TESTIMONY OF PAUL SCHOTT STEVENS
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DEPARTMENT OF LABOR
HEARING ON 408(B)(2) PROPOSAL

APRIL 1, 2008

I am Paul Stevens, President and CEO of the Investment Company Institute, the national association of US investment companies. I have with me Michael Hadley, ICI's associate counsel for pension regulation. The ICI would like to thank the Department of Labor for the comprehensive way it is addressing 401(k) disclosure in the Form 5500 revisions, these proposed regulations, and the anticipated participant disclosure regulations.

ICI strongly supports disclosure rules for the 401(k) marketplace that will help assure that plan fiduciaries have all the information they need to make the decisions entrusted to them under ERISA.

My testimony will address the features of the proposal that the Department should retain, and the features of the regulation that should be revised to achieve a more workable and useful disclosure regime.

Features of the Proposal that Should Be Retained

The proposal would require service providers to disclose the direct and indirect compensation they or an affiliate receive in connection with services to a plan. This straightforward requirement fills a gap in existing regulations. It will help assure that fiduciaries understand the ways in which the fees of investment products compensate plan service providers.

Let me give two examples. First, mutual funds commonly make payments to unaffiliated 401(k) service providers to defray the cost of plan recordkeeping or other administrative services. These payments go by various names—service fees, 12b-1 fees, sub-transfer agent fees—but whatever the label, the Department's proposal contemplates that the recipients inform plan fiduciaries about all such payments. Although in the case of mutual fund fees, these payments come from fees disclosed in a mutual fund's prospectus, the prospectus does not and cannot provide the kind of individualized disclosure to the plan that the recipient of the fees can and should provide.

Second, a 401(k) recordkeeper affiliated with a financial services firm may make investment products of an affiliate available to the plan. If so, the plan fiduciary should understand the full picture of the compensation received by the firm, including the fees going to the recordkeeper's affiliate. The Department's rule captures this. It would require the recordkeeper, in effect, to tell the employer—"the direct charge for recordkeeping is X, but remember that you have selected a proprietary investment, so our affiliate will also receive Y in investment advisory fees."

This is an appropriate disclosure structure and we urge the Department to retain it.

The Department also should retain the rule that, when a bundle of services is priced as a package, the service provider is not required to create an artificial allocation of fees for services, such as between investment management and recordkeeping. Some recordkeepers that do not offer proprietary financial products would have the Department require their full-service competitors to "unbundle" investment management and administrative expenses, even if these components are not separately contracted for or priced. In effect, they ask the Department to impose their business model on the entire industry. The Department is correct to focus on disclosure of real payments and not require the disclosure of artificial allocations. The key for plan fiduciaries is to compare the total cost of recordkeeping and investments of one provider with the total costs of recordkeeping and investments of another provider or group of providers.

Features of the Department's Proposal that Should Be Clarified

There are aspects of the Department's proposal that need to be clarified or improved to ensure that the disclosures provide information that is useful to fiduciaries and are workable for service providers. They are detailed fully in our comment letter. I will confine my remarks to two key issues.

First, it is imperative that the Department make clear that this regulation does not turn service providers to mutual funds into service providers to plans. Mutual funds do not hold plan assets and their advisers are not ERISA fiduciaries. Mutual funds have dozens—sometimes hundreds—of service providers, none of whom has any idea about the extent to which particular employee benefit plans are invested in the mutual fund. If these entities were turned into service providers to every plan that invests in the fund, it would at the very least become extremely costly and difficult for mutual funds to be offered to employee benefit plans. It also will expand exponentially the information that plan fiduciaries must review, and all or most of that information will not be of assistance to them – quite the contrary. Avoiding information overload is especially important for smaller plans—and I would note that about nine out of every ten 401(k) plans have fewer than 100 participants.

This is not to say that plan fiduciaries do not need to know the fees and expenses of all plan investments – including mutual funds – to fulfill their duties under ERISA to select and monitor prudently plan investments. They do. Our letter suggests two ways the Department can reach that result without upending ERISA.

The Department could issue guidance on ERISA's general fiduciary rules reminding fiduciaries of the need to obtain and consider fees and expense information about investment options, for example by reviewing a mutual fund's fee table and reviewing and comparing similar information for other investment products.

Alternatively, the Department could require that service providers offering access to investment options on a platform undertake to provide the responsible plan fiduciary with basic fee and expense information about the investment options chosen by the fiduciary. This is a routine practice now.

In either case, the information required about mutual fund fees should not extend beyond the information the SEC requires funds to provide to all their investors. In this regard, SEC regulation already assures comprehensive and consistent disclosure of mutual fund fees.

Put another way, the Department should not create special disclosure items about mutual funds that would apply just to one set of investors.

Second, the Department should scale back the broad sweep of the disclosures regarding conflicts of interest—which, as written, would require a service provider to determine whether any relationship with anyone "may" create a material conflict of interest in performing services. In our view, the purpose of this disclosure is already achieved by the requirement to disclose all direct and indirect compensation, as well as compensation earned by an affiliate, in connection with plan services.

The conflict of interest disclosures of the Department's rule, along with the other items of the proposal, should be designed to avoid redundant disclosures that obscure relevant information. We recommend the Department narrow the conflict disclosure rule to situations in which a recommendation is being made.

These are complex issues. It is important that the Department develop a final rule that is workable and calculated to assure that plan fiduciaries receive the kind of information that assists them in fulfilling their obligations to enter into reasonable service arrangements. I would be happy to take questions.