BRUCE L. ASHTON
HEATHER BADER-ABRIGO
MARC L. BENEZRA
PASCAL BENYAMINI
SUMMER CONLEY
JOSEPH C. FAUCHER
STEPHEN I. HALPER
MARTIN M. HEMING
JONATHAN A. KARP
MEENA P. KOTAK
JEFFREY D. LEWIS**

REISH & REICHER
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
11755 WILSHIRE BOULEVARD
10TH FLOOR
LOS ANGELES, CALIFORNIA 90025-1539
TELEPHONE (310) 478-5656
FACSIMILE (310) 478-5831

www.reish.com
fredreish@reish.com • bruceashton@reish.com

LELAND J. REICHER
C. FREDERICK REISH*
JASON C. ROBERTS
RYAN R. SALSIG
MARK E. TERMAN*
RYAN C. TZENG
MICHAEL A. VANIC
GARY A. WEXLER

OF COUNSEL
ADAM M. COHEN
STEPHEN P. WILKES

*ALSO ADMITTED IN DC
**ALSO ADMITTED IN MT

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VIA EMAIL E-ORI@DOL.GOV

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: **408(b)(2) Interim Final Rule**

Ladies and Gentlemen:

We are writing to provide comments on the interim final rule, Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure, 29 CFR 2550.408b-2. In this letter, the term "Regulation" refers to the interim final regulation published in the Federal Register on July 16, 2010.

Our comments are as follows:

1. **Covered Plans.** The Regulation describes a covered plan as an "employee pension benefit plan" within the meaning of Section 3(2)(A) of ERISA, with specified exceptions. It is not clear whether the reference to Section 3(2)(A) incorporates the definitions contained in the regulation under that section, specifically, Regulation Section 2510.3-3(b), (c) and (d). For example, it is not clear whether a plan that otherwise meets the definition in the Regulation but provides benefit only to a business owner and his or her spouse is a covered plan. We suggest that this be clarified.

2. **Indirect Compensation.** The Regulation defines indirect compensation as compensation received from any source other than the covered plan, the plan sponsor, the covered service provider or an affiliate or subcontractor of the service provider. In some situations, a participant may pay directly for a service it receives (such as investment advisory services). Such a payment would not fall within the definition of direct compensation, since it is not a payment from the plan, but would appear to be considered indirect compensation, since it is not listed as one of the exceptions. Thus, if a participant were to pay for a service

personally, this would appear to be indirect compensation that would cause the service provider to be subject to the entire disclosure regimen of the Regulation. While this situation may not be common, we assume that it was not intended and suggest that the rule be clarified.

3. **Investment Disclosure – Recordkeeping and Brokerage Services**. There are two issues that arise under this section:

   a. Subsection (G)(2) indicates that a covered service provider may satisfy the disclosure requirement by providing materials of the issuer so long as, among other things, the issuer is not an affiliate of the service provider. Presumably, this means that if the issuer is an affiliate, the service provider must make the disclosure in some other way. It is unclear whether a registered investment company (mutual fund) would be considered an affiliate of a broker-dealer or recordkeeper if the fund were managed by an affiliate of the broker-dealer or recordkeeper. The mutual fund itself is owned by potentially thousands of shareholders and, under the terms of the Investment Company Act, is required to have an independent board of directors. However, the investment manager of the fund may have a brother-sister broker-dealer or recordkeeper. Is the fund itself (the issuer in this case) an affiliate of the broker-dealer or recordkeeper?

   b. The additional disclosure requirement of this section is imposed on both the recordkeeper and the broker-dealer that provides brokerage services to participant-directed individual account plans with designated investment alternatives. It is unclear, however, whether both entities must provide the disclosure, thus potentially causing the responsible plan fiduciary to receive the information twice, or whether it is sufficient if one of them provides it. There is a clear exception at the end of subsection (F), indicating that an (A)(2) fiduciary is not required to make the disclosure if the disclosures are made under subsection (G); but there is no similar exception under (G) itself. We suggest that this be clarified.

4. **Other Services for Indirect Compensation**. This section describes a variety of covered services, including "securities or other investment brokerage." Especially in the 401(k) marketplace, smaller plans are often sold by the broker that provides multiple benefit plans to a plan sponsor. These brokers are often licensed as insurance brokers and do not have or operate under securities licenses. While we presume that such brokers would be covered service providers, possibly

fitting under the term "other investment brokerage," we suggest that the list be clarified to include insurance brokers.

5. **Short Summary**. The DOL requested comments on whether covered service providers should provide a short summary of the disclosures they give to the responsible plan fiduciary. In our view, such a summary should generally be required. We submit that an exception to the summary requirement would be appropriate when the service provider enters into an integrated contract with the client for its services, such as in the case of investment advisors that use an advisory agreement that fully describes their services and includes the necessary disclosures. However, in the case of service providers that do not have such an agreement or that use multiple documents (versus a single integrated agreement) to evidence the contract, we urge the Department to require the short summary.

For example, we understand that some broker-dealers and mutual fund complexes take the position that providing internet links to multiple prospectuses or prospectus summaries (and, possibly, to statements of additional information – SAIs) to the responsible plan fiduciary is sufficient to satisfy the advance disclosure requirement for eligible indirect compensation under Schedule C. Regardless of whether this is an accurate interpretation of the Schedule C requirements, the issue is whether this method of disclosure by a broker-dealer providing brokerage services (that is, a covered service provider under subsection (iii)(B) of the Regulation) would satisfy the Regulation. Stated slightly differently, does the regulation contemplate "disclosed" information that can be found by reviewing linked information (or potentially a thousand or more pages) or does the regulation contemplate meaningful disclosure? (The prospectus and SAI for a single mutual fund may be 75 to 100 pages long; as a result, a fiduciary for a plan with 20 mutual funds could need to review 1,500 to 2,000 pages, unless the fiduciary was directed to specific pages or provisions).

It is true that, while the prospectus for a given fund may disclose the compensation paid by that fund for "distribution or other services," the prospectus will not indicate the recipient of the compensation (other than perhaps referring to the "dealer"), does not adequately describe the services being provided by the service provider (other than "distribution") and may not even adequately describe the compensation to be paid, inasmuch as a single prospectus may cover multiple share classes. Further, the prospectus will not describe any additional services the broker-dealer's registered representative who serves the plan may provide, such as assistance with participant enrollment or the assembly of fund performance data to assist the fiduciaries in monitoring the plan's investments. In that situation, we submit that a supplemental disclosure document would be necessary; and once

such a supplemental document is necessary, we submit that there would be little added burden on the broker-dealer to summarize the other information required by the Regulation. More importantly, in our view, such a summary would materially assist the fiduciary, inasmuch as the fiduciary would not need to read through potentially dozens of documents to ferret out the necessary information.

If such a summary is required, we also suggest that the DOL provide a sample form to be used to make the disclosure, making it clear that service providers are free to develop their own forms of disclosure. The DOL may also wish to consider indicating that, if a covered service provider uses the sample form (or one substantially similar to it), this will provide a safe harbor for compliance with the requirements of the Regulation (though we do not consider the establishment of a disclosure safe harbor to be essential to our suggestion of a sample form).

6. **$1,000 Threshold**. The Regulation applies to a covered service provider that "reasonably expects to receive $1,000 or more in compensation...." It is unclear whether this refers to $1,000 over the life of the arrangement with the plan or whether it is intended to be an annual amount. We suggest that this be clarified.

7. **Fiduciary Status**. The Regulation requires covered service providers to disclose whether they will be providing services in a fiduciary capacity, under either Section 3(21)(A) of ERISA or under the Investment Advisers Act or both. The implication is that if the service provider does not reasonably believe that it will be providing fiduciary services, it is not required to make any comment regarding fiduciary status. We submit that it would be helpful to responsible plan fiduciaries if the Regulation required service providers to represent whether they will or will not be providing fiduciary services. In our view, this would be helpful because (a) it will avoid any confusion as to whether the service provider is or is not providing fiduciary services and (b) it will require the responsible plan fiduciary to consider whether it is acceptable for the service provider not to be serving in a fiduciary capacity.

8. **Description of Services**. We urge the Department to make more explicit the requirement that the service provider describe its services. We submit that a statement that the service provider is providing, for example, "brokerage services" or "recordkeeping services" would not be adequate for the responsible plan fiduciary to understand the exact services for which the plan will be paying or for which the service provider will receive indirect compensation. Further, this would not enable the fiduciary to understand any limitations on the services to be received. Thus, leaving a vague standard of disclosure could result in a disservice to the responsible plan fiduciary. For example, we understand that some service

providers will be referring to the descriptions in prospectuses (*e.g.*, "distribution or other services" or services as a "dealer" of mutual funds) or will be using the codes from the Schedule C instructions).

A second concern is that this places the burden of adequate disclosure on the fiduciary rather than on the service provider. The indication by the Department that the "level of detail required to adequately describe the services to be provided pursuant to a contract or arrangement will vary depending on the needs of the responsible plan fiduciary." The implication of this statement is that it will be up to the fiduciary to determine what information it needs rather than up to the service provider to ensure that it is making adequate disclosure. In our view, this inappropriately shifts the burden of the Regulation. The service provider understands the scope of its services, what it does, what it can do, what it cannot do and what it is unwilling to do. Except in relatively large plans with sophisticated advisers or in-house benefits professionals, the responsible plan fiduciary may have little or no appreciation for how the service provider actually operates. Thus, we submit that service providers should be required to provide a more detailed description of their services, including any limitations on those services (*i.e.*, services that are not provided).

9. **Independent Contractors & Broker-Dealers and Registered Investment Advisors**. The Regulation requires specified disclosures among related parties. In our experience, broker-dealers and registered investment advisers conduct their activities through employees or independent contractors, or both. In those cases, the services and the method of delivery are substantially similar. However, it appears that, where the compensation is calculated on a transactional basis, the disclosures vary. For example, where the registered representative of the broker-dealer is an independent contractor, the representative is, under the Regulation, either an affiliate or subcontractor of the broker-dealer, and thus the transactional compensation paid (or expected to be paid) to the registered representative must be disclosed. However, there is an exception for representatives who are employees.

10. **Changes in Annual Operating Expenses**. The Regulation requires that certain fiduciaries, recordkeepers and brokers must make disclosures about plan investments, including a description of annual operating expenses. The Regulation further requires that any changes must be communicated within 60 days after the service provider learns of the change. We have heard from recordkeepers, who may provide services related to hundreds of investments, that there are changes to operating expenses on a relatively frequent basis (and that most are minor changes in the mutual fund expenses). Because of the frequency

of the changes, the cost of compliance within the 60-day window appears to outweigh the benefit of the timeliness of the information. We recommend that changes of that type be permitted within 60 days after the end of either the plan year or the calendar year, or either.

Also, in the section regarding recordkeeping services, in certain circumstances recordkeepers must disclose a reasonable and good faith estimate of the "cost" of recordkeeping services. While the Regulation is clear that formulas and percentages may be used for compensation, the same is not true of costs. The Regulation should be amended to provide the same flexibility for describing costs as for compensation.

A similar issue exists for the disclosure of expenses under the provisions related to expense disclosure for investments by (A)(2) fiduciaries, recordkeepers and providers of brokerage services.

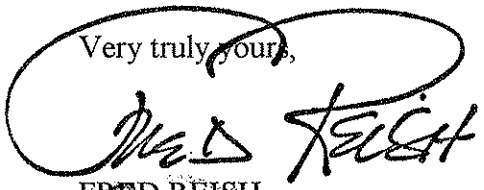
11. **Effective Disclosure**. Unfortunately, the Regulation is not clear about whether the information must be provided in an effective manner or whether fiduciaries can simply be pointed in the direction of the information and then be left to search for the proverbial "needle in the haystack." If the latter, the Regulation will not be particularly helpful to small employers who have limited resources and limited time. While the requirement of a "summary" and a "roadmap" would be very helpful, the Regulation and/or the preamble should clearly state that compliance requires that the information be "delivered" to fiduciaries in a manner that the "average" fiduciary can "effectively" "review, understand and evaluate." Further, since ERISA section 408(b)(2) is a prohibited transaction rule, the burden is on the service provider to prove that it has satisfied its conditions. The Preamble should instruct service providers on that concept.

12. **Timing of Disclosures**. While it is important that all plan fiduciaries be given the required information, the deadline for disclosures for existing plans may be difficult for some providers to satisfy. For example, large providers with thousands, or even tens of thousands, of plan clients may not be able to reasonably convey all of the necessary information within the time limits. While that is partially attributable to the large numbers, it is also due to other reasons, such as the use of different contracts and disclosure policies over the years, the need to respond to questions from fiduciaries about the disclosures, and so on. Since this should only apply to a limited number of providers, we recommend a program where providers can obtain extensions for reasonable cause.

13. **Disclosure of Changes.** The provision on reporting changes requires the disclosure be made "not later than 60 days from the date on which the covered service provider is informed of such change . . .". We recommend that the beginning of the notice period be the later of the date the service provider is informed or the effective date of the change. For example, if a service provider decides on June 1st to increase its fees the following January 1st, the disclosure would likely be most effective if it were made on, or about, January 1st.

We would be pleased to discuss any of these comments.

Very truly yours,



FRED REISH

BRUCE ASHTON