

COMMENT LETTER

August 30, 2010

Institute Comment Letter on DOL 408(b)(2) Service Provider Disclosure Interim Final Regulation (pdf)

August 30, 2010 Submitted electronically Office of Regulations and Interpretations Employee Benefits Security Administration U.S. Department of Labor 200 Constitution Avenue, NW Washington, DC 20210 Attn: 408(b)(2) Interim Final Rule Ladies and Gentlemen: The Investment Company Institute¹ is pleased to express its strong support for the regulation under section 408(b)(2) of ERISA. The Institute has long supported effective disclosure to plan fiduciaries that enables them to fulfill their ERISA obligations. This regulation will provide significant dividends for plan fiduciaries because it will allow them to be better informed about plan service providers and have fee information on all plan investments. The Department addressed thoughtfully the comments raised by interested parties. While the Department did not implement all of our suggestions, it clearly took concerns of the retirement industry seriously and we believe that, with a few clarifications we describe below, the regulation will meet the goal of helping fiduciaries hire and monitor key service providers and understand potential conflicts of interest. We also applaud the Department for soliciting comments on the interim final regulation. We recommend the Department issue a final regulation as quickly as possible. ¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.18 trillion and serve almost 90 million shareholders. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 2 of 13 Below, we recommend features of the interim final regulation that should be retained and then make suggestions for clarifications and additional guidance that will make the regulation more effective. We then address the disclosure statement. Finally, we the interim final regulation Features of the Interim Final Regulation that Should be Retained The interim final regulation focuses fiduciaries on the key information they need to evaluate provider services and compensation and, with a few clarifications we recommend below, will not overwhelm them with detail. In addition, we believe the interim final regulation provides clarity to recordkeepers and other service providers on what is required and sets up a reporting structure with respect to plan investment fees that is workable for service providers and issuers of investments. The should retain the features of the proposal that reflect these principles. The Department should retain the covered service provider categories. The categories of covered service provider focus on key plan services: direct fiduciary services, fiduciary services to a plan asset investment, services as a registered

investment adviser, recordkeeping or brokerage services where a platform of investments is offered to plans, and other services where indirect compensation will be earned. A service provider is covered only if the provider reasonably expects to receive \$1,000 or more in compensation in connection with covered plan services.² The Department confirmed in the interim final regulation that service providers to mutual funds, who are not parties-in-interest to the plan and who often have no direct contact with or knowledge of the plans investing in the funds, are not covered by the regulation. This avoids a number of problems described in our prior comment letter. We strongly recommend that the Department retain paragraph (c)(1)(iii)(D)(2) of the regulation. ² The Department asks whether \$1,000 in expected compensation is a reasonable threshold. We believe that it is. A few of our members have noted that there is no timeframe for the \$1,000 threshold, which appears to mean it is not evaluated on an annual basis but instead over the expected life of the contract. This could lead to interpretive questions, for example, with contracts that automatically renew or those that have no time frame but can be terminated at any time. The Department should consider providing some guidance. We do not have a position because our members tell us they expect it will be more cost effective to provide the 408(b)(2) disclosures in all cases. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 3 of 13

The Department should retain the structure of recordkeeper or broker as conduit of investment fee information. Plan fiduciaries selecting investment options for a 401(k) plan menu need to know the fees and expenses of all plan investments to make a prudent selection and fulfill their duties under ERISA; knowing this information also ensures that fiduciaries understand the total cost of a plan. The Department properly addressed this concern by requiring recordkeepers and brokers to disclose key fee information with respect to those investments for which recordkeeping or brokerage service are provided. This is a routine practice now because plan recordkeepers and brokers deal directly with plan fiduciaries and have access to investment-related information for investments they make available to plans. Making this structure workable depends on two features of the interim regulation that should be retained: first, allowing a recordkeeper or broker to satisfy the requirement by providing current disclosure materials of the issuer of the investment, provided certain conditions are met, and second, limiting the requirement to those investments the provider makes available on its platform. The Department should retain the required fee disclosure data points for investments. The interim final regulation requires three pieces of fee information with respect to all plan investments:

- A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);
- A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed; and
- A description of any ongoing expenses in addition to annual operating expenses (e.g., wrap fees, mortality and expense fees).

Requiring that the fiduciary receive this information with respect to all investments is a crucial feature of the proposal and a significant improvement over current rules and should be retained. These three pieces of information provide a good picture of the cost of an investment, allow comparability among investments, and, in the case of mutual funds, are already readily ascertainable by recordkeepers and brokers because they are calculated and disclosed by the fund to satisfy SEC rules. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 4 of 13

Requests for Clarifications and Guidance The clarifications and guidance that we request below are designed to ensure that the industry fully understands the application of the regulation and that it is not interpreted in a way that reduces its effectiveness or imposes unnecessary compliance costs. With the exception of the first item, for which we recommend a slight modification to the regulation, all of these clarifications could be

achieved by providing guidance in the preamble to the final regulation.³ Updates on investment fees throughout the year. The interim final regulation requires covered service providers to disclose changes in the information required by paragraph (c)(1)(iv) as soon as practicable, but not later than 60 days from the date the covered service provider is informed of the change, unless the disclosure is precluded due to extraordinary circumstances beyond the covered . Since the requirement for a recordkeeper or broker to disclose fee under a strict reading of th all of the investments on its platform, and whenever a fund files an updated prospectus with the SEC or otherwise updates its expense ratio, the recordkeeper or broker must disclose the change to those plans for which that investment is a designated investment alternative. Mutual funds are required by SEC Rule 8b-16 to file updated prospectuses with the SEC not more than 120 days after the close of their fiscal year. Mutual funds do not end all of their fiscal years on the same day (e.g., December 31) they end at different times throughout the year, including those within a fund family or complex. According to Institute data, less than half (41%) of open-end mutual funds have a fiscal year ending in December, the next most common is October (15%), and the remainder of funds have fiscal years distributed throughout the other 10 months of the year. ⁴ e slightly because the disclosed expense ratio is based, in part, on actual expenses incurred during the prior year. ³ We recommend that the Department provide guidance and clarifications in the preamble to the final regulation published would provide more certainty to the industry and may be entitled to more deference if challenged in court. ⁴ shareholders. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 5 of 13 Because the Department removed the materiality threshold from the regulation, it appears that a change of a single basis point could trigger an obligation on the part of the recordkeeper or broker to provide an update.⁵ If plan fiduciaries continually receive notices that one or another designated investment alternative has updated its expense ratio, fiduciaries may begin to ignore these notices. We recommend that the Department modify the interim final regulation to provide that a recordkeeper or broker will be deemed to satisfy the update requirements of paragraph (c)(1)(v)(B) with respect to the investment disclosure required by paragraph (c)(1)(iv)(G)(1) if the recordkeeper or broker provides an update at least once a year on all of the designated investment alternatives and states that during the year it will provide upon request a copy of the latest disclosure materials described in paragraph (c)(1)(iv)(G)(2) from the issuer of the designated investment alternative. Application of recordkeeping definition to participant-level accounts held on mutual fund books. The interim final regulation maintenance of covered plan and participant and beneficiary accounts, records, Whether an entity is providing recordkeeping services is important because it results in the entity being treated as a covered service provider if more than \$1,000 in compensation is reasonably expected and imposes on the entity the obligation to provide a reasonable and good faith estimate of the cost to the plan of those ed investment alternatives. In most cases, account holding of the recordkeeper or broker), as it would for any investor. Some of our members report that occasionally a small plan will open accounts on the fund under the name of individual participants transfer agent will provide account statements, as it would for any investor. These statements might be provided directly to the participant, to the plan fiduciary, Other than maintaining these few participant-level accounts, the transfer agent may not perform any of the other services ordinarily associated with plan administration, such as calculating employer contributions, performing non-discrimination testing, calculating vesting, or assisting in preparation of 5 es will need to be disclosed in 2012 (see Table 4) is woefully understated, since most participant-directed 401(k) plans will have investments whose expense ratios change during the year. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 6 of 13 Form 5500, although the fund company may make available a prototype plan document for use by the plan sponsor. that term is generally understood in

the 401(k) industry. We believe that whoever is performing necessary plan administration, such as the employer. The Department should clarify whether solely maintaining a participant-level account in these circumstances if it is, the Department should clarify how the transfer agent should comply with the requirement to disclose the cost to the plan of the recordkeeping services, as required by paragraph (c)(1)(iv)(D), since the services provided may be no more than the fund performs for a non-plan investor. Investment menu changes designated by responsible plan fiduciary. Paragraph (c)(1)(v)(A) requires that if an investment alternative is not designated at the time a contract or arrangement is entered into, then the fee information on that investment alternative required by paragraph (c)(1)(iv)(G) must be provided as soon as practicable, but not later than the date the investment is recordkeeping arrangements, but plan fiduciaries replace designated investment alternatives from time to time. Often, the responsible plan fiduciary, working with a consultant or investment adviser, will collect data on possible replacement investments and take the steps required under the governing plan documents to substitute investments (such as by a vote of the plan committee), and on recordkeeper of the change. In this circumstance it is obviously impossible for a recordkeeper to provide the disclosure required by (c)(1)(iv)(G) in advance of being informed of the responsible plan believe that in these circumstances, the applicable provision is paragraph (c)(1)(v)(B), which requires a service provider to disclose a change in the information previously provided as soon as practicable, but generally not later than 60 days after being informed of the change. We ask the Department to confirm our understanding. Use of prospectus for affiliated fund. Paragraph (c)(1)(iv)(G)(2) provides that a recordkeeper or broker may comply with the obligation in paragraph (c)(1)(iv)(G)(1) to provide fee information for designated investment alternatives by providing current disclosure materials of the issuer (e.g., a prospectus in the case of a mutual fund) that contains the information. This applies, however, only if the issuer is not an affiliate. Some of our members have expressed concern that this could be interpreted to mean that a recordkeeper or broker would be precluded from providing a prospectus of an affiliated mutual fund to meet the disclosure obligation in paragraph (c)(1)(iv)(G)(1). We do not believe the Department could have intended this result. It would not make sense for a service provider to create a new document that would simply repeat the fee information disclosed in the prospectus, and a fund company essentially selling a fund through a document other than a prospectus might raise concerns under securities law.⁶ We believe the correct interpretation of the interaction between paragraphs (G)(1) and (G)(2) when a designated investment alternative is a fund affiliated with the service provider is that the service provider still can provide the prospectus of the affiliated mutual fund to meet the disclosure obligation, but that the service provider is not necessarily protected if it turns out the information in the prospectus is incorrect.⁷ We ask the Department to confirm our understanding. Electronic disclosure. In the preamble to the proposed regulation, the Department stated that disclosures under the regulation can be made electronically to responsible plan fiduciaries, although neither the proposed nor interim final regulation addresses the issue. The preamble to the interim final regulation does not state expressly that electronic disclosures may be used, although the economic analysis assumes that half of all disclosures under the regulation will be made electronically and points out that many services are electronically savvy, as are most plan fiduciaries. Because this issue is of great importance to the cost of compliance with the regulation, which ultimately will be borne by plan participants, we think it would be worthwhile for the Department to reiterate in the preamble to the final regulation that disclosures required by the regulation can be made electronically. Off-platform investments. The requirement in paragraph (c)(1)(iv)(G)(1) that a recordkeeper or broker provide fee information for designated investment alternatives as described in paragraph (c)(1)(iii)(B) of this section will be provided

pursuant to the contract or through a platform or similar mechanism) in connection with such recordkeeping services or brokerage 6 See Securities Act of 1933 §§ 2(10), 5, and 10.

7 Instead, the service provider would need to avail itself of the provision for disclosure errors in paragraph (c)(1)(viii), which is available if the provider acted in good faith and with reasonable diligence. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 8 of 13 offered to all its current and potential plan clients, the investments covered by this situation are clear. - including limited partnerships, separate accounts or legacy investments, and will request that the recordkeeper receive data from the investment provider. In these circumstances the recordkeeper may not have a contract with the provider of the investment. Because paragraph (c)(1)(iv)(G)(1) cross references (c)(1)(iii)(B), it appears that the obligation to provide fee information applies only to those investments a recordkeeper generally makes available to plans through its platform and not those investments which in a particular instance it has agreed to include in the plan records it maintains. We ask the Department to confirm our understanding. Indirect compensation for brokerage windows. Although brokerage windows are not may be subject to the 408(b)(2) disclosure obligation if, as is routinely the case, the broker receives indirect compensation from some of the investments offered in the brokerage window, such as 12b-1 fees, and the broker reasonably expects to receive more than \$1,000 in direct and indirect compensation. Because these brokerage windows offer participants access to potentially hundreds or thousands of investments, and the investments participants will select in the future cannot be predicted, the broker might feel compelled to comply with the obligation by providing a master list of the indirect compensation from every investment. This sort of disclosure would not be helpful to plan fiduciaries. Paragraph (c)(1)(viii)(C)(3) provides that if compensation cannot reasonably be expressed in terms of a monetary amount or formula, it can be expressed by any reasonable method that contains sufficient information to permit evaluation of the reasonableness of the compensation. We recommend the Department confirm that it would be a reasonable method for a broker to disclose the fact that the investments available through the brokerage window may pay indirect compensation, disclose a range of that indirect compensation, and offer to make available upon request the specifics for any particular investment.8 Non-ERISA 403(b) plans. Service providers to a 403(b) plan exempt from ERISA coverage pursuant to 29 C.F.R. 2510.3-2(f) may rely on a representation from the plan sponsor that the plan 8 The broker still would be required to disclose direct compensation (e.g., commissions or asset-based account fees) that it will charge in connection with access to, or purchases and sales through, the brokerage window. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 9 of 13 meets the conditions of the exemption, since many of the conditions are based on the actions of the plan sponsor. It is possible, especially in light of recent changes in the regulation of 403(b) plans, that a plan initially believed to meet the exemption might subsequently be determined not to meet the exemption. The Department addressed analogous circumstances in the interim final regulation. Section (c)(1)(v)(1) provides that if a non-plan asset investment is subsequently determined to hold plan assets, the required disclosures must be made as soon as practicable, but not later than 30 days from the date the covered service provider knows the investment holds plan assets. Similarly, section (c)(1)(vii) provides that service providers can correct reasonable errors or omissions as soon as practicable, but not later than 30 days after learning of the error or omission. We recommend the Department confirm that similar relief would be available if a plan reasonably believed not to be a is subsequently determined to be a covered plan. Summary Disclosure Statement The Department asks for comment on whether it should require covered service providers to uld provide an overview for the responsible plan fiduciary of the information required to be disclosed and include a roadmap describing where to find the more detailed elements of the disclosures required by the regulation. We

can appreciate the advantages of a summary disclosure, and many of our members who offer bundled recordkeeping and similar services provide this sort of summary, which typically is designed to highlight the total cost of the plan (including the cost amount of that cost that the service provider receives in indirect compensation. In addition, because the separate recordkeeping disclosure required by paragraph (c)(1)(iv)(D) will be inherently artificial and the key number for a responsible plan fiduciary is the total cost of the services, we expect most providers will provide the separate recordkeeping disclosure in a way that puts it in context of the entire cost of the plan. While we do not oppose the notion of the Department requiring that information provided to plan fiduciaries include a summary of this type, it is critical that any requirement for a summary in the final regulation be workable. In considering whether to require a summary, the Department should take into account the following. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 10 of 13 The Department should not impose a particular form or format. The Department estimates that 695,000 plans and 10,000 service providers will be subject to the regulation.⁹ The regulation covers many different kinds of services and even within a narrow band of services like 401(k) plan recordkeeping or brokerage, the arrangements will vary. No one form or format could cover all of these arrangements without an extensive, detailed rulemaking record. More importantly, the retirement industry continues to see significant innovation in disclosure and currently firms compete in part on the basis of their ability to help fiduciaries understand fees so fiduciaries feel comfortable they are fulfilling their duties. The impetus in the industry to improve this disclosure continuously is similar to the innovation in participant benefit statements that have occurred because the quarterly benefit statements required by the Pension Protection Act need not be in a particular form or format. Department requirements for a particular form or format could stifle this needed innovation and competition. The Department should not eliminate the provision allowing recordkeepers and brokers to rely on the information in existing regulated disclosure documents of investment issuers or allow fee disclosure to obscure other key information. As stated earlier, the only way to make workable the requirement that recordkeepers and brokers serve as conduits of fee information for designated investment alternatives is if they can rely on the current disclosure materials of the issuer of the investment (e.g., the prospectus in the case of mutual fund). If the Department decides to require that the fees of designated investment alternatives be summarized in one place, the Department must retain the core principle that recordkeepers and brokers can rely upon the information in existing regulated disclosure materials. Nor should any summary of costs take away from other key information about plan investments and services. We understand the appeal of isolating and summarizing other required disclosures of investments and services. We note, however, that mutual fund disclosures under SEC rules include more than just fee information precisely because fees are not the only thing an investor should consider before investing in a mutual fund. The new summary prospectus is designed to include 9 The actual service provider n appears to be based on pre-2009 Schedule C filings. have captured service providers that work solely with smaller plans. In addition, prior to the 2009 filings (which have just begun to be made), Schedule C reporting was more limited in the service providers covered. For example, service providers receiving only indirect compensation generally were not reported on the pre-2009 Schedule C. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 11 of 13 visers and portfolio managers.¹⁰ The Department als one of several factors fiduciaries need to consider in deciding on service providers and plan investments ¹¹ Since there may be no opportunity for comment on the application of a summary, there must be significant flexibility in how service providers comply. Because we anticipate that the Department will seek to issue a final regulation as soon as possible, the Department will not have the opportunity to solicit formal comments to resolve problems in implementing the

requirement and meet the goal of ensuring plan fiduciaries and service providers can read the rule and know exactly what is required. Issuing a final regulation which then requires modifications through extensive FAQs would do a disservice to plan fiduciaries and service providers. Without a chance to review the requirement the Institute and its members cannot anticipate the problem areas, but a partial list might include 403(b) plans; brokerage windows; insurance and annuity fees; broker compensation received from multiple investment firms; investments like employer stock funds, limited partnerships, stable value funds, and GICs; service structures like joint ventures and - whether a particular document is short enough to co an entire new summary if only one minor element changes. If the Department decides to proceed to require a summary, flexibility is key. Economic Analysis We strongly agree that the interim final regulation will have significant economic benefits. We are concerned, however, that the Department economic analysis repeats a statement that the Department made in 2008 and retracted in 2009 that the regulation could reduce fees by 11 basis points per year.¹² The Department initially reached this conclusion in its economic analysis in the proposed participant disclosure regulation¹³ and proposed investment advice regulation.¹⁴ In the 10 See 74 Fed. Reg. 4546 (Jan. 26, 2009). 11 See Department of Labor, Meeting Your Fiduciary Obligations, available at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>. 12 See 75 Fed. Reg. 41600, 41628 (July 16, 2010). 13 See 73 Fed. Reg. 43014, 43020 (July 23, 2008). 14 See 73 Fed. Reg. 49896, 49903-04 (Aug. 22, 2008). Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 12 of 13 tion, we explained why that conclusion is based on a misreading of the literature cited, misinterprets the statistics presented, and fails to recognize empirical difficulties in some of those studies. We included a detailed appendix on the issue.¹⁵ We also explained why we believed the participant disclosure regulation would have other benefits justifying its costs. And we agree that this interim final regulation will have benefits that justify its costs, particularly since the Department addressed many of the issues that could have created unjustified compliance costs for service providers. The Department responded to our comments when it analysis for the final investment advice regulation issued on January 21, 2009.¹⁶ The Department the available research provides an insufficient basis to confidently determine whether or to what degree participants pay inefficiently high investment prices. The Department should not repeat the 11-basis point conclusion in final economic analysis of its 408(b)(2) regulation. Rather, it should follow the more detailed and thoughtful analysis set forth in the January 2009 final investment advice regulation. Effective Date Because the Department concerns of the service and investment provider community, including by removing an obligation to amend contracts, we believe that an effective date of July 16, 2011 is workable. This conclusion rests, however, on the assumption that the final regulation will not impose new obligations on service providers. If it does, the effective date should be extended to give service providers at least a year to implement the new requirements. We also recommend that the Department provide an exception to the application of the regulation to contracts and arrangements entered into prior to the effective date in one limited circumstance: individually-owned 403(b) custodial accounts and annuity contracts, where the contract or account is held by a vendor that, as of January 1, 2009, is no longer authorized to receive 15 <http://www.dol.gov/ebsa/pdf/cmt-09090825.pdf>. 16 See 74 Fed. Reg. 3822, 3840-42 (Jan. 21, 2009). That regulation was ultimately withdrawn for unrelated reasons. Office of Regulations and Interpretations 408(b)(2) Interim Final Regulation Page 13 of 13 contributions under the plan.¹⁷ For these types of 403(b) contracts and accounts, the plan fiduciary typically does not retain any material rights and we question whether application of the 408(b)(2) regulation would be appropriate. The Department has extended relief to certain pre-2009 contracts and accounts in the context of annual reporting on Form 5500

(see Field Assistance Bulletin 2009-02, as supplemented by FAB 2010-01), recognizing that these contracts and accounts have become disconnected from the sponsoring employer. Similarly, in the context of the 408(b)(2) regulation, it may be either impossible for plan fiduciaries to ensure compliance with respect to pre-2009 contracts and accounts, or possible only at substantial expense. * * * We commend the Department for its thoughtful approach to the interim final regulation and for seeking further comment. We believe the clarifications we recommend will ensure that the regulation is most effective in helping plan fiduciaries have the information they need to determine that undersigned at 202.326.5826 (podesta@ici.org) or Michael Hadley at 202.326.5810 (mhadley@ici.org) with any questions. Sincerely, /s/ Mary Podesta Mary Podesta Senior Counsel Pension Regulation 17

The Institute requested guidance relating to pre-2009 individually-owned 403(b) contracts and accounts in a letter to the Department dated November 12, 2008 (supplemented by a letter dated March 17, 2009, responding to questions raised by the Department). The November 2008 letter is available at:
http://www.ici.org/policy/comments/09_ebsa_403b_com.

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