's  
19 excess revenue going to a service provider.

20 MR. BUTIKOFER: All right.

21 Thanks.

22 CHAIRMAN CAMPBELL: That'll do it?

1 MS. BORLAND: Thanks again.

2 CHAIRMAN CAMPBELL: Thank you very  
3 much.

4 All right. Fiduciary Risk  
5 Management.

6 MS. FLORES: I want to start by  
7 first saying thank you for the opportunity to  
8 address your Panel on such a controversial  
9 issue.

10 My name is Jessica Flores. I'm  
11 the Managing Director for Fiduciary Risk  
12 Management. And here today with me is Bert  
13 Carmody who is our Director of Fiduciary  
14 Consulting.

15 Fiduciary Risk Management is a  
16 firm that works with large plan sponsors on  
17 the retirement plan side of ERISA. We provide  
18 independent fiduciary services, audit and  
19 litigation support and independent employee  
20 education.

21 **A big part of what we do is**  
22 **conducting fiduciary compliance reviews to**

1 include comprehensive examinations of service  
2 provider relationships. Through these  
3 examinations, we've identified significant  
4 areas of misleading sales practices and  
5 disclosures, which in many cases had led to  
6 participant abuse and increased fiduciary  
7 liability.

8 The leaders of our firm have come  
9 from the inside of some of the industry's  
10 largest service providers. We are here today  
11 in response to the issues we've witnessed  
12 taking place in the retirement plan industry,  
13 and to make certain that both the  
14 participants' and fiduciaries' interests are  
15 well represented.

16 Because we focus solely in the  
17 retirement side of the business, we restrict  
18 our commentary to apply to that category of  
19 ERISA plans. So that's our full disclosure  
20 statement.

21 We want to start today by  
22 discussing the new burdens that are placed on

1       fiduciaries through these proposed regs. To  
2       simply execute this effectively, fiduciaries  
3       would have to understand the total inner  
4       workings of investment, consulting,  
5       administration and insurance companies, et  
6       cetera, et cetera, et cetera, to include how  
7       they structure professional affiliations, who  
8       their subsidiaries are, and then the  
9       subsidiaries of the subsidiaries and their  
10      relation to the organization, not simply their  
11      relation to the plan, as well as how the sales  
12      engineering department works with the finance  
13      and product departments to compute and manage  
14      various sources of revenue. This would have  
15      to be understood for each organization that  
16      may have a relationship to the plan. We've  
17      worked with some of the most sophisticated  
18      plan committees and have not seen anyone  
19      capable of figuring out this puzzle even if it  
20      was their full-time job every day to do so.

21                   We actually disagree with previous  
22      statements that the larger plan sponsor has

1           this figured out.     We service that group  
2           primarily as an organization, and we have yet  
3           to find very many plan sponsors who have a  
4           handle on this where we would say it was much  
5           more of a handle than what small service  
6           providers have or small plan sponsors have.

7                     The proposed regulations are  
8           written vaguely, which we understand is done  
9           so intentionally as a catch-all like many  
10          other parts of ERISA.   However, with vague  
11          rules and limited understanding of sources of  
12          service provider and investment industry  
13          compensation, how are fiduciaries going to  
14          know if they're getting the whole story?

15                    There are so many layers and  
16          sources of compensation when dealing with  
17          these various types of investment products and  
18          financial institutions.   How deep are we going  
19          with these regulations?   The vagueness of the  
20          rules can be interpreted many different ways  
21          depending on the fiduciaries' understanding of  
22          these service models.

1                   Are we asking fiduciaries to be  
2                   responsible for the regulation and disclosure  
3                   of the investment and insurance industries?  
4                   If we're not, then why would we require them  
5                   to police a system that has historically  
6                   escaped the requirement to disclose how they  
7                   earn revenue. Who will monitor, regulate or  
8                   oversee the disclosures to determine if they  
9                   are accurate, reasonable and can be relied  
10                  upon by the fiduciary?

11                  Our next point is what is new  
12                  about these regulations? Disclosure  
13                  requirements exist now -- 5500, Schedule A,  
14                  Schedule C. They've been around for a long  
15                  time. We have prospectuses, statements of  
16                  additional information. What has prevented  
17                  service providers from disclosing before?  
18                  What new behaviors are we going to expect from  
19                  these regulations?

20                  We are asking for several  
21                  different buckets of disclosures when we  
22                  already require disclosures. Just because we



1 ask more questions, does that mean we're going  
2 to get more answers and more accurate answers?

3 We read that a prohibited  
4 transaction will occur if service providers  
5 fail to comply. However, back to our previous  
6 point of the depth of disclosure required, the  
7 rules are vague. Does compliance mean all  
8 sources of compensation in relation to running  
9 investments, and the plan platform including  
10 those investments sold directly to  
11 participants? Will key areas of compensation  
12 sources and conflicts of interest be  
13 disclosed?

14 Some examples of some key areas  
15 where these compensation sources can exist, we  
16 can start with investment-related. Of course,  
17 you have the expense ratios that are commonly  
18 disclosed in prospectuses. But you also have  
19 trading fees. You've got securities lending.

20 You've got custodial relationships. There  
21 are sub-advisory level compensation. And then  
22 there's this new trend to layer trust and

1 layer funds to create additional areas for  
2 compensation. Are we going to dig into these  
3 things through these regs?

4 What about product offerings that  
5 are oftentimes sold through retirement plan  
6 relationships -- through DC plans primarily?  
7 Self-directed brokerage accounts, guaranteed  
8 interest accounts -- there are significant  
9 management spreads that are built inside  
10 guaranteed interest accounts and are typically  
11 not disclosed to plan sponsors through a  
12 negotiation process making for competition  
13 that can sometimes be deemed unfair.

14 What about asset allocation funds?

15 These are typically funds on top of funds,  
16 and sometimes on top of funds again.  
17 Oftentimes we see the management of the asset  
18 allocation model itself fee being disclosed,  
19 but we don't see the underlying allocation of  
20 the fund expenses being disclosed in addition,  
21 which could make these numbers much, much  
22 higher than what is being reported currently.

1                   And then what about participant  
2                   level product sales? This has been a very  
3                   controversial issue of these regs. Insurance  
4                   products are very oftentimes sold through DC  
5                   plans. Are the compensation that is generated  
6                   from these insurance product sales going to be  
7                   included in this?

8                   What about roll-over products as a  
9                   result of access to these participants that  
10                  come out of these plans, or roll-over other  
11                  assets in the 401(k) when they call into call  
12                  centers. There's an overwhelming increased  
13                  focus on capturing and retaining these assets  
14                  as baby boomers continue to retire. We  
15                  recommend that the required disclosures  
16                  include IRAs as we've seen this as a very  
17                  lucrative marketplace for service providers.

18                  What about service providers  
19                  compensation directly by the plan sponsor and  
20                  not through the plan? These relationships  
21                  usually fall into consulting categories who  
22                  will probably be the first place fiduciaries

1 turn with these disclosures and reporting  
2 responsibilities. It is very common for the  
3 benefit consulting houses to participate in  
4 relationships that would impose conflicts of  
5 interest. If they are not required to  
6 disclose simply because they bill the plan  
7 sponsor directly, how will fiduciaries know if  
8 they're getting their information from the  
9 right sources? We fear these conflicts will  
10 continue to permit substandard guidance to  
11 fiduciaries.

12 Unfortunately, there's not a  
13 requirement for independence of consulting  
14 firms at the present time. Will these  
15 regulations change this? If not, will the  
16 efforts be well served?

17 We believe the requirement of  
18 reporting conflicts should be irrelevant to  
19 fiduciary status. Most fiduciaries hire these  
20 experts to rely upon for fiduciary compliance  
21 and advice. They should be informed of  
22 material conflicts that exist.

1                   We also are very concerned about  
2                   the disconnect of regulatory agencies and the  
3                   effects on fiduciaries.     The disclosures  
4                   necessary to make these regulations effective  
5                   as intended fall under other regulatory  
6                   purview.   How will plan sponsors deal with one  
7                   agency mandating the rules -- the Department  
8                   of Labor -- when other agencies like the SEC  
9                   and OCC may be controlling the information?

10                   The SEC is already publicly  
11                   acknowledging their inability to effectively  
12                   monitor investment company disclosures.   This  
13                   is the key reason they have not increased the  
14                   depth of required disclosures already.   In a  
15                   statement from the SEC published recently,  
16                   they propose creating a new self-regulatory  
17                   organization simply to give these issues the  
18                   necessary attention.

19                   Bert actually has a handout that  
20                   he's going to pass out just to provide an  
21                   example of my next point.

22                   This is an illustration of a

1 collective trust fund. And this is a real  
2 fund that we dissected recently.

3 While the OCC has historically  
4 maintained strict disclosure policies in  
5 regards to collective trusts, and these  
6 investments are frequently noted for their  
7 transparency and cost effectiveness for plan  
8 sponsors. Our team has recently directed one  
9 of these vehicles to provide an illustration  
10 to this Panel to provide the multiple areas of  
11 hidden compensation.

12 As you can probably already tell,  
13 this is a very complicated diagram. And it's  
14 complicated for us who look at these things  
15 every single day. Could you imagine the  
16 complicatedness for fiduciaries?

17 These trusts are often layered  
18 with other trusts or funds and do not report  
19 the various areas of the layered compensation  
20 that is driven from these investments,  
21 therefore making the investment vehicle to  
22 appear much more cost effective than it really

1 is.

2 We are seeing these collective  
3 trust arrangements becoming much more  
4 convoluted in this era of plan sales than they  
5 were back when they were popular in the early  
6 '90s. We believe that much of this is due to  
7 the new pressure placed on compensation.  
8 Service providers believe they must show less  
9 compensation to be competitive, yet their own  
10 shareholders demand record returns every  
11 quarter. In order to satisfy both parties,  
12 they must earn maximum revenue on their  
13 products while disclosing a minimum portion to  
14 decision makers.

15 FRM is very concerned about the  
16 new areas of misleading practices being formed  
17 around collective trusts. As we've shown in  
18 this illustration, many of the trusts invest  
19 in multiple layers of other trusts, but then  
20 circle back and invest in the original trust.

21 We see no advantage to investors who use a  
22 product that is managed like the one in this

1           example, yet we are seeing these arrangements  
2           marketed very aggressively right now.

3                       We entirely disagree that current  
4           prospectuses even come close to properly  
5           disclosing to investors.       And that's  
6           regardless to which regulatory agency they  
7           fall under.

8                       And we don't even have time today  
9           to discuss what's going with state insurance  
10          commissioners, so we'll leave that one alone.

11                      If we're serious about getting  
12          accurate disclosures, why aren't the agencies  
13          working together?     And we do have a  
14          suggestion; let's not just complain.

15                      We recommend that the Department  
16          require a separate certified filing that fully  
17          discloses the business practices and sources  
18          of revenue of all organizations providing any  
19          service that has a relation to an ERISA plan.

20                      This will avoid the concerns that business  
21          models vary.   And quite candidly, they're not  
22          varying that drastically.   And there's not



1           that many different models.       This is not  
2           difficult. This is not rocket science, as has  
3           been claimed repeatedly.

4                       The Department should make certain  
5           that service providers describe their business  
6           models and sources of compensation to avoid  
7           the ongoing game of shells that continues to  
8           exist in this industry. This should not be  
9           done according to the proposed regulations,  
10          where a bundled service provider would  
11          disclose       the       compensation       business  
12          arrangements for all participating firms.  
13          This has been the traditional way of gathering  
14          disclosures on the Schedule C, and for  
15          fiduciaries. And this has not proven to be  
16          reliable. This report should be provided to  
17          the Department of Labor and plan fiduciaries  
18          that are existing clients of the service  
19          provider.

20                      In the case of the bundled service  
21          provider relationships, each participating  
22          firm should certify their own disclosures on

1 the form, and the form should ultimately be  
2 filed by the bundled service provider. In  
3 addition to the filing, a certified statement  
4 that shows the breakdown of allocation of such  
5 revenue that has been generated from the plan  
6 and its investments as well as the revenue  
7 produced by offering participants additional  
8 services and products should also be provided.

9 We suggest that all service  
10 agreements -- both existing and new -- be  
11 required to comply with these regulations in a  
12 timely manner. We do not agree that providing  
13 these disclosures is overly burdensome for  
14 these service providers. Their cost  
15 accounting and revenue departments have  
16 already computed these figures on their books  
17 of business. And yes, it is figured all the  
18 way down to the plan level prior to  
19 negotiating these fees and prices up front.

20 The fiduciaries' responsibility  
21 under this scenario would be to gather the  
22 disclosures and determine the ongoing

1           suitability of their service provider  
2           relationships and continue to run their  
3           businesses, but they would not be responsible  
4           for the totality and accuracy of such  
5           disclosures.

6                       The key problem with our  
7           suggestion is of course the right to have  
8           trade secrets protected. These are companies  
9           that compete against one another. However,  
10          even with the current proposed regs, we  
11          believe that most of the larger service  
12          providers will provide a degree of disclosure  
13          that meets satisfactory levels and then  
14          classify other areas of compensation under the  
15          purview of trade secrets.

16                      We do not think these regulations  
17          should offer trade secret protection if they  
18          are to be effective. We are not requiring  
19          them to disclose how they make investment  
20          decisions or manufacture their products, but  
21          simply to disclose how they earn money from  
22          the \$17 trillion sitting in America's

1 retirement system.

2 We encourage the EBSA to set the  
3 standard for appropriately defining fiduciary  
4 and service provider relationships as it  
5 relates to qualified retirement plans.

6 And we thank you for the  
7 opportunity to share our perspective and  
8 experience with your Department. And we  
9 welcome any questions that you have.

10 CHAIRMAN CAMPBELL: Great. Thank  
11 you. Let's start down there.

12 MR. CAMPAGNA: I'm just trying to  
13 boil down your testimony.

14 (Laughter.)

15 MR. CAMPAGNA: So up front, you  
16 believe there are misleading sales practices  
17 and many pension consultant relationships have  
18 conflicts.

19 MS. FLORES: Absolutely.

20 MR. CAMPAGNA: So our regulation  
21 attempts to deal with that.

22 MS. FLORES: Yes.

1           MR. CAMPAGNA: But then at the  
2 fund level, you're saying that the current  
3 regime of disclosure through the SEC and  
4 otherwise just doesn't work, and you're  
5 advocating this self-certification process?

6           MR. CARMODY: You had mentioned  
7 earlier Form ADV as an example. I think that  
8 came up in one of the conversations this  
9 morning.

10           But if you think about what an ADV  
11 does, it's sort of at the fund practice level,  
12 and it doesn't relate to a specific plan. And  
13 the burden to determine what the decisions are  
14 land on the plan fiduciaries. And SEC's at  
15 the fund level. So we're seeing a lot of  
16 expenses -- a lot of other things that don't  
17 make it to the plan level. We see the  
18 prospectuses. It does not provide sufficient  
19 disclosure.

20           MR. CAMPAGNA: What do you think  
21 about what we have in the proposed regulation?

22           There is indirect compensation at the sales

1 level, plus the idea that the bundler would  
2 point to where in the prospectus would be this  
3 information regarding indirect compensation.  
4 Is that helpful? Or is the prospectus just  
5 not a good document?

6 MS. FLORES: The prospectus  
7 alludes to the fact -- if you read an SAI or a  
8 prospectus, it'll say this fund participates  
9 in securities lending. This collective trust  
10 participates in securities lending. This  
11 trust has transaction costs. This trust may  
12 invest in other sub-advise trusts. But it  
13 does not describe how much revenue is actually  
14 generated.

15 We've dissected plans and  
16 collective trusts and mutual funds that are  
17 securities lending to their own affiliated  
18 products to earn additional revenue on the  
19 money in the retirement system. Now, an  
20 argument that we hear every single day about  
21 this is well, that's reflected in performance.

22 Well, if that's the case, then why are we

1 worried about expense ratios or anything if it  
2 comes down to performance?

3           There's a huge degree of variation  
4 in a fund that meets a prudent investment  
5 requirement that just says it keeps up with  
6 some benchmarks. It keeps up with its peer  
7 groups. It's got a relatively inexpensive  
8 expense ratio with something that's performing  
9 in the top quartile every single quarter. And  
10 a lot of these differences in performance when  
11 you find an allocation in the fund of similar  
12 investments can be due to the inefficiencies  
13 in the way they management these things -- the  
14 way that they handle transaction costs, the  
15 way that they address securities lending.  
16 There's a lot of inner workings going on in  
17 these funds that is not being addressed. And  
18 the SEC is looking at it but they really just  
19 don't know what to do with the information.

20           PANEL MEMBER CAMPAGNA: So correct  
21 me if I'm wrong again, so you're advocating at  
22 the fund level at least that there be some

1 kind of allocation of the specific services  
2 that the fund performs down to the individual  
3 plan level, not just here's what the fund  
4 charges but tell the plan what they are paying  
5 as a result of their --

6 MS. FLORES: Absolutely. But it's  
7 not even being disclosed from a general  
8 investor platform. We're not asking them to  
9 take something that's a whole 100 percent of  
10 information and then allocate the percentage  
11 that's applied to this particular plan. It's  
12 not getting disclosed at any level.

13 PANEL MEMBER CAMPAGNA: Thank you.

14 PANEL MEMBER WILLIAMS: Go ahead.

15 PANEL MEMBER DWYER: Well, I want  
16 to follow up on Mr. Campagna's question. Give  
17 us more examples. What's happening? What is  
18 happening that is not being disclosed in the  
19 SEC disclosures? Give us one to --

20 MR. CARMODY: Let's use our  
21 collective fund example, because a lot of  
22 mutual funds run the same way. Okay?



1                   If you were to look at this -- and  
2                   again I'm just going to pick on a couple. But  
3                   what you don't see here is how much money's  
4                   being made on premium income. Again, not  
5                   disclosed because what that would do, it would  
6                   actually lower the price of the investment.  
7                   Any of the interfund lendings, or any of the  
8                   other types of securities lending, which  
9                   particularly among affiliates. The accountant  
10                  in me says do an intercompany elimination and  
11                  determine what the real cost is. But if I'm  
12                  having a cost on one side and yet another  
13                  affiliate, not another reporting umbrella's  
14                  getting the income on the other side at the  
15                  net entity level, there's no cost. Or the  
16                  cost is substantially less. This is why we  
17                  get very, very cynical about -- or certainly  
18                  skeptical about some of the compensation  
19                  disclosures because we know they're missing  
20                  the mark.

21                  And then when you have  
22                  relationships like this, Rube Goldberg could

1 not have done a nicer job designing this  
2 schematic. This is all public information.  
3 We basically traced transactions through a  
4 variety of 5500 relationships from a very,  
5 very large financial provider. But when  
6 you've got these things, then what's a plan  
7 sponsor fiduciary going to do? Because  
8 ultimately, he's the one that's got to make  
9 sense out of all this, and he's got to have a  
10 good idea of how this works. And we're  
11 concerned about that. And we think that the  
12 providers need to basically disclose what  
13 these relationships are. Some of these are  
14 messy. Some of these are complicated. But  
15 the providers are not the ones that are facing  
16 litigation. They're actually beholden to you  
17 folks to make sure that we've got a right clue  
18 on how they should do their fiduciary duties.

19 This is complicated.

20 MS. FLORES: Well, if you look at  
21 this diagram, what's most concerning is this  
22 multiple arrows that go back and go right down

1 the path again. So it's an ongoing repeated  
2 process.

3 How in the world is a fiduciary  
4 going to figure out what the true underlying  
5 compensation is when if you read the  
6 prospectus on this particular collective  
7 trust, it discloses 15 basis points. And that  
8 is only the top level of collective trusts,  
9 which is a group of collective trusts that  
10 invest in other groups of a collective trust,  
11 and other groups and other groups, and then  
12 circles back and invests in the top group  
13 again and goes all the way back down the line.

14 Why does the investment need to be  
15 this complicated? How do they even manage  
16 these investments? How can you even dissect  
17 this investment to determine whether or not  
18 the underlying investments is prudent?  
19 There's one problem. But two -- what's the  
20 purpose of making this so complicated? And  
21 the purpose is because we are constantly  
22 pressuring service providers to be more cost

1 effective and shareholders are constantly  
2 pressuring them to earn more revenue. They  
3 have got to find somewhere to put it. And so  
4 where they're finding it to put it is to layer  
5 out these vehicles to a point where it's so  
6 complicated -- and people aren't this  
7 question. They're not asking for disclosure  
8 on these underlying investments and how much  
9 they're earning on them.

10 MR. CARMODY: Here's another  
11 example. And we look to self-directed  
12 brokerage account, because that's essentially  
13 a nondisclosed area because most plan sponsor  
14 fiduciaries basically say, hey, you paid your  
15 money, you take your choice. Well, you have  
16 very, very high transaction charges in there.

17 You have very, very high things all the way  
18 around.

19 Great -- great income opportunity  
20 for platforms. Very, very -- not at all  
21 disclosed to the plan sponsor fiduciary. And  
22 yet it's their investment. It's under their

1       auspices. It's under their control. It's  
2       under their piece. Wonderful income place.  
3       Not disclosed.

4                   MS. FLORES:     And we're seeing  
5       conflicts of interest that exist right now  
6       with the self-directed brokerage accounts.  
7       When you call into the call center, we saw one  
8       particular plan that in less than a year of  
9       having a self-directed brokerage account --  
10      this is a billion dollar plan -- \$200 million  
11      had already went into the self-directed  
12      brokerage account. Twenty percent of assets  
13      in a year moved to the self-directed brokerage  
14      account. That is producing an enormous amount  
15      of revenue that no one even discusses.

16                   Now, without some level of  
17      participant level pushing and advisory, I  
18      don't understand how an organization that was  
19      not that sophisticated if you look at their  
20      demographics of participants had 20 percent of  
21      their assets head there in less than a year.  
22      We find this as a significant area of abuse.

1                   And that's why we're encouraging  
2                   the Department to consider what's going on the  
3                   participant level. It's not just the plan  
4                   level. There is so much going on in the  
5                   participant level that is yet to even be  
6                   discussed in this forum.

7                   MR. CARMODY: Another example is I  
8                   heard something about free services earlier in  
9                   a couple of our conversations. Nothing is  
10                  free and we've all come to that rather awkward  
11                  conclusion. And as Jessica alluded to  
12                  earlier, one of the major things that folks do  
13                  is they want to capture those roll-over  
14                  assets. What kind of sales is going on there  
15                  and what kind of fees?

16                  There is some litigation on that  
17                  now. But I think it's a larger question. And  
18                  that is if I'm sponsoring a plan -- I'm a plan  
19                  sponsor fiduciary -- and my employees are  
20                  being sold product in which the service  
21                  platform is getting a great deal of revenue, I  
22                  should at least have a clue as to what that is

1 and use that as part of my negotiation. But  
2 at the very least, I'd be at least disclosing  
3 what their practice is. What are you selling?

4 At what share class? What kind of products?  
5 What kind of process do you have?

6 And that's a whole area that --  
7 although it's not directly fee-related, it's a  
8 practice that's very, very similar to this  
9 whole issue of disclosing fees. It's all a  
10 big secret. And the plan sponsor fiduciaries  
11 are on the hook. And that's what we're  
12 concerned about.

13 PANEL MEMBER DWYER: Thank you.

14 PANEL MEMBER ZARENKO: Okay. I  
15 just want to repeat what I think I'm hearing  
16 from you. You tell me when I slip off here.

17 So definitely room for  
18 improvement?

19 MS. FLORES: Yes.

20 PANEL MEMBER ZARENKO: And you do  
21 think there should be mandated disclosures on  
22 the part of all service providers to plans?

1 MS. FLORES: Absolutely.

2 PANEL MEMBER ZARENKO: You don't  
3 think the proposed regulation that we issued  
4 gets it right. But do you still think the  
5 Department of Labor should be getting into  
6 this business?

7 MS. FLORES: Absolutely.

8 PANEL MEMBER ZARENKO: Okay.

9 MS. FLORES: Somebody needs to be.

10 PANEL MEMBER ZARENKO: Okay. And  
11 then to the extent -- I'm sure you realize --  
12 some of the issues that you're talking about  
13 go beyond our statutory jurisdiction. And I  
14 think what I'm hearing you say is to a plan  
15 fiduciary, that kind of thing means nothing.

16 MR. CARMODY: That's right.

17 PANEL MEMBER ZARENKO: That you  
18 want the information so you get together with  
19 the other regulators --

20 MR. CARMODY: If it's the IRS or  
21 the DOL or the SEC at it's doorstep, that's  
22 the government. And if you think about it,



1 he's not going to sit there and do the  
2 interagency who's on first, what's on second.

3 But we are concerned because as we  
4 see things move out as people try to disclose,  
5 where are they going to go? Are they going to  
6 try to figure out in places that have less  
7 disclosure. Gee, what are those vehicles?  
8 Things that you folks don't normally see a  
9 lot, and that lands under the OCC or the SEC,  
10 because those are not things that you normally  
11 look at in the normal deal, or we don't see in  
12 other places. So we're all kind of chasing  
13 each other.

14 PANEL MEMBER ZARENKO: Okay. In  
15 your comment letter, you suggest that our  
16 proposed regulation creates more problems than  
17 it solves, and the danger of trying to define  
18 what information has to be disclosed means  
19 people will just shift their business  
20 practices or call it something else to not  
21 disclose it.

22 So if that's true, what do we do?

1           You can't just have a regulation that says  
2           you must disclose everything, and we really  
3           mean it. So what do we do?

4                   MS. FLORES: And that's part of  
5           our suggestion of why they need to be able to  
6           describe their business practices. There's  
7           not that much variation in business practices  
8           of service providers servicing this thing.

9                   You've got very large insurance  
10          companies. You've got very large mutual fund  
11          companies. And then you've got this new  
12          arrangement of these collective trusts that  
13          have kind of come back around. It's an old  
14          arrangement. It's a new arrangement again  
15          because it's more complicated than ever.

16                   It's not that varying between all  
17          the varying providers that -- there's no  
18          secret why wholesalers move around from one  
19          product to another. It doesn't take them that  
20          long to get up to speed on the next product at  
21          the next company they go to work for. And  
22          it's because it's not that much different.

1           See, what you need to start by is  
2           understanding -- I mean, there should be some  
3           sort of certification process. If you're  
4           going to have access to America's wealth -- to  
5           American household wealth -- retirement plan  
6           assets represent 39 percent of American  
7           household wealth. If you're going to have  
8           access to that money to our economy, then you  
9           must abide by these rules. You must declare  
10          how you run your business, how you get paid,  
11          what your interests are, why do you care about  
12          roll-over accounts.

13                 Let's just be honest here. It's  
14                 all about assets and money. That's why you  
15                 care about roll-over accounts. You don't  
16                 really care if the guy can live out his  
17                 retirement for the next 40 years. It's about  
18                 money. It's all about money.

19                 And they need to be able to take  
20                 what they do as a business and a marketing  
21                 package and turn it into dollars and present  
22                 it to the Department if they're going to

1 service this business.

2 PANEL MEMBER ZARENKO: So I think  
3 it sounds like a priority and disclosure for  
4 you is not just dollars but business  
5 practices?

6 MS. FLORES: Exactly. Because  
7 business practices are going to tell you where  
8 the additional dollars are.

9 PANEL MEMBER ZARENKO: And just  
10 knowing the dollars isn't enough?

11 MS. FLORES: Yes. And any --

12 PANEL MEMBER ZARENKO: Because  
13 either it's not complete it or it doesn't  
14 explain the conflicts that are --

15 MR. CARMODY: It's a set up for  
16 the dollars. Let's go back to the roll-over  
17 piece. Because if I'm on a service provider  
18 side, and I'm actively selling roll-over  
19 accounts to terminating participants, that's a  
20 whole big huge income piece picked up that I  
21 don't normally disclose. That's a business  
22 practice that at the very least needs to be

1 disclosed to the plan sponsor fiduciary.

2 MS. FLORES: Another big trend  
3 that we've seen all too many times, especially  
4 as independent education providers who charge  
5 a fee per head for our service, we compete  
6 everyday against major financial firms that  
7 will go in and provide 10,000 employees free  
8 education. That is very, very generous for an  
9 organization with profitability margins like  
10 these financial organizations.

11 They're not providing this for  
12 free. They're going in there and they're  
13 asking participants to do other ancillary  
14 business with them.

15 If you just looked at well, is  
16 this particular company paid a fee from the  
17 plan for providing this? No. But they have  
18 open access to the participants. They're  
19 communicating about the plan. They're  
20 providing information on the plan. And  
21 they're using that as an entree to sell  
22 additional product.

1                   That needs to be known to the  
2 Department if you're going to truly protect  
3 the interests of participants, because it's  
4 not just what happens to this money while it's  
5 sitting in the plan, but what happens when  
6 it's rolled out of the plan.

7                   MR. CARMODY:     Another example.  
8 Sub-TA fees. Sub-transfer agent fees.

9                   Up until recently, a very, very  
10 large mutual fund provider that sold  
11 exclusively through brokers basically had a  
12 two-tiered fee arrangement. Twelve dollars a  
13 head went back to the service provider if they  
14 had full marketing access to the records. If  
15 they could not, only got names, Social and  
16 address just to do it, then they would pass  
17 back \$3. Okay?

18                   Now is that disclosed normally to  
19 a plan sponsor fiduciary? The answer's no. I  
20 think the comment by the lady from Hewitt  
21 basically saying that 60 percent of your large  
22 plan accounts have a clue as to what fees are,

1 I'm surprised it's that high. Because when  
2 you see these things going on -- folks are  
3 running their businesses and trying to do  
4 something in line, folks are way ahead of  
5 them. And that makes it hard for them to do  
6 their job.

7 PANEL MEMBER WIELOBOB: I have one  
8 quick question. You've heard some other  
9 witnesses today -- I assume you have -- say  
10 that disclosure of business practices would  
11 hurt the market, be anticompetitive, trade  
12 secrets and so forth. How would you respond  
13 to that in this context?

14 MS. FLORES: We completely  
15 disagree because if you go to any national  
16 conference -- I encourage you all to go attend  
17 one -- from some of the associations, and you  
18 go and listen. There's breakout sessions, and  
19 every single advisor is running around in the  
20 breakout sessions and they're learning how to  
21 market roll-over products. And they're  
22 learning how to do best practices.

1                   And service providers -- I don't  
2                   care if you go from one to the next. One  
3                   might be a little better at providing employee  
4                   education. One might have a team that's all  
5                   over the U.S. And one just might have 10  
6                   people in a local office. It is irrelevant.  
7                   In most instances, these things are run almost  
8                   identical.

9                   These are not trade secrets. It's  
10                  not that hidden. This is not trade secrets.  
11                  It's not like they're manufacturing a secret  
12                  recipe to a cake. We're not asking them to  
13                  divulge how they get their investment returns  
14                  in the top quartile. We're asking them to  
15                  divulge how they earn money. And that's not  
16                  really a trade secret.

17                  PANEL MEMBER WIELOBOB: Thank you.

18                  MR. CARMODY: Thank you.

19                  CHAIRMAN CAMPBELL: Thank you very  
20                  much.

21                  MR. CARMODY: Thank you.

22                  CHAIRMAN CAMPBELL: Next is Mr.



1 Hutcheson.

2 MR. HUTCHESON: Good afternoon.

3 Thank you. Can you hear me okay?

4 My name is Matthew Hutcheson, and  
5 I serve as an independent ERISA 321 fiduciary.

6 And I appreciate the opportunity to speak to  
7 you today.

8 American workers who participate  
9 in qualified retirement plans are not being  
10 adequately protected, but they easily could  
11 be. Currently, plan decision makers --  
12 whether plan sponsors or participants -- have  
13 no way of knowing much less understanding the  
14 crazy quilt of costs embedded in retirement  
15 plans. I want to speak today on behalf of the  
16 millions of plan participants who trust that  
17 we will finally enable fiduciaries of  
18 qualified plans to discharge their duties  
19 solely in the interests of plan participants  
20 and beneficiaries for the exclusive purpose of  
21 providing benefits.

22 Things are different now than they

1           were when ERISA was originally enacted. The  
2           recent Supreme Court decision in LaRue v.  
3           DeWolff casts a sobering line on today's  
4           reality. Accounts are now predominantly under  
5           the control of participants who have become  
6           decision makers with respect to plan assets.  
7           So disclosure to plan participants has never  
8           been more necessary.

9                            Their decisions impact the  
10          retirement income security of not only  
11          themselves but also of their beneficiaries.  
12          And ERISA has always afforded equal  
13          protections to beneficiaries. And that's an  
14          important aspect of my testimony today.

15                         If decision makers, whether named  
16          fiduciaries or simply those with discretion  
17          with respect to plan assets or operations,  
18          lack possession of and understanding of plan  
19          costs, they cannot judge whether any such cost  
20          is reasonable. Most providers of investment  
21          products and plan services claim that they  
22          have no duty to disclose costs to decision

1 makers. Yet decision makers have a duty to  
2 know and understand those costs.

3 In a vacuum of information,  
4 prudent decision makers cannot assume that the  
5 cost of any service is reasonable, and  
6 therefore cannot comply with ERISA's sole  
7 interests and exclusive purpose rules. And  
8 those rules exist for the protection of  
9 participants and beneficiaries. And plan  
10 beneficiaries are almost always in the dark,  
11 even from the plan participant.

12 When all relevant information is  
13 available to buyers and sellers of products  
14 and services, and they freely agree to an  
15 exchange of value, then it is safe to judge  
16 that the costs reflected in the transaction is  
17 fair and reasonable. In those circumstances,  
18 decisions can be made in the sole interests of  
19 participants.

20 The simple solution I offer today  
21 is a method of disclosing all costs in an easy  
22 to understand format. It enables decision

1 makers to judge prudently whether costs are  
2 reasonable in relationship to the services  
3 provided.

4 There are five necessary elements  
5 of full and fair disclosure. First, the  
6 disclosure of gross and net returns expressed  
7 in dollars.

8 Second, the disclosure of net  
9 rates of return for each fund at both the plan  
10 and the participant level expressed in  
11 percentages. These good folks here pointed  
12 out probably the most important thing you'll  
13 hear in this testimony and in this hearing, is  
14 that there is a huge difference between fund  
15 level costs and returns at fund levels, and  
16 the returns that a participant receives. And  
17 therein lies the key difference.

18 A comparison of the net returns  
19 for the account or a plan as a whole against -  
20 - this is the third item -- a comparison of  
21 the net returns for the account or a plan as  
22 whole against the standard index that reflects

1 the net rate of return for that participant or  
2 the plan could be achieved through a broadly  
3 diversified market tracking portfolio. In  
4 other words, if a participant was in the  
5 market to determine what's reasonable, it's  
6 just compare what their net rate of return is  
7 to what they could have actually received had  
8 they done nothing except been broadly  
9 diversified.

10 Fourth, a standard report format.

11 And fifth, a disclosure of conflicts of  
12 interest of any. And I'd like to clarify.

13 406(b) of ERISA says that disclosure of  
14 conflicts of interest are relating to the  
15 impact at a participant level, or to a plan.  
16 So I believe in conflicts of interest being  
17 disclosed that could be adverse to the  
18 participant or the plan.

19 Let me lay out each of these in a  
20 little more detail. The difference between  
21 gross and net returns is equal to the total  
22 costs for any period. It's as simple as that.

1           By disclosing gross and net returns with a  
2           breakdown           between           investment           and  
3           administrative costs causing the gap between  
4           the two, any decision maker can at a glance  
5           quickly compare the costs for given services.

6           The details from which the total investment  
7           and administrative costs are derived should  
8           also be available to any decision maker upon  
9           request.     And I believe that means the  
10          fiduciaries, the plan sponsor or the  
11          participants, or the beneficiary for that  
12          matter. If they want to know what the cost is  
13          of each of the services that they're buying,  
14          they should know.

15                   And I hate to go back to the car  
16          analogy, but I don't see it as the price of  
17          the car and all of the components of the car.

18          I don't view it that way at all. I see the  
19          price of the car -- whatever that is -- and  
20          then the cost to drive it. I want to know the  
21          cost of the insurance. I want to know the  
22          cost of the registration to register it. I

1 want to know the cost to drive the car, not  
2 just to buy it. That's what I want to know.

3 Cost details should be delivered  
4 in a timely and complete manner. Generally,  
5 costs are immediately known by those charging  
6 them, and could easily be provided to decision  
7 makers within 20 days following the end of a  
8 reporting period.

9 We should avoid a system of  
10 definition-dependent disclosure that allows  
11 providers to coin new terms or implement new  
12 techniques that circumvent the intent of  
13 regulations. We see this very game being  
14 played now in the case of revenue sharing  
15 because it by name was not specifically  
16 defined in the statute.

17 Let's face it. Providers of  
18 financial services will always try to be at  
19 least one step ahead of the regulators. They  
20 can hide costs faster than legislators or  
21 regulators can find them. Any method other  
22 than gross to net disclosure simply prolongs

1 the game of blind man's bluff that has gone on  
2 too long.

3 This simple gross to net  
4 disclosure method catches all fees and arms  
5 decision makers with sufficient information  
6 and understanding to assess the reasonableness  
7 of the costs of operating or participating in  
8 the plan. It ends the opportunity and  
9 temptation to hide costs once and for all.

10 The second element is to disclose  
11 the true net rates of return expresses  
12 percentages on a fund-by-fund basis, and to  
13 clarify, at a participant level -- the real  
14 rate of return for a participant. True net  
15 rates of return mean the returns for a  
16 specific plan or participant account for the  
17 relevant period. By contrast, fund level  
18 rates of return are generally not helpful  
19 because those do not capture costs incurred at  
20 the plan level or more importantly, at the  
21 participant level. This element reveals the  
22 effects of participant choices in fund



1 selection and also captures costs incurred at  
2 an individual level, for instance, when a  
3 participant is charged for borrowing against  
4 his or her account balance.

5 The third element provides context  
6 and meaning for disclosure. Everybody's  
7 grasping and struggling to figure out what we  
8 need to know. What you need to know is any  
9 cost that is charged to a participant account  
10 is dollars that they won't have for retirement  
11 income security when they're old. And so, to  
12 measure this you have to have some reasonable  
13 way of saying what could I have had had I done  
14 a simple broad market investment. And I'll  
15 explain this.

16 So by contrasting real net rate of  
17 returns with what could have been had the  
18 planner/participant invested in the broad  
19 market through a low-cost portfolio, this  
20 third element of disclosure is not just  
21 another benchmarking scheme. Decision makers  
22 are regularly told that more and/or better

1 services equate into better net rates of  
2 return despite the added cost.

3 I'm an independent fiduciary. I  
4 am the purchaser of goods and services on  
5 behalf of the participants in the plans who  
6 hire me. And I have people come in all the  
7 time and say we offer all of these services,  
8 therefore our product offering is better than  
9 somebody else's. Well, if the performance is  
10 better and it results in greater income for  
11 the participants to spend when they're old, I  
12 agree. But that's not the case. And how do  
13 you know? That's what I'm trying to convey to  
14 you is there is a method of determining and  
15 cutting through all this.

16 Sponsors and participants have a  
17 right to know the bottom-line results  
18 regarding the relationship between costs and  
19 performance. Establishing a broad market  
20 tracking point of comparison enables decision  
21 makers to determine whether the net  
22 performance of a plan justifies its cost.

1 Underperforming the index reveals that there  
2 is an easily avoidable problem either with  
3 poor portfolio construction, excessive costs,  
4 or both, and it enables decision makers to  
5 correct those problems to enhance future  
6 retirement income.

7 The fourth element is standardized  
8 reporting. Uniform disclosure enables  
9 fiduciaries and participants to compare  
10 investments with a plan and one service  
11 provider against another service provider.  
12 Appendix A -- and Mr. Williams, I'm not sure  
13 if you got my email with Appendix A, but I  
14 emailed it. It'll also be available on the  
15 internet if people want to see it. It's also  
16 included in my letter that I sent -- my  
17 comment letter.

18 The Appendix A is that grid laying  
19 out what I believe to be an ideal standardized  
20 method of disclosure that when delivered  
21 promptly to decision makers will enable them  
22 to make prudent choices regarding services,

1 servicing and serving the best interests of  
2 participants. The format for disclosure  
3 accurately summarizes historical information  
4 in a manner that is easily understood by  
5 decision makers with varying levels of  
6 expertise, and therefore is useful in making  
7 decisions that benefit the plan and its  
8 individual participants.

9 The fifth element of disclosure is  
10 conflicts of interest. A detailed statement  
11 that clearly discloses the names of  
12 individuals or entities whose interests are or  
13 could potentially be -- and here's the  
14 qualifier -- adverse to the interests of the  
15 plan or the interests of its participants is  
16 essential. It should contain facts and  
17 circumstances and other written explanations  
18 and clarifications. For example, revenue  
19 sharing including its amount and purpose  
20 should be disclosed in this purpose because  
21 it's compensation shared between service  
22 providers.

1           I know I need to wrap it up. So  
2           this hearing is not about the well-being of  
3           service providers or the financial service  
4           industry, or even about me. It's about the  
5           plan participants. And I believe that this  
6           form of disclosure as I've described to you --  
7           those five elements -- will indeed protect the  
8           interests.

9           And my final comment is this. At  
10          the end of the day, we're not suggesting that  
11          we should control the industry. And we're not  
12          suggesting that plan sponsors or participants  
13          should be told what to do. All we're saying  
14          is tell them what the purpose of the services  
15          are and what the economic impact of those are,  
16          and then let them make their own decisions.  
17          But that's how everything else works. And we  
18          should demand that also.

19          And I appreciate the opportunity  
20          to testify. And I'll take your questions.

21                   CHAIRMAN CAMPBELL: Okay. We'll  
22          start over here.

1                   PANEL MEMBER WIELOBOB: So in your  
2                   example, you're looking at like a per  
3                   participant illustration of net and gross?

4                   MR. HUTCHESON: That's exactly  
5                   right.

6                   And this is an important thing.  
7                   Anything that can be done at the plan level  
8                   can be split out at the participant level.  
9                   Anything that can be done at the participant  
10                  level can be rolled up to the plan level. So  
11                  saying that it's too difficult to do one or  
12                  the other is not the case.

13                  PANEL MEMBER WIELOBOB: And that  
14                  was my question. So you're actually talking -  
15                  - we're talking here about informing plan  
16                  fiduciaries.

17                  MR. HUTCHESON: Right. And so --  
18                  but it's both. It's combined into one.

19                  If you can provide plan  
20                  fiduciaries with the gross to net, you can  
21                  provide anybody with that information if they  
22                  want it.

1                   PANEL MEMBER WIELOBOB: We've been  
2 talking is indirect service providers and  
3 their compensation. This would all be rolled  
4 into that, I presume -- into the numbers?

5                   MR. HUTCHESON: That's right. And  
6 I want to clarify. Even though the format of  
7 disclosure is simple as you look at it, there  
8 has to be detail that backs it. And that  
9 detail is sum totaled into the simple  
10 disclosure.

11                   We hear that plan participants  
12 will become overwhelmed or frightened or  
13 discouraged by too much information. Well, I  
14 just summarily disagree with that. I mean,  
15 people are smart. We're adults. We pay our  
16 bills. We work hard. We do what we can to  
17 get ahead in this world. And they're capable  
18 of understanding this stuff.

19                   But it starts with a simple  
20 disclosure statement. And then the detail  
21 behind it of who's providing what services and  
22 what those services are for, and whether

1           there's conflicts of interest is absolutely  
2           key to being able to provide something that is  
3           so simple like this.

4                         PANEL MEMBER WIELOBOB: Thank you.

5                         PANEL MEMBER ZARENKO: One follow  
6           up. You sort of talked through what you think  
7           plan fiduciaries need to know. Do you have  
8           any comments about the way we approached it in  
9           our proposed regulation? I just can't tell if  
10          you sort of feel like that just missed the  
11          mark, or in revising to a final rule we need  
12          to keep these things in mind.

13                        MR. HUTCHESON: Yes. The latter.

14                        First of all, I applaud you for  
15          the hard work that you did. Clearly, you're  
16          trying to get to the issue of this matter.  
17          And I appreciate that very much.

18                        I didn't want to come and split  
19          hairs on the proposed regulation. What I'm  
20          saying is look, at the end of the day, we've  
21          got to provide something to participants  
22          that's meaningful and easy to understand.



1           The first question is, is it  
2 possible to provide full disclosure. Yes.  
3 The difference between gross and net returns  
4 is the cost, and it encompasses everything.  
5 And that cost is relevant to a lot of things -  
6 - constructing portfolios, estimating real  
7 rates of return over time, constructing a  
8 portfolio with a profit risk profile. If  
9 costs are higher and people don't internalize  
10 that, they may create a portfolio that has  
11 less risk, and to adjust you have to increase  
12 the costs because you've got to increase the  
13 volatility of the fund trading -- whatever.  
14 Those are examples.

15           So the issue in the regulation  
16 that I disagreed with is that bundled service  
17 providers can't be treated differently for the  
18 reasons that have been stated in the last  
19 couple -- if you disclose an expense ratio  
20 that pays for something other than fund  
21 management, that's not good. I want to know  
22 what I'm paying for. And so if there's

1 subsidies built into the expense ratio, those  
2 need to be identified and exculpted out,  
3 carved out and reported separately. Hiding  
4 things in aggregate form, like in a prospectus  
5 for example, is not helpful to fiduciaries or  
6 participants.

7 And the prospectus -- the very  
8 name denotes forward-looking estimate. That's  
9 what prospectus means. It's not the real  
10 thing. What the real costs or what happened  
11 after the fees are charged, and that's why you  
12 have to get down to the plan level and/or the  
13 participant level to find out what's being  
14 assessed.

15 PANEL MEMBER ZARENKO: I think a  
16 lot of your discussion has focused on costs.  
17 And I want to go into a little terminology  
18 here. Our reg focuses on compensation that's  
19 received by the service provider.

20 MR. HUTCHESON: Right.

21 PANEL MEMBER ZARENKO: And I just  
22 want to make sure we're talking about the same

1           thing. I'll give a real easy example.

2                        But say if a participant takes out  
3 a loan, I think our contract would require if  
4 that costs \$50 to take out a participant level  
5 loan.

6                        MR. HUTCHESON: Right.

7                        PANEL MEMBER ZARENKO: That's the  
8 compensation to the service provider --

9                        MR. HUTCHESON: Right.

10                      PANEL MEMBER ZARENKO: -- if the  
11 participant chooses to take out the loan.  
12 That's I think what we're envisioning. When I  
13 think of the costs to the service provider,  
14 maybe \$18, or \$32, or whatever it is.

15                      MR. HUTCHESON: I see your point.

16                      I'm talking about what's charged and assessed  
17 to the plan or to the plan participant for  
18 whatever the service is. That's what I'm  
19 talking about.

20                      The reason why I use the term cost  
21 is because just last week, I got one of these  
22 contracts that was previously discussed. And

1 in there, there are fees defined in one  
2 category. And then the next paragraph, there  
3 are charges. And the next paragraph, there  
4 are assessments. And the next paragraph,  
5 there are allowances. They're all costs. You  
6 can call them whatever you want. I want to  
7 know what they are. And so our fees are only  
8 this? All right. Well, what are your  
9 charges, allowances, assessments and  
10 everything else? Tell me all those.

11 So when I say costs, we're talking  
12 about --

13 PANEL MEMBER ZARENKO: So we are  
14 talking about the same thing?

15 MR. HUTCHESON: Yes. And there's  
16 one other thing that I don't think your  
17 regulation contemplated. And that is the  
18 transaction costs.

19 The brokerage commissions can be  
20 quite substantial when somebody is trying to  
21 get a better than market rate of return, and  
22 they're turning over the assets within the

1 funds, they're incurring brokerage  
2 commissions. And there's also other friction  
3 that's costs. And those are just as relevant.

4 Those transaction costs can be equal to or  
5 greater than the fund expense ratio itself.  
6 In fact, a number of years ago, thestreet.com  
7 published -- they looked at a fund that had a  
8 one percent expense ratio, had a five-star  
9 rating from Morningstar, and had 800 basis  
10 points in transaction costs -- not disclosed.

11 That's nine percent fee on one fund. The  
12 participants thought they were being charged  
13 one percent.

14 Now in an efficient market --  
15 that's contested all the time -- I believe the  
16 market is efficient, therefore trying to beat  
17 the market and charging all those trading  
18 costs is a futile exercise, and participants  
19 need to make up their mind. Do they want to  
20 embrace an approach where they try to beat the  
21 market? If yes, how much does it cost?

22 And it has to do with the validity

1 of what's reasonable to an individual or to a  
2 decision maker. Because reasonable means  
3 something different to me than it does to you.

4 But you start with disclosing the economic  
5 impact and then let the people make their own  
6 mind up about what reasonable is.

7 PANEL MEMBER ZARENKO: Thank you.

8 PANEL MEMBER DWYER: Those  
9 brokerage commissions, would they be disclosed  
10 anywhere at anytime --

11 MR. HUTCHESON: Yes.

12 PANEL MEMBER DWYER: -- under the  
13 current regulatory regime?

14 MR. HUTCHESON: Well, there's an  
15 SEC requirement disclosure in a supplement to  
16 the financial statement of a fund that's  
17 called the statement of additional  
18 information. These folks before me mentioned  
19 that. And they're stated in the statement of  
20 additional information as either a hard dollar  
21 cost or a basis point charge.

22 PANEL MEMBER DWYER: And that

1 would be after the transactions?

2 MR. HUTCHESON: That's right. And  
3 it is in addition to the expense ratio. It's  
4 in addition to any consulting fees that are  
5 passed through to the plan level trustee for  
6 payment -- the CPA audit fees that may be paid  
7 by the plan and so forth. They're in addition  
8 to those. And they can become quite  
9 substantial.

10 PANEL MEMBER DWYER: Another  
11 question. Many commenters have told us that  
12 it would be just way too burdensome -- very  
13 difficult -- to get information that goes  
14 beyond the expense ratio, for instance, from  
15 investment managers to funds that the plan  
16 would invest in. What are your thoughts on  
17 that?

18 MR. HUTCHESON: Well, that's  
19 nonsense.

20 PANEL MEMBER DWYER: Why?

21 MR. HUTCHESON: Well, because  
22 first of all, it's immediately known every

1 time you buy or sell a stock, there's a \$.03  
2 to \$.06 per share trade. And it's a real cost  
3 that's assessed against the participant  
4 account balance. It's immediately known.

5 And so what we're talking about --  
6 you know on the 1099, there's little codes  
7 that say this is for an IRA roll-over, this is  
8 for a premature distribution. It would be so  
9 simple to assign every time a cost is done,  
10 this has got a code B. This is a brokerage  
11 cost. And you just tag it with a B, and  
12 that's what it is. And you funnel all those  
13 into a central location, or from the service  
14 provider's location down to the plan level  
15 record keeper. And shazam! You've got all of  
16 those costs.

17 And the record keeper knows the  
18 pass-throughs. And a pass-through is like  
19 where a CPA or a lawyer provides a legitimate  
20 service. They invoice the plan. The trustee  
21 authorizes it. And it's paid from the plan  
22 assets. Those are known by the record keeper



1           because they have to initiate a trade to free  
2           up the cash to pay the service provider.

3                       So a lot of this stuff is  
4           immediately known. The key is bringing it in  
5           to a centralized location where it can be  
6           compiled in the statement that I'm proposing.

7                       PANEL MEMBER DWYER: Thank you.

8                       CHAIRMAN CAMPBELL: Going back to  
9           the question about brokerage that you had  
10          asked. So the SAR's are all after-the-fact  
11          trades. If you were entering into -- or  
12          summary of after-the-fact information -- if  
13          you were entering into a contract you were  
14          providing an estimate up front, how would you  
15          see that being laid out?

16                      MR. HUTCHESON: It's an excellent  
17          question.

18                      Going to last year's brokerage  
19          commissions probably doesn't give the fair  
20          picture because as the economy ebbs and flows,  
21          fund managers make decisions as they go along.

22                      And so one year, you may have high brokerage

1 costs.

2 I think the key is for  
3 participants to have enough information to  
4 understand what the purpose of the fund is.  
5 So if it's an actively managed fund and it's  
6 supposed to be trying to attain a certain  
7 output -- a certain modeled rate of return  
8 which the regulations already provide for -- I  
9 think having some measure of understanding  
10 what the historical -- maybe a three-year  
11 turnover cost is. Because transaction costs  
12 are fairly represented in the amount that a  
13 fund turns over. It's underlying securities.

14 Let me tell you --

15 CHAIRMAN CAMPBELL: It's  
16 essentially the approach the SEC's taken  
17 recently.

18 MR. HUTCHESON: Yes. There's a  
19 simple mathematical algorithm that can  
20 calculate reasonable cost based on turnover.  
21 And so we estimate things in the market all  
22 the time, like what the value of a publicly-

1           traded security is. A lot of that stuff's  
2           based on all relevant information. And the  
3           market sets the price. And based on turnover,  
4           you could take a similar approach using a  
5           simple mathematical algorithm.

6                        So       transaction       costs       are  
7           important. I'm not saying that those are more  
8           important than anything else. I'm just saying  
9           that claiming that all of these costs are not  
10          available or as burdensome, it's burdensome to  
11          the participant not to have them. But that's  
12          about it.

13                       PANEL MEMBER CAMPAGNA:       Okay.  
14          Portfolio transaction cost brokerage. What  
15          we're hearing from funds is that it's  
16          impossible to break out what plan they're  
17          really involved in, because the broker is  
18          actually performing the service for the fund.  
19          And you think that that's a possible piece of  
20          information that can come back to the plan?  
21          Or do you agree with the arguments that it's  
22          very difficult to get that information?

1                   MR. HUTCHESON: Well, I think that  
2                   that is a hair-splitting red herring.

3                   I appreciate you asking the question.  
4                   But I don't think it's relevant. I think that  
5                   you can look at the fund and see what the  
6                   overall approach is to managing the fund and  
7                   monitoring the turnover of the underlying  
8                   securities. And that's a good reasonable way  
9                   to determine what that cost is.

10                  And like I said, whether an  
11                  individual plan incurs more transaction costs  
12                  -- yes, maybe. But it's not going to be  
13                  material. I think you can get a good material  
14                  number by looking at what the fund manager's  
15                  doing at the fund level for that particular  
16                  item. And I think it's relatively simple to  
17                  do it.

18                  PANEL MEMBER CAMPAGNA: But you  
19                  need more than what's currently in the  
20                  prospectus where the turnover ratio is  
21                  actually described regarding portfolio  
22                  transactions. Is that what you're saying?

1                   MR. HUTCHESON:     Well, this is  
2                   where we're coming down to issues of  
3                   understanding of how to construct a portfolio  
4                   that is prudent.     It comes down to  
5                   understanding what the overall objective is.  
6                   And if the funds have substantial turnover and  
7                   the returns are low, that becomes immediately  
8                   relevant.

9                   And the transaction costs are not  
10                  in the prospectus.   They're not stated in the  
11                  prospectus anywhere.   They're stated after  
12                  they've happened in a supplement to the fund's  
13                  financial statement that they file annually  
14                  with the SEC.   But it's a relevant cost -- a  
15                  very important cost -- and not disclosed.   And  
16                  that's why I propose the gross to net.   It  
17                  captures it.

18                  PANEL MEMBER CAMPAGNA:   And that's  
19                  all in Appendix A?

20                  MR. HUTCHESON:    Yes.

21                  PANEL MEMBER CAMPAGNA:   Thank you.

22                  PANEL MEMBER BUTIKOFER:   So you're

1           advocating that we get this total dollar  
2           disclosure and then allow everything else to  
3           be upon request. One concern with an approach  
4           like that though is are enough people going to  
5           request it for it to be beneficial versus if  
6           we just allow the information to automatically  
7           be required and available?

8                       MR. HUTCHESON: Well, it's a good  
9           question.

10                      I have no objection to it all  
11           being immediately available. I don't object  
12           to that. I'm trying to provide a reasonable  
13           balanced approach that I can live with as a  
14           fiduciary. I'm looking at this from my own  
15           point of view saying what can I live with.

16                      Fiduciaries -- and this is no  
17           secret -- many fiduciaries in the United  
18           States are asleep. They don't really  
19           understand. They're good people. They're  
20           trying to do the best they can. They may be  
21           overwhelmed with their businesses or whatever,  
22           but they're absent in their duties.

1                   And a lot of times, participants  
2 bring things to the attention of fiduciaries  
3 that they the fiduciaries would not have  
4 otherwise known. And so I'm an advocate of  
5 making sure that the details are available.  
6 If a participant wants those details, I think  
7 that we ought to give them those details.

8                   If we give those details to  
9 everybody, is it going to help them create  
10 more retirement income? Maybe over three or  
11 four years once people start getting it, and  
12 it's absorbed and they start to assimilate  
13 what this means. Maybe.

14                  But in the meantime, I'm proposing  
15 something that I believe is an incredibly  
16 simple solution. It's gross to net. The  
17 difference between the two is the cost of the  
18 plan to a participant or the plan level. You  
19 can roll it up or roll it down either way.  
20 It's getting the relevant information. And  
21 then two different people can measure whether  
22 that's reasonable for them.

1 PANEL MEMBER BUTIKOFER: Thanks.

2 CHAIRMAN CAMPBELL: All right.

3 Thank you very much.

4 MR. HUTCHESON: Thank you.

5 CHAIRMAN CAMPBELL: And last on  
6 our agenda for the first day is Chris Thixton  
7 of Pension Consultants, Incorporated.

8 MR. THIXTON: Do I have to talk  
9 fast?

10 CHAIRMAN CAMPBELL: We will give  
11 you your full measure of time. We can't  
12 promise the audience will stay.

13 MR. THIXTON: As long as you do.

14 Thank you for the opportunity to  
15 speak. My name's Chris Thixton. I'm the  
16 Director of Vendor Services for Pension  
17 Consultants representing the firm.

18 Pension Consultants works  
19 exclusively with employers that have qualified  
20 retirement plans. I'm not going to comment at  
21 all on welfare and health plans.

22 Specifically, I work with



1 employers with qualified plans in their  
2 searches, their valuation, monitoring,  
3 benchmarking, negotiations, helping retirement  
4 plan committees make decisions on their  
5 service providers. So as I listen today to  
6 everybody else in terms of what they advocate  
7 and their association and their business  
8 model, I'm taking notes and I'm thinking how  
9 in the world after this goes into effect are  
10 the plan sponsors -- the fiduciaries -- going  
11 to use the disclosures and the information?  
12 And I normally work in the trenches gathering  
13 the information. And today, we're really  
14 talking about a 50,000-foot view of what needs  
15 to be done.

16 There's always been a  
17 responsibility. People have commented on it  
18 already today that the plan fiduciaries have a  
19 responsibility to investigate, a duty to know,  
20 to act in the best interests of the  
21 participants to make these decisions. It's  
22 been there.

1                   The gentleman that sat on our far  
2                   right asked the question two or three times  
3                   today, are plan sponsors getting the  
4                   information that they need? And initially, if  
5                   they don't ask the right questions, the  
6                   answer's no, they're not getting the correct  
7                   information.

8                   This proposed regulation will be  
9                   sweeping. December 13th -- that'll be the day  
10                  that I mark on my calendar. That's when it  
11                  came out. Oh my word. Look at that. That's  
12                  going to be sweeping. It's going to change  
13                  the way that we all do business. It's going  
14                  to put it on its ear. And from my standpoint,  
15                  this is going to be a good thing.

16                  Now can we go from A to Z in one  
17                  step? I don't know that that's necessarily  
18                  possible. But if we get from A to B to C to  
19                  D, all the way up to M and N, it's going to be  
20                  a good thing for the plan sponsors and the  
21                  participants.

22                  My comments are this. First of

1 all, you talk about the manner in which  
2 disclosures can be provided. There's not a  
3 manner in terms of timing. There's not a  
4 manner in how it needs to be provided. And I  
5 contend that a lot of plan sponsor  
6 fiduciaries, it's all they can do to read a  
7 record keeping service agreement, let alone  
8 every piece of disclosure that comes in.

9 I do think there's potential for  
10 inundation. I think that the way that it's  
11 written right now, it's open for  
12 interpretation. You've got one service  
13 provider that could interpret it a certain way  
14 and say this is how we're going to make  
15 disclosures, and boxes and boxes of  
16 information come in. You have another service  
17 provider that says this is the way that we  
18 interpret it, and we're going to provide  
19 everything really crisp and clean, and it's  
20 submitted electronically.

21 At the very minimum, there needs  
22 to be some type of reference document to say

1           this is everything we're providing you. This  
2           is everything that you need to know. Under  
3           408(b)(2), the shift that people talk about  
4           today from the plan sponsor to the service  
5           providers, the service providers in that  
6           representation need to say under 408(b)(2),  
7           this is everything that we need to provide  
8           you. Here's the source document to say here's  
9           when it's coming, here's where it's at. So at  
10          least the plan sponsor fiduciary knows that  
11          they have all the information and where they  
12          can go to get the information.

13                    We've talked about does the  
14          prospectus give enough information. We can  
15          argue that. Is it going to be disclosed in  
16          the record keeping service agreement? In the  
17          appendix? In a trust agreement? In some type  
18          of side agreement? At least let's just get  
19          the information. That's the thing that I'm  
20          excited about with the regulation is just  
21          having more information because we do in  
22          working with service providers, we spend a

1           tremendous amount of time just getting  
2           information. And this regulation shifting to  
3           service providers says you need to provide  
4           this information, it's going to help. It  
5           absolutely will help.

6                         We talked a lot about fees and  
7           please, let's not sidestep the issue of  
8           services. At the very beginning of the  
9           regulation it says disclose all services.  
10          From my standpoint, it's kind of interesting  
11          -- if I may -- you had all the service  
12          providers at the top of the day, and then the  
13          people that kind of work with the plan  
14          sponsors looking at the service providers.  
15          Here we are at the end of the day, so we're  
16          pitted morning against evening.

17                        It's not my intent to go to battle  
18          against a service provider in terms of getting  
19          information. But sometimes that happens. We  
20          want information to make a well-informed  
21          decision acting in the best interests of the  
22          participants. So we talk about fees.

1 All services again. What is all  
2 services? In my seat today, I'd like for the  
3 Department to provide greater clarification on  
4 a lot of these issues. You did this right.  
5 You did this wrong. We need to do this. We  
6 need to change this.

7 If you'll take what you have right  
8 now and provide greater clarification so we  
9 all understand what it means as a service  
10 provider that provides banking -- does that  
11 include a simple checking account to make  
12 distributions, and then have to go through all  
13 the disclosure requirements? Where are those  
14 lines? Because whatever you put into play is  
15 what we're going to have to follow. And if we  
16 understand it, then we're all on the same  
17 page.

18 Right now, I've heard so many  
19 different comments in terms of their  
20 interpretation that it's not really clear.  
21 And that's the one thing when I make that next  
22 step with a plan sponsor working with a

1           committee, I want to understand how the game  
2           is played. If we understand it, then we can  
3           work within that. Right now, we work within  
4           the 404(a), the plan fiduciary responsibility  
5           to evaluate and monitor, to make good  
6           decisions. This will help.

7                     All services -- let's go back to  
8           that. I think it's easier to monitor and  
9           evaluate and make decisions on fees than it is  
10          services, because if you continue to press and  
11          to push and to ask information for fees, if  
12          they're a big enough plan you will get that  
13          information. Now you'll be exasperated.  
14          You'll be worn out. It'll be several weeks,  
15          even months to get the information. But  
16          you'll be able to get it.

17                    But what about services? How do  
18          you compare and evaluate services in a way  
19          that -- education? Well, we'll do education.

20                    What does that mean? We'll outsource your  
21          loans and distribution. What does that mean?

22                    In terms of all the deliverable services to

1 both the plan sponsor to the participant, what  
2 is that?

3 We talked about the car. We've  
4 worn that out already. But in terms of the  
5 actual services we're going to receive in the  
6 bundle or broken apart, how can we go down  
7 through and make a determination of what we're  
8 actually going to receive if we're just  
9 aggregating it all together?

10 We'll provide testing. We'll  
11 provide record keeping. We'll provide  
12 reporting. Okay. But the actual execution,  
13 the day-to-day, the benefit manager, the HR  
14 director, the CFO responsible for the plans,  
15 they'll end up going, well I thought you were  
16 going to do a lot more than that.

17 Please just provide clarification  
18 on what all services means. I like the idea  
19 of having all services disclosed. I think it  
20 will be helpful to the plan sponsors making  
21 decisions.

22 I'll concede the fact that to the



1 service providers, it'll take a lot of time to  
2 run through their groups and to get it all in  
3 order to be able to disclose. I do think  
4 it'll take a tremendous amount of time on  
5 their part. I think it'll be a tremendous  
6 cost on their part. But at the end of the  
7 day, it's going to be helpful. It's going to  
8 be helpful to the plan sponsor and ultimately  
9 to the participants.

10 So again, the all services -- we  
11 need that clarification. We need that  
12 included in the regulation, and not just broad  
13 categories. Because there's a lot of  
14 evaluation and monitoring and decision making  
15 on the services, and not just group them  
16 together.

17 Two. On the fees, this has been  
18 said before, and I'll echo it again. There  
19 are two major components in any retirement  
20 plan. It's the investments and the record  
21 keeping. You want to call it administration.

22 All right?

1           On the investments, what's your  
2 net return? The gentleman before just talked  
3 about net return. Forty basis points, 50  
4 basis points, 60 basis points for investment  
5 management. At a certain point it has to  
6 become a moot point if you're doing your due  
7 diligence on the investments. Net return is  
8 imperative. It's the most important thing.

9           There are no such things as 200,  
10 300, 400 basis points, funds that are just  
11 outstanding that everybody's just going to  
12 beat down their door because they have great  
13 returns and they're charging a lot. It  
14 doesn't exist.

15           Plan committees look at the  
16 investments and they determine, that's  
17 appropriate investment. We're doing due  
18 diligence on that investment. It's good.

19           What are the expenses related to  
20 that money management? Separate and distinct  
21 is what is the service's -- what is the  
22 expenses, the cost, the compensation for

1 record keeping. And I don't care if it's  
2 stated as a per participant, or an asset-based  
3 charge, or a combination thereof. There needs  
4 to be fees attributed to the administration  
5 record keeping, and fees attributed to the  
6 investments.

7 At the end of the day, you can  
8 wrap them all together and say here's the all  
9 inconclusive, but break it apart to be able to  
10 see just the amount on the investments and  
11 administration record keeping. I don't even  
12 mind if -- wrap it all together. Don't make  
13 the affiliates break it down, because you can  
14 still determine the fees attributable to  
15 record keeping is X amount as basis points or  
16 per head. And then that's the basis of making  
17 your comparisons and evaluations. One per  
18 head, one asset-based -- you can compare that  
19 for record keeping.

20 But again, if we wrap it all  
21 together, then -- and the lady from Hewitt  
22 mentioned it -- the largest portion of that

1 fee is going to be the amount attributed to  
2 the investment management -- 40 basis points,  
3 60 basis points. Again, it's a moot point  
4 when you look at net return. If we're really  
5 going to act in the best interests of the  
6 participants when it comes to the record  
7 keeping, focus in on that amount attributed to  
8 the record keeping. All right?

9 Simple point -- and in fact I'd  
10 like to answer some of the questions you've  
11 already asked today -- is what happens if  
12 there was no revenue sharing? What if there  
13 was no revenue sharing on any of the funds? I  
14 assure you that every service provider's going  
15 to figure out what it takes to provide  
16 administration and record keeping, if there's  
17 nothing to share back. So those two need to  
18 be broken apart and separated.

19 Now my last comment -- and the  
20 last two parties have hit it a little bit --  
21 is my term: cross-selling. That's something  
22 that I don't believe or maybe it's not my

1 understanding in the regulation, it wasn't  
2 addressed.

3 In the issue of cross-selling, I  
4 come in as a broker or an intermediary, or  
5 maybe I'm a representative of a service  
6 provider, and my job is to provide the  
7 education or to provide value added. And then  
8 in the negotiation process, the service  
9 provider says, we will provide you services  
10 for this 401(k) plan for 40 basis points. Now  
11 if you'll allow our representatives to sell  
12 additional financial services -- IRAs, college  
13 education, capture the roll-over -- then the  
14 fee's going to be 35 basis points. In  
15 addition to that is, all right, our job on  
16 site as a registered representative is to  
17 provide services to the plan. The plan is  
18 paying it for the service provider. They're  
19 paying for the representative on site to  
20 benefit plan participants.

21 And what it turns out to be is,  
22 75, 80, 90 percent of the time, is selling

1 additional financial services. And then you  
2 have participants that are not benefiting --  
3 subsidizing the people that are getting  
4 individual attention, typically, the HCEs,  
5 those with high account balances.

6 So we have the plan paying  
7 somebody to solicit additional financial  
8 services. So I believe the issue of cross-  
9 selling -- it would be very beneficial --  
10 should be addressed.

11 Now it's at the end of the day,  
12 and you have to worn out. I've been worn out  
13 just sitting there at my desk, but if I can  
14 summarize, the disclosures are going to be a  
15 good thing. Please clarify how it needs to be  
16 provided -- some reference document so that we  
17 know exactly -- specifically what we're  
18 dealing with. Otherwise, we're going to be  
19 cross-eyed. Currently, plan sponsors find it  
20 difficult to go through all the information  
21 that they get now.

22 Second, please clarify on the all

1 services. What does that mean, and just  
2 exactly what do you expect a service provider  
3 to provide? I think that's a very good thing.

4 I would ask for a lot more information than a  
5 service provider's going to be willing to  
6 provide. So we'd have to come to some point,  
7 but you're the ones that are going to make it  
8 happen.

9 And with fees, separate out the  
10 record keeping and investments.

11 Finally, address this issue of  
12 cross-selling. This issue of cross-selling --  
13 and if I had more time, I would dive deeper  
14 into it -- what are the services going to be  
15 provided? All right? Who's subsidizing what?

16 In a 401(k) plan, you've got a 457. We'll  
17 throw that in also. Because your 401(k)'s big  
18 enough. Well, who does the 457 benefit?  
19 Typically higher wage earners.

20 So that's a practice that I don't  
21 see in terms of conflicts of interest  
22 addressed, but it's always set out on the

1 side. It's always going on. And it's not  
2 just brokers or registered representatives.  
3 It's the people within the service providers  
4 -- as the lady from Georgia had mentioned --  
5 collecting assets. That's a big, big issue.  
6 And it's big dollars.

7 Thank you.

8 CHAIRMAN CAMPBELL: All right.  
9 Thank you. Start over here.

10 MS. WIELOBOB: I don't have any.

11 MS. ZARENKO: I'm thrilled to hear  
12 you saying that this regulation will help.  
13 But I just want to know what you mean -- help  
14 plan fiduciaries make better decisions? Help  
15 establishing a more efficient marketplace? Do  
16 you mean intangible benefits, i.e., plans and  
17 participants are going to pay less over time  
18 because of increased transparency? When you  
19 say it helps, what do you mean?

20 MR. THIXTON: Ma'am, I've toted  
21 this little flashlight around going, you have  
22 to do due diligence on your plan. You've just



1 shined a huge spotlight on this issue. Okay?

2 Now you put teeth -- you put teeth into it.

3 A service provider has to provide  
4 disclosures. Well, in my line of work, I ask  
5 for information. No, we're not going to  
6 provide that to you. You turn to the plan  
7 sponsor. Include them, or cut them. Well, we  
8 don't want to cut them because we really think  
9 they'll be good. How do you get information?

10 This is going to force people to provide the  
11 information.

12 Now the whole open for  
13 interpretation issue, that's my concern.  
14 Please just provide additional clarification  
15 on what that is because my definition of how I  
16 read everything and what a service provider  
17 may be at odds still. But at least if we can  
18 get additional information -- all right --  
19 regardless if the plan sponsors do it  
20 themselves or they hire somebody to help them,  
21 if you've got the information, then it's going  
22 to help provide more meaningful evaluation.

1                   Currently -- and again, the  
2 question is do the plan sponsors get the  
3 information they need? No. No, I've got 12  
4 projects going on right now. And of course,  
5 they send these big boxes of information and I  
6 always start off cross-eyed.

7                   At least this provides some  
8 uniformity to say here, this is where we're  
9 going to start. And I think that once you get  
10 the ball rolling, there's going to be more  
11 guidance -- interpretative bulletins. There's  
12 going to be other best practices that have  
13 come along that provide this information.

14                   I'm not in favor of standardizing  
15 everything. I work with enough service  
16 providers, and in fairness to them, that would  
17 be very, very difficult. But to get the  
18 information.

19                   Another example, everybody talks  
20 about the mutual funds. There's been a little  
21 discussion on collective trusts, group annuity  
22 contracts. What about stable value accounts?

1           What about the fixed accounts where you're  
2           dealing exclusively with the yields -- the  
3           crediting rates? And the service providers  
4           will say, well, there is no operating costs.  
5           Those are huge swings. Those are huge swings  
6           in terms of fees and how it affects the  
7           overall plan when it's bid out. It will help.

8                   MS. ZARENKO:        So you think  
9           possibly over time people will be paying lower  
10          fees?

11                   MR. THIXTON:    Ma'am, I have no --  
12          I have no dreams that this regulation will get  
13          us where we need to be in 12 months, but it'll  
14          provide a huge, huge step in the right  
15          direction.

16                   MS. ZARENKO:    And of course, with  
17          benefits there come costs.       Additional  
18          disclosures -- it's more time.    It's more  
19          paper.        It's more lawyers.    It's more  
20          everything.    It seems like you would support  
21          the idea that the benefits of this proposal,  
22          especially in the long term, will outweigh the

1 burdens.

2 MR. THIXTON: Yes. Now, I will  
3 for the service providers' standpoint, when I  
4 read the costs to do this, they'd mentioned it  
5 several times a day, it'll be a lot more. I  
6 do this type of analysis. It'll be a lot  
7 more. There'll be a lot of costs. So  
8 anything that can be simplified -- and that  
9 comes into the clarification again -- if we're  
10 clear in terms of what it is that has to be  
11 disclosed -- all right -- then we know  
12 exactly what we're aiming at. But right now,  
13 there's a target out there, and I don't know  
14 where to aim. So if it's clear, then we can  
15 all get on the same page.

16 MS. WIELOBOB: Can I make a quick  
17 interrupt? When you're talking about costs of  
18 compliance, do you see that as like an initial  
19 high cost that once the industry gets used to,  
20 it would -- yes?

21 MR. THIXTON: Absolutely.  
22 Absolutely.

1 MS. WIELOBOB: Go ahead. Thanks.

2 MS. DWYER: Of the bundle  
3 provision of the regulation, what's your  
4 position on that? We have -- At the moment,  
5 the proposed regulations do not require  
6 allocating. What do you think about that from  
7 --

8 MR. THIXTON: In terms of  
9 allocating how their compensation is defined?

10 MS. DWYER: Yes. A provider that  
11 offers a bundled service under the proposed  
12 regulation would not need to allocate  
13 compensation within the bundle. What are your  
14 thoughts on that? Do you think --

15 MR. THIXTON: I believe I  
16 understand. If I can address maybe two parts  
17 of it.

18 MS. DWYER: Right.

19 MR. THIXTON: One is, I am very  
20 much a proponent of separating out the  
21 investment costs from the record keeping.

22 Now somebody mentioned earlier,

1           okay so you get over on the record keeping,  
2           now we're going to break it down under the  
3           record keeping on all the different  
4           affiliates. I don't think that's necessary.  
5           Personally, I'd love to see it. But for what  
6           is on the table and what you're trying to  
7           accomplish, and ultimately the time versus  
8           costs to implement these things, if we just  
9           had the record keeping costs together, that's  
10          all that necessary. But -- and I go back  
11          again -- if there is no revenue sharing, we're  
12          going to get a lot of fees attributed to  
13          record keeping.

14                        It can be done. And in fact, I  
15          can give you plenty of case examples of where  
16          it is done with bundled providers. They  
17          simply separate out the two. They don't drill  
18          down among affiliates. But they can say this  
19          much for investment management, this much for  
20          record keeping. And as the lady from Hewitt  
21          had mentioned is over time, if you know what  
22          it is on record keeping, that's what you focus

1 on record keeping.

2 The investments -- you ought to be  
3 doing that ongoing -- consistently also.  
4 Reviewing investments, changing them out --  
5 what's the fees? Determining if the net  
6 return is appropriate based on the objective.  
7 So those two should function separately, and  
8 you bring it together at the end, put a nice  
9 little bow on it to say the total cost is.

10 But I've done this for several  
11 years now, and I simply have no way of being  
12 able to provide counsel to a plan sponsor  
13 without separating out those two and making a  
14 meaningful recommendation.

15 If --

16 MS. DWYER: All right. Go ahead,  
17 please.

18 MR. THIXTON: If you're unbundled,  
19 if you're bundled, it can be done. It can be  
20 done. It's just the drilling down I think is  
21 the hair splitting. And of course, I'm not in  
22 a position to hair split anything myself.

1 (Laughter.)

2 MR. THIXTON: But I don't think  
3 that's necessary within the regulation.

4 MS. DWYER: Thank you.

5 CHAIRMAN CAMPBELL: How often in  
6 your work with your clients do you actually  
7 run across service providers who are saying  
8 this has no cost?

9 MR. THIXTON: Mr. Campbell, the  
10 answer would be never.

11 Now re-phrasing the question, how  
12 many clients come to me with a box of  
13 information where they've gone out to vendors  
14 -- service providers -- and asked for an RFP,  
15 a request for information? It comes back and  
16 it says it's free every day, every week. I  
17 mean, I always refer to the box. They send a  
18 box. They'll have five, 10, 12 different RFPs  
19 in there. And inevitably over half of them  
20 have that it's free, the zero price plan,  
21 which I love to hear that.

22 But when you engage in a process



1 and you write out we want to know what the  
2 compensation is -- and I like the gentleman  
3 that spoke just before me. I use the gross to  
4 net differently. But tell me what you want to  
5 make. Wrap it all up. You don't have to  
6 break it down on the investment side. Wrap it  
7 all up on the record keeping side. You don't  
8 have to break it down. Just tell me what you  
9 want to make, all inconclusive.

10 If you ask that question  
11 correctly, and then you determine the fees --  
12 or the revenue sharing that's attributable to  
13 this particular plan, you can come up with a  
14 net amount.

15 But I don't care if it's small  
16 plans that are under \$25 million, those that  
17 are net \$50 to \$100 million, or even the  
18 larger plans over \$100 million, they'll still  
19 come up with the, hey, here's the zero price  
20 plan, and the all inclusive, all services are  
21 being provided. Again, that comes back to the  
22 clarification of what are those services so we

1 can assess one group's services to another.

2 CHAIRMAN CAMPBELL: So going to  
3 your suggestion for kind of the executive  
4 summary or the reference document, basically  
5 you're envisioning what? Say a one- or two-  
6 or three-page, whatever length disclosure that  
7 says in the 12 boxes we sent to you, look in  
8 box 3 for page 7 and that's where you'll find  
9 this part. Is that kind of what you're  
10 describing?

11 MR. THIXTON: Yes. Absolutely.  
12 And in my dreams when I think about what  
13 408(b)(2) will really look like, once there's  
14 a greater clarification on services and on  
15 fees, okay there it is. Service providers,  
16 this is what you need to provide. Okay?

17 They have a lot of the information  
18 already. They have it in their service  
19 agreements. They have it in the prospectuses.

20 They have it in the supplement of additional  
21 information. They have it in the trust  
22 agreements. Why make them put together one

1 document? You know, one big document and  
2 combine it all? Let them send it all and then  
3 provide this one source document to say,  
4 listen, we have to comply with 408(b)(2), and  
5 in doing so, these are the things that we have  
6 to provide to you, and this is what we've sent  
7 to you.

8           Because what's going to happen is,  
9 they're going to turn that information over to  
10 another person on the committee. It might be  
11 me. We'll do work. We'll put it in a filing  
12 cabinet. All right? Put it on the network.  
13 Then six months -- 12 months down the road,  
14 somebody's going to pick it out. All right?  
15 Well, if they had the one document, then they  
16 know how many other documents they need to  
17 pull out to find the information.

18           One of my challenges right now,  
19 again, and I don't deal in as much information  
20 as what you're proposing that needs to be  
21 disclosed, is just getting the information  
22 right now crosses my eyes. Do we have it?

1 And again, there isn't the uniformness. Well,  
2 where would it be found?

3 So I spent a lot of time just  
4 organizing. And I do this for a living. You  
5 provide this to the plan sponsor, they'll  
6 quit. They'll give up.

7 Now, this is me coming from the  
8 50,000-foot view back down to the trenches.  
9 Once this goes into effect, how are we going  
10 to use it? How is it going to be meaningful?

11 All right?

12 CHAIRMAN CAMPBELL: Okay.

13 MR. CAMPAGNA: Yes. What you just  
14 described, how does it differ from what we  
15 have proposed, which is that the service  
16 provider can point to the prospectus, point to  
17 other documents and say here's where the  
18 information is. Is it close to what you're  
19 proposing or do you have something else in  
20 mind?

21 MR. THIXTON: Sir, I think -- and  
22 again, if you allowed me to write the proposed

1 regulation, I'd be a lot stricter. But for  
2 what I think what's needs to happen for the  
3 plan sponsor, if they point to say hey, it's  
4 in the prospectus. All right? Now, that's  
5 going to be the operating expense.

6 MR. CAMPAGNA: Well, what about  
7 page 5 in the prospectus and paragraph 6 --  
8 something to that effect?

9 MR. THIXTON: That'd be great.

10 Now let me tell you what's not  
11 there. And I think some people have echoed  
12 it. It makes reference to the, well, we may  
13 engage in sub-transfer agent-types of  
14 arrangements. You're not going to find that  
15 in a prospectus. There's going to have to be  
16 another disclosure saying this is what that  
17 sub-TA is going to be.

18 And there's certain service  
19 providers that say, we don't engage in revenue  
20 sharing. That's not right. They all do.  
21 Now, it may not be in 12b-1. It may not be a  
22 sub-TA. It may not be a finder's fee or a

1 dealer concession. But there are factors that  
2 are considered. And in fact the big issue  
3 there is a lot of times we'll be in the stable  
4 value product. All right? Those crediting  
5 yields will be adjusted as a factor to  
6 determine the overall pricing.

7 So to the extent that they don't  
8 have it in the prospectus, there'll need to be  
9 an additional disclosure, which is referenced  
10 in the source document. And there will need  
11 to be additional disclosures generated. And  
12 that's the one thing I know the service  
13 providers don't want to do. It will take a  
14 lot of time.

15 We ask for that right now. The  
16 one gentleman you asked about how long does it  
17 take to push things through on the insurance  
18 level. Okay? We've been working on one for  
19 18, 24 months. All right? They can't get it  
20 through the state. And it's on a product.  
21 It's not for a particular plan sponsor. It's  
22 on a product. So it's going to be a lot of

1 head banging for service providers, but  
2 eventually we get through it initially, and  
3 then it'll be better.

4 MR. CAMPAGNA: Thank you.

5 MR. THIXTON: Yes.

6 MR. BUTIKOFER: Two questions.  
7 You've talked about giving this box of  
8 information with this sheet, but is that still  
9 going to be too overwhelming for -- especially  
10 for small fiduciaries --

11 MR. THIXTON: Yes.

12 MR. BUTIKOFER: -- where can they  
13 actually use it or are going to have find  
14 someone to help?

15 MR. THIXTON: You know what? I'd  
16 actually pull it out of the preamble. You  
17 have something in there that says that plan  
18 sponsors might find more liability and may  
19 want to engage outside consultants. That's  
20 why I remembered December 13th. I appreciate  
21 that.

22 (Laughter.)

1           MR. THIXTON: Yes, sir. I do  
2 think it'll be inundating. But right now --  
3 as Mr. Campbell asked -- well, we've got this  
4 zero price plan. People get hit with it all  
5 the time. Zero price, it sounds great.

6           You asked the question earlier.  
7 Would there be any advantage of allocating  
8 costs into the investments over the record  
9 keeping? Absolutely. We do that right now in  
10 the industry with zero price plans. But at  
11 least the step we're taking provides more  
12 information.

13           Again, it's always been the  
14 responsibility of the plan sponsor to  
15 investigate and to know. Now again, a lot of  
16 them don't do it, but at least if they had the  
17 information, it's going to be easier for them  
18 to make that determination as opposed to well,  
19 what question do I have to ask. How do I even  
20 get the information? And some service  
21 providers right now will go, well, you're not  
22 big enough. I'm not going to provide it.



1           This 408(b)(2) will at least state you have to  
2           provide a certain amount of information.

3                         Again, I have no ideas of grandeur  
4           of they'll use it. But at least it'll be  
5           there.

6                         So, a second question?

7                         MR. BUTIKOFER: Yes, the question  
8           was follow up to a question you talked about  
9           there's going to be this high startup cost.  
10          And then the compliance costs -- if I caught  
11          your answer correctly -- you think is going to  
12          fall substantially.

13                        MR. THIXTON: I believe that to be  
14          true.

15                        MR. BUTIKOFER: And do you have a  
16          story behind that assumption? I'm assuming  
17          that a lot of the high cost is going to be  
18          learning about the regulation and how to  
19          comply with it. And I think you've also  
20          suggested that a lot of the information is  
21          actually already readily available if we could  
22          just pull it all together is what we've heard

1 throughout the day.

2 MR. THIXTON: You said do I have a  
3 story?

4 MR. BUTIKOFER: Sure.

5 MR. THIXTON: Well, yes. Yes, I  
6 do.

7 I'll give you an example of a plan  
8 that's roughly \$100 million, and they've got  
9 5,000 participants. They go through their  
10 search process to find a service provider.  
11 They have a 401(k). And they narrow it down  
12 to their final two. They go through the site  
13 visits. And they go, you're the one.

14 So they send the service  
15 agreement. And again, through the whole  
16 process is what services do you provide -- the  
17 all services issue. Right? Well, we do this,  
18 and we do this. And the PowerPoint looks  
19 great. And they've got the interaction and  
20 they've got all the bundle material. That's  
21 great. And we ask for memos of understanding  
22 to say, well, just exactly how do you execute

1           this. How do you implement this type of  
2           service and how's it executed and how do we  
3           measure it? All right?

4                        So we're talking about it -- and  
5           of course, the red carpet treatment. And then  
6           when the service agreement comes in, it's  
7           indemnifications and it's the hold harmless,  
8           and it's the line items of, well, we'll  
9           provide record keeping. And we'll provide  
10          testing. We'll do signature rate of 5500.  
11         You know, those types of things.

12                      And we raised the hand and said  
13          well, you had mentioned through this whole  
14          process that you would do X and Y and Z, and  
15          this is how you would do it. This is the  
16          service standard attached to it. And they  
17          said yes, we would. And of course, a \$100  
18          million plan, they're big enough to command  
19          that. So what we do is we start to engage in  
20          a process of putting that in the service  
21          agreement.

22                      Sir, it was five iterations that

1           took three months.       So that's just one  
2           example.   But it was big enough.   They wanted  
3           the business.   And they did it.   And that was  
4           just one set of requests that we had.   All  
5           right?

6                       Now, you get into what your  
7           regulation is going to require, and then  
8           additional questions that we ask.   And of  
9           course, it's got to go through compliance and  
10          legal and everything else.   I actually do feel  
11          sorry for the service providers for what  
12          they're going to have to comply with.

13                      But again, we get past the initial  
14          push, it ought to be easier to maintain.

15                      MR. BUTIKOFER:   Thanks.

16                      MR. WILLIAMS:   Just a comment.   I  
17          mean, it'll be easier on the service provider  
18          if they know what they have to disclose --

19                      MR. THIXTON:   Absolutely.

20                      MR. WILLIAMS:   -- so they can get  
21          ahold of it.   So then it's just a question of  
22          delivery of information.   And then people like

1           you and others that are hungry for the  
2           information, they'll hopefully know what to do  
3           with it to lead the plan sponsor to the  
4           decision that they need to make an informed  
5           decision.

6                         And the costs associated with  
7           gathering the information will go down if we  
8           can more accurately define what the  
9           information is that has to be delivered by the  
10          service provider.

11                        What I'm curious about in terms of  
12          writing the class exemption is whether we need  
13          to extend the class exemption concept to a  
14          service provider who through no fault of his  
15          own cannot get ahold of the information that  
16          they're required to be providing under the  
17          service agreement.

18                        MR. THIXTON: I think that's a  
19          very good point. I think it's going to be  
20          needed. And of course, it almost becomes that  
21          out to say well, I couldn't find it.

22                        You mentioned the preamble.

1 Provide a specific monetary amount and if not,  
2 you may use a formula. That doesn't say that  
3 in the actual regulation. It does say it in  
4 the preamble. Well, I think everybody's going  
5 to use some type of formulate, unless your  
6 core business is hey, we're going to give a  
7 hard dollar amount. Everybody's going to use  
8 the formula.

9 I think it would be an out to say,  
10 well, we couldn't get the information. Well,  
11 try harder.

12 MR. WILLIAMS: Right. Well, a lot  
13 of people are worried though about these  
14 inadvertent errors and omissions. And then I  
15 view the class exemption as a way to deal with  
16 that problem.

17 The service provider would have a  
18 duty to do certain things to get ahold of the  
19 information. But it is foreseeable that you  
20 would have service providers in a situation  
21 where they are not getting the information as  
22 a conduit to provide for the plan. So part of

1 the issue is how much of a burden can we put  
2 on the service provider to get ahold of  
3 information that would have to be disclosed.

4 Do you have any thoughts on that?

5 MR. THIXTON: Well, yes. But I  
6 think I might defer.

7 I'm an advocate for the plan  
8 sponsor fiduciary, not the service provider.  
9 But if you don't treat the service provider  
10 well, if it's not fair to them, if they don't  
11 make a fair amount of profit -- which some  
12 people say they make more than a fair amount  
13 -- the onus still is on the plan sponsor. I  
14 mean, we're shifting a lot of the disclosure  
15 requirements to the service provider. I think  
16 that's excellent.

17 But for a plan sponsor to wash all  
18 their hands and have to do nothing, I don't  
19 think is right either. Because ultimately,  
20 they have to make a determination what's in  
21 the best interests of their plan that benefits  
22 their participants.

1                   Now the example given earlier  
2                   about well, their fees are going to be high,  
3                   and they can't negotiate. I think that's just  
4                   an issue of they're small. They can't. They  
5                   can't. They can't. They can't negotiate. So  
6                   it is what it is. A plan sponsor's going to  
7                   have to make that determination. They're  
8                   going to have to make the final decision.

9                   I don't think it's fair to push  
10                  everything over to the service provider. But  
11                  the same point, the thing that really makes me  
12                  excited about this regulation is the business  
13                  people run businesses. The service providers  
14                  -- they're trained, they're skilled. Their  
15                  job is to sell the plans, to get you to say  
16                  yes. All right. Get them to disclose more  
17                  information to make a more meaningful  
18                  evaluation on the plans that are going to be  
19                  offered to the participants.

20                  MR. WILLIAMS: Thank you.

21                  CHAIRMAN CAMPBELL: Any other  
22                  questions?



1 All right. Well, thank you very  
2 much.

3 MR. THIXTON: Thank you.

4 CHAIRMAN CAMPBELL: And that  
5 brings to a thrilling conclusion our first day  
6 of administrative hearings on the 408(b)(2)  
7 regulation.

8 Thank you all for your attention  
9 and for showing up. And I'm sure we'll see  
10 some of you tomorrow.

11 Thank you.

12 (Whereupon, at 5:40 p.m., the  
13 hearing was adjourned, to reconvene at at 9:00  
14 a.m., April 1, 2008.)

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