



P.O. Box 2900  
Valley Forge, PA 19482-2900

[www.vanguard.com](http://www.vanguard.com)

February 11, 2008

FILED ELECTRONICALLY

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, D.C. 20210

RE: Proposed ERISA Section 408(b)(2) Fee Disclosure Regulation

Dear Sir or Madam:

Vanguard appreciates the opportunity to submit these comments on the Department's proposed regulation regarding reasonable service provider agreements and fee disclosure under ERISA section 408(b)(2). We believe that our experience with providing full and candid disclosure of plan and investment fees to our 401(k) plan-sponsor clients positions us well to provide helpful comments to the Department on this very important issue.

**1. Vanguard supports the Department's proposal to provide full disclosure of direct and indirect service provider fees.**

At the outset, we applaud the Department for its continued focus on ensuring that plan sponsors understand all fees being paid by their plan and, by extension, their participants. Our experience demonstrates that plan sponsors benefit from having critical service and fee information simply presented in a consolidated and comprehensible package. Vanguard regularly provides "All-In" Fee Reports to our bundled defined contribution plan sponsor clients, a sample copy of which is attached as Exhibit "A". Our clients consistently tell us that this tool allows them to easily understand the fees paid by their plan and participants, and helps them satisfy their ERISA fiduciary duties.

The objective of the proposed regulation is to ensure that plan sponsors understand: (1) all of the services being provided to their plan, (2) the fees paid directly and, importantly, indirectly by the plan for those services, and (3) any compensation third parties receive in connection with services provided to the plan. By achieving this goal, the Department will provide an excellent foundation for helping plan sponsors satisfy their ERISA duties and, by extension, will help participants better achieve their retirement-savings goals.

In our view, the proposed regulation substantially meets this important objective. Plan fiduciaries need to know that the information received from their service providers is reliable, that the fees to be paid for services are fully disclosed and reasonable, and that the service provider has no hidden or conflicted interests in its provision of services.

In our experience, the 401(k) plan market is extremely price competitive. However, sponsors must still expend significant time and effort comparing fees among providers because of varying formats and service models as well as unique fee structures associated with different investment vehicles. By moving toward a more uniform standard of fee disclosure, the Department's initiative serves two important ends: (1) it will reduce the time and effort spent by sponsors assembling and comparing price information, and (2) it will help facilitate apples-to-apples comparisons of different service models and investment products.

In order for the regulations to have their intended effect of enhancing plan sponsors' understanding of fees so that they can fulfill their fiduciary duties, the disclosures must be meaningful and should not include duplicative, confusing or irrelevant information. The final regulation should not leave plan fiduciaries questioning their precise legal obligations with respect to the disclosed information. In this regard, we believe the proposed regulation would benefit from additional clarification in several respects as explained below.

## **2. Current mutual fund expense disclosures provide simple and comparable expense information.**

The securities laws in place today require that all mutual funds disclose expenses to investors in the Prospectus and Statement of Additional Information. In general, these expenses are summarized in an easy-to-understand "expense ratio" that reflects the money deducted from a fund's earnings and assets to pay for annual operating expenses, including investment advisory fees, legal and accounting services, postage, printing, telephone service and other administrative costs of the fund. Mutual funds are also required to provide disclosure of any sales loads and 12b-1 charges applicable to the fund.<sup>1</sup> We have found over the years that mutual fund expense ratios provide very effective, simple and – importantly – comparable expense information to enable investors to gauge the value they receive on their investment selection.

We would strongly encourage the Department to require service providers for all types of plan investments (e.g., separate accounts, collective trusts and insurance products) to provide plan sponsors with expense ratio disclosures in a similar form and subject to similar rules as mutual fund expense disclosures so that plan sponsors can easily compare available investments.<sup>2</sup> This expense ratio disclosure approach provides plan sponsors with a very accurate picture of their most relevant investment-related costs, without extraneous and potentially confusing additional disclosures, and would provide a level playing field for all types of plan investments.

---

<sup>1</sup> Where we mention the term "expense ratio" in this comment letter, we are referring to all asset-based fund fees and expenses (including sales loads and 12b-1 fees), even though sales loads are disclosed separately and not technically included in a fund's total operating expense ratio.

<sup>2</sup> We recognize that other investment products structure their fees in different ways from mutual funds. Obviously all relevant expenses would need to be incorporated into the expense ratio of non-mutual fund products and we would recommend that Department develop standards to ensure that comparable disclosures are provided for all investments.

The Department's proposed regulation appears to suggest that additional disclosures may be required regarding management fees, float revenue, brokerage commissions and soft dollars within a mutual fund. While helpful disclosures related to these items are required of mutual funds today,<sup>3</sup> we are concerned that the Department's proposed regulation may go beyond the disclosures required today by the Securities and Exchange Commission (SEC) in the Prospectus and the Statement of Additional Information.

The disclosure regime for mutual funds in place today works extremely well for investors, and is entirely consistent with the policy objectives of the Department. Additional disclosures of the type suggested in the proposed regulation may lead to more confusion rather than less, when it comes to plan sponsors trying to understand their investment-related costs. We recommend that the Department confirm that compliance with the SEC fee disclosure requirements is sufficient for purposes of section 408(b)(2).<sup>4</sup>

Recognizing that not all plan investment options are registered and subject to these expense disclosure rules, Vanguard would suggest that the Department require that non-registered investment products provide fee disclosure content similar to the fee information provided by registered mutual funds. This will foster an environment where plan sponsors can make truly apples-to-apples comparisons of investment fees.

### **3. Bundled service providers should also provide expense ratio-type disclosures for unaffiliated investments.**

We commend the Department for its conclusion that bundled service providers need not "unbundle" their services and fees. Requiring a bundled service provider to separate out the fees charged for each integrated service within the bundle would result only in an artificial and immaterial allocation of fees. As the Department correctly recognized, any such requirement would have no net impact where the services are available only as part of a bundled arrangement.

In addition, we support the proposed regulation's requirement that bundled service providers should disclose fees received from unaffiliated investment options offered on the bundled platform. Our bundled plan clients have found this sort of consolidated expense disclosure for the plan's investment options very useful and we have effectively been providing this to our bundled plan clients for years through our All-In Fee Report (see attached Exhibit A).

The proposed regulation also requires the bundled service provider to disclose the fees paid to unaffiliated investment options on the bundled platform. For this type of a consolidated disclosure approach to work, however, it is imperative that: (1) all plan investment products, including non-registered products, be required to provide expense ratio-type disclosures to the bundled provider, and

---

<sup>3</sup> For example, mutual fund prospectuses provide a turnover rate that gives an indication of how transaction costs, which are not included in the fund's expense ratio, could affect the fund's future returns. In general, the greater the volume of buying and selling by the fund, the greater the impact that brokerage commission and other transaction costs will have on its return. As such, turnover rate is a helpful indicator of the level of trading activity within a fund.

<sup>4</sup> An approach that does not require plan sponsors to "look through" a mutual fund for a breakdown of underlying expenses is consistent with existing statutory and regulatory guidance regarding mutual funds. For example, the underlying assets of a mutual fund are not considered plan assets and thus there is no fiduciary "look through" to the mutual fund manager's investment decisions. See ERISA section 401(b)(1) and DOL Interpretive Bulletin 75-3.

(2) the bundled provider not be required to disclose information regarding the unaffiliated funds (or other investment option) beyond the fund's expense ratio (or equivalent fee disclosure).

Correspondingly, when a mutual fund company's funds are on an unaffiliated intermediary's recordkeeping platform, the provision of the prospectus to the intermediary should satisfy the fund company's disclosure obligations. This is the case particularly because, as a practical matter, the fund company often will not know the identity of the plan sponsor in this context. Again, we would expect that the recordkeeping intermediary would be providing the required fee disclosures to the plan sponsor directly.

As an aside, it would be helpful for the Department to clarify that the bundled provider should only be required to make reasonable efforts to retrieve information from unaffiliated third parties and should not be held accountable for the accuracy of such information. The bundled provider should be permitted to report the failure of an unaffiliated third party to provide necessary information. The failure by an unaffiliated third party to provide the bundled provider with information for the reporting of fees or notification regarding material changes should not result in a prohibited transaction. The proposed regulation (along with the proposed prohibited transaction exemption) affords protections to plan fiduciaries when a primary service provider fails to comply with its disclosure obligations through no fault of the plan fiduciary. Similar protection should be afforded to the bundled service provider that, despite reasonable efforts, is unable to collect the necessary information from unaffiliated third parties or when such information proves inaccurate.

#### **4. Broad service descriptions should be sufficient.**

The proposed regulation requires service providers to list the services to be provided to the plan, but no guidance is offered as to the required level of detail. We urge the Department to conclude that for purposes of section 408(b)(2), a broad description of services (e.g., investment management, recordkeeping, brokerage, participant education, web and phone services, etc.) is sufficient.

Service providers should not be required to break down the services that comprise these broad descriptions (e.g., recordkeeping includes the maintenance of separate participant accounts, loan administration, hardship determination, beneficiary administration, match calculation, payroll related services, etc.), as the nature of the services may change as new technologies and processes become available. This suggested approach is consistent with the example given in the preamble to the proposed regulation. In addition, utilizing this approach will allow plan sponsors to line up the service providers' disclosures with the service and compensation codes outlined by the Department (along with the IRS and PBGC) in the instructions for Schedule C of the Form 5500.

#### **5. Formulae should be permissible in all contexts.**

The proposed regulation permits the service provider to disclose fees to the plan sponsor through use of a formula in lieu of a specific dollar amount so long as the compensation is described "in such a way that the reasonable plan fiduciary can evaluate its reasonableness." While the actual text of the regulation permits a sufficiently informative formula to be used in all contexts, the preamble implies that a formula may be used only where the service provider "cannot" express the fee as a monetary amount. We would recommend that the Department clarify that a formula permitting a reasonable plan fiduciary to evaluate the reasonableness of compensation may be used by a service

provider in any context and without a limitation as to the feasibility of expressing the fee in actual dollars.

**6. Transition relief should be extended.**

The proposed regulation indicates an effective date 90 days following the publication of the final regulation. Retention of this timeline will not permit sufficient time for plan sponsors and service providers to become compliant with the final regulation, particularly with regard to any need to amend all existing service contracts to conform to the specific requirements of the regulation.

Following publication of the final regulation, plan sponsors will need time to ask questions of their service providers and become educated on the new disclosures and agreement requirements. Plan sponsors and service providers will need time to evaluate current documents and arrangements and determine what needs to be done to become compliant with the new regulation. In doing this, existing documents will need to be revised and new documents may need to be drafted. Because it is anticipated that the rules in the proposed regulation may evolve substantially from the proposed regulation, very little drafting or other compliance efforts may be undertaken in advance of the final regulation.

We suggest that the Department consider multiple structures for the effective date of this regulation. It would be reasonable for the Department to implement a shorter time frame for new arrangements (i.e., plan sponsors who have no existing contract or relationship with a service provider). However, a longer time frame will be necessary for existing relationships where the parties must determine if contracts will need revision or renegotiation. For example, all new arrangements may be required to meet the requirements of the final regulation if the agreements are signed one year or more after publication of the final regulation. Allowing a similar minimum evaluation window of at least one year, existing arrangements then could be brought into compliance by the earlier of the expiration date of existing agreements or two years after publication of the final regulation.

\* \* \* \* \*

Vanguard appreciates the opportunity to provide these comments to the Department and we reiterate our support of the Department's efforts, which clearly will have a positive impact for plan sponsors and participants. Please let us know if we can be of any additional assistance on this important initiative.

Respectfully submitted,



F. William McNabb  
Managing Director  
Institutional Investor Group

# Exhibit A



## **Vanguard All-In Fee Report XYZ Company 401(k) Plan February 2008**

**Client Name:** XYZ Company

**Plan Name:** XYZ Savings Plan

**Plan Number:** 000000

### **Asset-Based Fees**

<b>Vanguard Fund Name</b>	<b>Assets</b>	<b>Operating Expense Ratio</b>	<b>Total Cost</b>
Vanguard Windsor II Fund Investor Shares	\$20,000,000	0.35%	\$70,000
Vanguard PRIMECAP Fund Investor Shares	\$15,000,000	0.46%	\$69,000
Vanguard 500 Index Fund Investor Shares	\$12,000,000	0.18%	\$21,600
Vanguard Wellington Fund Investor Shares	\$5,000,000	0.29%	\$14,500
Vanguard Retirement Savings Trust	\$3,000,000	0.30%	\$9,000
Vanguard Total International Stock Index Fund	\$2,000,000	0.31%	\$6,200
Vanguard Explorer Fund Investor Shares	\$1,000,000	0.51%	\$5,100
Vanguard Target Retirement 2025 Fund	\$1,000,000	0.20%	\$2,000
<b>Vanguard Total</b>	<b>\$59,000,000</b>	<b>0.33%</b>	<b>\$197,400</b>

### **Non-Vanguard Asset-Based Fees**

<b>Fund Name</b>	<b>Assets</b>	<b>Operating Expense Ratio</b>	<b>Asset-Based Fee</b>	<b>Total Cost</b>
Non-Vanguard Value Fund	\$1,000,000	0.81%		\$8,100
<i>Portion of Asset Based Fee Paid by Fund Company to Vanguard</i>			0.35%	
Non-Vanguard International Growth Fund	\$1,000,000	1.47%		\$14,700
<i>Portion of Asset Based Fee Paid by Fund Company to Vanguard</i>			0.25%	
<b>Non-Vanguard Total</b>	<b>\$2,000,000</b>	<b>1.14%</b>		<b>\$22,800</b>

### **Service Fees**

<b>Service Fee Description</b>	<b>Service Cost</b>
Annual Recordkeeping Per Participant Fee (1168 Participants @\$10)	\$11,680
Compliance Testing Package B	\$5,000
<b>Total Service Fees</b>	<b>\$16,680</b>

**Additional Service Fees**

Annual Administrative Fee For Each Loan (Paid by Participant)	\$25 Per Loan Maintenance
Origination Fee Per Participant Loan (Paid by Participant)	\$40 Per Loan Origination

**Total Fees**

Vanguard Fund Fees	\$197,400
Non-Vanguard Asset Fees	\$22,800
Service Fees	\$16,680
Additional Service Fees	Variable
<b>Total Fees</b>	<b>\$236,880</b>

**Total Expense Ratio**

Total Fees	\$236,880
Total Assets	\$61,000,000
<b>Plan Expense Ratio</b>	<b>0.39%</b>

*\* Vanguard expense ratios are as of each fund's latest fiscal year. If applicable, outside fund expense ratios were obtained from Lipper, Morningstar or the fund company and are only as current as the information supplied to these entities by third parties. Vanguard is not responsible for the accuracy of data provided by third parties.*