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September 8, 2008

The Honorable Bradford Campbell
Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW, Suite S-2524
Washington, D.C. 20515

Re: Comments on Proposed rule issued July 23, 2008.

Dear Assistant Secretary Campbell:

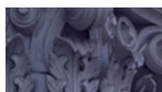
I am writing to comment on the Proposed Rule issued on July 23, 2008, regarding fiduciary responsibilities associated with fee disclosure in individual account defined contribution plans. The Department is to be applauded for its continuing work and effort. Although I do not believe the regulation adequately resolves the matter of helpful disclosure as currently proposed, it appears, though, that the regulations need only a very small step forward to resolve the issue of disclosure once and for all.

Remaining issues to be resolved

There are three primary issues that have not been adequately resolved. Each is very simple to address and to avoid the appearance that the proposed rule does not adequately protect participants, I urge you to incorporate the following elements into the regulation:

1. **Revenue Sharing**: The regulation does not require sufficient clarity about certain types of charges. An apparent glaring omission is the failure to require a breakout of the Revenue Sharing component from the total expense ratio. Revenue Sharing has nothing to do with fund management, yet it is charged against participant accounts as though it does. It is also communicated to participants that way, misleading them to conclude that fund management services cost more than they actually do. Participants need to know what the cost of fund management is net of Revenue Sharing so informed investment decisions can be made.

   There still appears to be a lack of understanding about why Revenue Sharing needs to be disclosed separately. Since 401(k) and other similar plans are governed by fiduciary standards of care, there should not be any confusion about the matter. However, confusion remains, so please consider the following three examples intended to clarify the matter:



Example A: How would the Department view the following scenario?

A plan sponsor requests a confidential meeting with a fund manager. During the meeting, the plan sponsor asks the fund manager to increase its expense ratio by 25% so it can shift the costs it currently bears to the participants, secretly. Then, the plan sponsor requests that the mutual fund company become the bill paying agent of the plan, sending the revenues derived from the 25% gross-up to another service provider, also secretly. Further, the plan sponsor asks the fund manager to do everything it can to obscure the gross-up so that the participants will find it nearly impossible to discover or understand, and further requests that participants are to be told that they are not paying anything for certain services. The plan sponsor and fund manager enter into the pact to secretly increase the expense ratio, secretly pass the revenues to a third party who could be related to the fund manager in some way, and who would never be able to invoice the amount received if that amount was paid directly by the plan sponsor (which is the true test of "reasonableness" – i.e. if the plan sponsor doesn't think it's reasonable for them to pay, why do they think it's reasonable for the participant to pay?) and then deny any such scheme exists if a participant inquires.

That scenario offends almost every person who hears or reads it. Yet, it is the very nature of Revenue Sharing, although most plan sponsors are simply victims of the scheme, as are participants. If traditional Revenue Sharing schemes are to remain, they must be disclosed separately from the fund management cost component so participants and fiduciaries are not misled

Example B: How would the Department view the following scenario?

A car salesman convinces a wary buyer that the *cost to drive a car* is the sticker price, and nothing more. The individual purchases the car, but soon finds out that the car has other expenses associated with it – expenses that were directly relevant to the decision making process, and potentially more important than the sticker price because of their ongoing, continuous nature. The buyer found that the cost to drive the car was far more than it would have agreed to pay had it known and understood what those costs to drive were ahead of time. The car got poor gas mileage; filling up the tank was a burden. The cost of insuring the vehicle was far more than the buyer could afford. The cost of registration and maintenance made the car unaffordable even though the sticker price seemed reasonable.

Some may try to obscure the issue by suggesting no buyer wants to know the cost of every nut and bolt in a car; that is not the relevant issue, though. The real issue is what it costs to actually drive the vehicle, to fill

the tank, to insure it, to maintain it, to register it, etc. There is a reason why those who sell new cars post what a buyer can expect to receive in mileage – so it can determine whether or not it can afford the car – to make a decision based on whether the buyer deems the overall costs of the car are reasonable. A gas guzzling car engine consumes far more fuel than would otherwise be acceptable if understood in its correct context.

Revenue Sharing in many cases exhibits the same kind of inefficiency in the retirement plan system. The very nature of Revenue Sharing is of sufficient importance to the long term security of millions of American workers that it is an obvious and necessary elemental disclosure, and must be separated from, and not be confused with, "unlike" services, such as fund management. Also, in order for a decision maker to quantify the value of a fund manager's services, the true cost of those services must be known and understood. It's so fundamentally elemental to properly discharging fiduciary standards of care and loyalty to participants; it is almost shameful we are still discussing it.

In conclusion with respect to Revenue Sharing, the harm occurs when Sponsors and Participants believe they are paying top dollar for quality investment management services, but in reality they are paying a bundled provider, for example, who siphons a material percentage of the investment management fee to an affiliate or other subcontractors for administrative services. It gives the false impression that the more paid to investment managers, the better those funds will perform. It also gives the false impression that administrative services cost less than they do, making it impossible to measure the true value of those services in light of actual costs. Participants in 401(k) Plans have as much right to know what they are paying for in investment management services as other investors do. If they are exercising control over the management of their account, such as where plans are subject to 404(c), they especially have the right to know what other services are paid from their accounts and purposely withholding that information is a breach of trust.

2. **Brokerage Commissions**: The regulation appears to have stopped short of requiring the disclosure of brokerage commissions. Some fund managers or institutions (and their trade groups) have complained that requiring the disclosure of certain implicit economic costs, such as spreads or market impact costs are difficult and costly to disclose. However, one cost that is inherent in transaction costs are brokerage commissions. Those are real commission charges, and they are reported annually by each fund as a dollar or as a percentage of assets. Since no one disputes the requirement to disclose brokerage commissions, and given that brokerage commissions reveal fund manager behavior, those are without question the domain and responsibility of the fiduciary and the participant decision maker. If a compromise is reached permitting spreads and market impact costs to remain undisclosed, the brokerage commission should still be an included disclosure element within the regulation.

3. **Uniformity in Disclosure**: There are two reasons that disclosure must be delivered in a uniform format, industry wide. The first is so fiduciaries and plan sponsors can quickly compare two different plans. Standardization will not only improve the efficiency of comparing plans, but it will also reduce mistakes caused by interpretational errors. Participants are entitled to standardized disclosure so they see the same thing when they move from one employer to another. That will greatly build understanding and confidence in the system. The second reason why disclosure must be delivered in a uniform format is that it will create an environment of transparency that will encourage fair competition.

What Should Be Disclosed, and to Whom

There should not be a debate over what should be disclosed. There are two core economic elements that dictate long-term outcomes within a defined contribution plan account.

1. Proper portfolio construction
2. Efficient, non-excessive administration

Obviously, there are costs associated with each. Those costs must be disclosed because they have a profound and real impact on outcomes. Thus, basic disclosure must include total economic impact caused by portfolio maintenance and administration.

However, given that there may be both fundamental and optional components integrated into either element, disclosure must be complete so that the person exercising control over the account (whether trustee or participant) can assess and evaluate the appropriateness, relevancy, and value of each service when viewed in light of desired outcomes.

Specific disclosure should include cost of investment management (including trading costs), record keeping and reporting, investment advice and agent commissions, and all remaining fees or charges if any.

To the extent record keeping and other optional services are underwritten through fund expense ratio subsidies, those subsidies must be extracted from the expense ratio and disclosed separately, on their own merits, so those exercising control can measure their value.

With respect to who should receive those disclosures, it is very simple. The appropriate fiduciary must always receive full and complete disclosure. That goes without saying. To the extent a participant is exercising control over their own account, it also goes without saying that they too must receive full disclosure. Without it, they cannot exercise informed control over their account, but rather are literally handicapped and will in all likelihood make poor investment decisions if the economics of a given portfolio are withheld from them as the decision maker.

That is not acceptable by any reasonable person or prudent fiduciary standard.

Practical Definition of "Reasonable"

It seems that there is some confusion as to when a fee or cost is reasonable, and when it is not. The reality is, any given thing or cost could be reasonable to someone.

To resolve this apparent conundrum, there must be a practical, mutually acceptable test for reasonableness. If all information is available to all parties to a transaction, and they willingly agree to proceed with that transaction, understanding the nature and desired outcomes of that decision, then the decision is reasonable. It's that simple. An easy test exists: What will the employer pay? If the employer will not pay it, then it might not be reasonable. If those costs passed on participants are deemed reasonable by a plan sponsor, there should be no hesitation on anyone's part to disclose all costs; after all those costs are reasonable. What is there to fear?

Form of Disclosure – only "Gross-to-Net" will suffice

There are two types of disclosure that Sponsors and Participants need in order to make prudent decisions. The first type of disclosure is required before a decision is made. It includes the cost of investment management (including trading costs), recordkeeping and reporting, investment advice and agent commissions, and all remaining fees or charges, if any, relevant to the decision. The first level of disclosure should be communicated via the Summary Plan Description.

The Department's proposed disclosure form is a starting point, but is still deficient.

Disclosure must be made on a fund by fund basis for it to be credible from a fiduciary and decision maker standpoint, and accordingly requires bundled service providers to disclose fees, expenses, revenue sharing etc. between affiliates or subsidiaries. In other words, this first level disclosure helps decision makers (Sponsors and Participants) know what fees and costs to expect from all sources before entering into a transaction, including a reasonable expectation of brokerage commissions.

The second type of disclosure helps decision makers know what they paid during a reporting period, at a glance. In other words, the second type of disclosure should be a summary of total fees paid, possibly on an annual participant statement. The details should also be immediately available to interested participants upon request. Summary disclosure can be quite simple and very inexpensive to deliver.

Consider the following ideal model:

A	B	C	D	E	F	G	H	I	J
Fund	Beginning Balance	Total Contributions	Withdrawals & Disbursements	Transfers	Gross Earnings	Investment Expenses	Admin. Expenses	Ending Balance	Net Return
ABC Stock	$ 9,562.12	$ 3,000.00	-	-	$ 989.20	($192.16)	($106.47)	$ 13,252.69	6.24%
XYZ Bond	1,588.00	500.00	-	-	61.92	($20.23)	($11.21)	2,118.48	1.66%
Stable Value	3,447.22	1,000.00	-	-	157.43	($64.30)	($35.63)	4,504.72	1.46%
Annuity	4,001.99	1,500.00	-	-	138.31	($96.95)	($53.72)	5,489.63	-0.26%
Total	**$ 18,599.33**	**$ 6,000.00**	**-**	**-**	**$1,346.86**	**($373.64)**	**($207.03)**	**$ 25,365.52**	**3.55%**

Fee & Expense Summary (Columns G & H)

1. Investment costs:	$ (373.64)	1.73%
2. Administrative costs*:	$ (207.03)	0.96%
Total costs:	**$ (580.67)**	**2.69%**

Note: The Revenue Sharing portion of the Administrative Cost is $56.05

Excess (Costs) or Returns

Your net return	3.55%
Your personal index	5.35%
Your excess (costs) or returns	**(1.80%)**

Explanation of column headings, A through J:

Column:

A. Fund – The name of the investment, whether mutual funds, ETF's, Annuities, Employer Stock, Collective Trusts, Pooled Separate Accounts, etc.

B. Beginning Balance – Reconciled from prior period ending balance. Beginning and ending balances "are what they are." In other words, they must tie to the actual values of the investments themselves, as reported by the fund/financial institutions. Beginning and ending balances are known and currently tracked by record keepers as a matter of practice.

C. Total Contributions – Known and tracked by record keeper.

D. Withdrawals & Disbursements – Known and tracked by record keeper.

E. Transfers – Movements between funds; known and tracked by record keeper.

F. Gross Earnings – Calculated. The ending balance is always known by the record keeper at the end of each valuation period. Since all of the other elements that account for the difference between beginning and ending balances are known, the only remaining item is gross earnings, which can be calculated with simple addition and subtraction. The alternative—calculating the gross returns for each

fund and participant—would, as the financial industry has stated, be prohibitively complicated and expensive, and would require the financial industry to disclose "gross returns" to a record keeper. We get to the same number this way, and since it is simple arithmetic, it will not cost more than a few hours of programming for record keeping systems.

G. Investment Fees & Expenses – The sum of investment expenses. Investment expenses include the actual expense ratio reported by investment firms on the investment product's financial statement, other fees (i.e. redemption fees, contract charges, etc.), plus brokerage commissions and costs to clear the trades, investment advice and agent commissions, custodial, and miscellaneous investment product fees/charges.

H. Administrative Fees & Expenses – The sum of administration and other operational expenses. Administration expenses paid by plan assets are already accounted for by the record keepers. It can include, but is not limited to, record keeping, compliance testing, reporting, consulting, legal, accounting, auditing, or other non-investment specific fees paid directly from plan assets.

I. Ending Balance – Calculated by adding columns A through H.

J. Net Return – Derived using standard guidelines for the calculation of investment returns and in common use currently. (For purposes of illustration, net returns in this sample statement are calculated simply by dividing Gross Earnings less Fees & Expenses [numerator] by the beginning balance plus one-half the net contributions [denominator]. In an actual statement, the calculation of net investment returns would be determined using more precise methods that take into account the dates and amounts of actual cash flows.)

The lower section of the disclosure statement identifies the breakdown of investment and administrative costs in both dollar and percentage terms. In addition, it compares the net returns for the individual with a personalized calculation of what they could have received if their plan balances had been invested in the most basic low cost prudent portfolio. If a participant cannot outperform the most basic low cost portfolio, then the costs of trying but failing are obviously excessive. That's a very simple way to resolve the "reasonableness" conundrum.

Although this may seem like a lot to absorb, it really comes down to a few very simple principles. First, combine data that is already available from multiple sources, apply a very simple mathematical formula, and full disclosure is the result. Because most of the analysis is happening at the record keeper level, it will not be costly nor will it be difficult to provide this level of full disclosure. The process will enable fiduciaries and participants to construct meaningful portfolios and to negotiate with service providers on an even playing field, with full information necessary to make prudent decisions.

The Gross-to-Net grid is an ideal standardized format. It gives all parties the needed information, at a glance, in its proper context. If the standardized disclosure grid is to be delivered to participants from a third party, that party should not be a bundled service provider or fund institution, for obvious reasons. Participant protective checks and balances are important.

Conclusion

Regulations should seek to protect participants within all types of business models, bundled, unbundled, etc. Regulations should not impede a participant's ability to exercise control over their account if subject to 404(c). That requires understanding – and understanding follows clarity and standardization. Regulations should not serve the industry, but rather should treat all parties equally. Full access to all relevant information in a meaningful format should be provided to all decision-makers, in order that that free trade and fair competition can work toward the best interests of the participants. Protecting their interests must be, after all, the central purpose of any proposed regulation.

Sincerely,

Matthew D. Hutcheson
Independent Pension Fiduciary