



Written Testimony of

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Before the

COMMITTEE ON EDUCATION AND LABOR

United States House of Representatives

Regarding

“The 401(k) Fair Disclosure for Retirement Security Act of 2007”

October 4, 2007

Chairman Miller, Ranking Member McKeon, honorable members of the Committee, my name is Larry Goldbrum and I am General Counsel of The SPARK Institute, an industry association that represents the interests of a broad based cross section of retirement plan service providers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. It is an honor for me to share our organization’s views on the proposed 401(k) Fair Disclosure for Retirement Security Act of 2007.

Although The SPARK Institute¹ has publicly supported and promoted meaningful fee disclosure by employers, retirement plan service providers and investment providers, we are concerned about the unnecessarily burdensome and costly approach taken in the 401(k) Fair Disclosure for Retirement Security Act of 2007 (the “Bill”). We believe the Bill will ultimately serve to weaken, not strengthen, the defined contribution system. The Bill, as currently proposed, will discourage new plan formations, will significantly increase plan costs, will discourage employee participation and savings, and will create fertile ground for frivolous lawsuits brought by plaintiffs’ lawyers primarily seeking settlements from perceived deep pockets.

I. Background

The disclosure provisions in the Bill require plan sponsors to make certain disclosures to plan participants and for plan service providers to make certain disclosures to plan sponsors. Earlier this year, the Department of Labor’s (“DOL”) issued a Request for Information (“RFI”) regarding plan participant disclosures. Included in our response to the RFI, were guiding principles that we believe should be followed by legislators and regulators in developing any participant disclosure rules and regulations. The principles are:

1. Fee information is only one of many data points and arguably not the most important one that participants should consider in making investment decisions.
2. Over-emphasis on fees and expenses may lead to poor investment decisions, as well as lower employee participation and contributions to employer sponsored retirement plans.
3. Participant fee disclosure must be short and simple to have any chance of being effective.
4. Only information that is reasonably likely to be read and influence the investment decisions of otherwise passive participant investors in choosing among their plans’ investment options should be included in any required disclosure.
5. Participants will ultimately bear the costs of any required disclosure and access to additional information.
6. Fee disclosure requirements should neither favor any one retirement plan or investment industry segment nor disrupt the current competitive balance among such service providers.

The following is a section-by-section analysis of our views regarding some of the more significant provisions of the Bill.

II. Plan Sponsor Fees and Conflicts Disclosures

A. General disclosure requirements - A plan may not enter into a contract involving compensation to a service provider of \$1,000 or more unless the “plan administrator” receives advance written disclosure from the service provider of certain required information. The required disclosures include identification of who provides the services under the agreement, including affiliates and third parties. Additionally, the disclosures must include: (1) a description of the services, (2) an itemized list of the expected annual “cost” of each

¹ The SPARK Institute represents the interests of a broad based cross section of retirement plan service providers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. Our members include most of the largest service providers in the retirement plan industry and our combined membership services more than 95% of all defined contribution plan participants.

component of such services, and (3) information about amounts paid to affiliates and third parties. Sections 111(a)(1) & (9).

SPARK Institute Observations - We are concerned that these requirements obligate service providers to disclose proprietary information that will become readily available to their competitors. The proposal is extremely broad and would require record keepers who subcontract out certain services that have nothing to do with participant investments to reveal the identity of their suppliers and the financial terms of their arrangements.

The proposal requires disclosure of the “cost” of the services. We presume that the reference is intended to mean the cost of such services to the plan or the participant, not the service provider’s costs. We are concerned that the language in the proposal is susceptible to confusion and misinterpretation. Additionally, the requirement that the service provider provide an itemized breakdown of the costs of the underlying component services will be onerous for bundled service providers. The information required for such breakdowns is generally not available and requiring an itemized breakdown is contrary to the bundling concept.

Additionally, the proposal does not take into account the fact that generally neither the plan nor the plan sponsor enters into agreements with the mutual fund companies that manage the funds used by the plans. If the proposal were to require such agreements the disruption to plan sponsors, retirement plan service providers, and investment companies would be significant. The time and resources necessary to obtain such agreements would be staggering. Moreover, it would be unreasonable to require retirement plan record keepers to enter into such agreements and make the disclosures on behalf of the investment funds selected by a plan.

B. Required minimum disclosures - The proposal includes a long list of information that must be disclosed by all service providers. The list includes sales commissions, start-up fees, investment management expenses, investment advice expenses, estimated trading expenses, expenses for administration and record keeping, legal fees, trustee fees, termination or surrender charges, total asset-based fees, 12b-1 fees, and soft dollars. Section 111(a)(2)(A). Expense estimates can be used if the actual amounts are not known. However, estimates that are later discovered to be materially incorrect must be corrected as soon as practicable. Section 111(a)(2)(B).

SPARK Institute Observations - We are concerned that the required minimum disclosures create a rigid and inflexible list of information that plan sponsors must receive from every service provider they deal with. Without restating the reasons we provided in other documents, we note that a conceptual framework that allows service providers flexibility to customize disclosures for their products and services should be established instead of detailed lists of disclosures.

Additionally, we are concerned that the proposal requires plan specific dollar disclosures or estimates instead of expressly allowing for the requirements to be satisfied by using fee or rate disclosures. Dollar disclosures and estimates of certain fees that are driven by factors beyond the control of the service provider can be difficult to calculate. Such fees include, for example, loan origination, distribution, and participant investment advice fees. A calculation or estimate of any of such fees is dependant upon decisions made by participants that cannot

always be predetermined. Additionally, dollar estimates of asset-based fees can vary significantly due to market fluctuation. Service providers will have to monitor their actual fees and compare them to their estimates on a regular basis in order to be able to make corrections required by the proposal. We are concerned that this entire process creates unnecessary additional work for plan sponsors and service providers when the same goal can be accomplished through simple rate disclosures.

C. Conflicts disclosure - The Bill requires detailed written disclosure regarding any potential conflicts that the service provider may have “due to [a] financial or personal relationship” that the service provider may have with the plan sponsor, the plan or other service providers, and for which the service provider receives payment for services. Such disclosure must include information about the use of the service provider’s proprietary investment products and whether the service provider receives payments from third parties for making such third parties investment products available. Section 111(a)(3).

SPARK Institute Observations - We are concerned that the language of this provision is needlessly broad, potentially confusing and susceptible to misinterpretation. We are concerned about the references to “personal relationships” and conflicts with other service providers which appear to be unnecessary. We believe that a more appropriate provision would be to require service providers to disclose potential conflicts that they may have with the plan, plan sponsor and plan participants as a result of financial compensation they may receive from third parties in connection with the plans that they service.

D. Mutual fund share classes - Service providers must disclose that the “share prices” of certain mutual funds share classes may be different from the funds’ retail share classes. The proposal appears to incorrectly refer to “share prices” instead of the expense ratio of the funds. Section 111(a)(4).

SPARK Institute Observations - Although we generally understand what we presume to be the point of this provision, i.e., to let plan sponsors know that there may be other share classes offered by a fund, the specificity of the provision causes it to miss its objective. Many funds offer multiple non-retail classes of shares (e.g., trust and institutional shares) that may be available to retirement plans and cheaper than retail classes. We are concerned that the focus on retail shares will likely defeat the purpose of the provision. We also note that the focus of the proposal on retail shares suggests that the drafters appear to be operating under the incorrect assumption that the expense ratios of retail shares classes are generally lower than the expense ratios of share classes used by retirement plans. We are also concerned that the assumed underlying purpose of this provision only applies solely to mutual funds. We believe that a more appropriate approach would be to establish a general conceptual requirement that meets the intended objective.

E. “Free services” - The proposal requires that any service provider that provides services “without charge or for fees set at a discounted rate or subject to rebate” must disclose the extent to which and the amount such service provider is paid by others from participant accounts. Section 111(a)(5).

SPARK Institute Observations - We are concerned that this provision, which appears to be intended to force disclosure of potential conflicts of interest, is too broad, duplicative with other provisions of the proposal, potentially confusing and susceptible to misinterpretation.

We note that other provisions in the proposal specifically require the disclosure of potential conflicts of interest. Service providers typically publish a “standard” price list for their services but generally discount such prices due to industry competition. The price lists are generally used for broad marketing purposes and during the very early sales stages (e.g., prospecting phase). Service providers generally do not publish or disclose publicly the actual fees that they are willing to accept for their services because that information is considered confidential and proprietary. Additionally, service providers’ fees are frequently negotiated with the plan sponsor and change based on many factors, including for example, the plan’s service needs and demographics. We are concerned that virtually every deal would be subject to the disclosure requirements of this provision merely because service providers generally charge less than the fees set forth in their standard publicly available fee schedules.

F. Model statements - The DOL is directed to issue a model statement for the foregoing disclosures. Section 111(a)(6).

SPARK Institute Observations - We are concerned that the DOL is being directed to accomplish the impossible. As we have stated before in other documents, a one size fits all disclosure form that is suitable for and acceptable to the various retirement plan services and investment providers, takes into account all of the products and investment structures, maintains the competitive balance in the affected industries, and is cost effect to produce will be virtually impossible to create. Although we recognize that service providers will not be required to use the model, we are concerned that some plan sponsors may demand it. Consequently, certain service providers may be competitively disadvantaged during the sales process.

G. Annual Disclosure - The written disclosure must be provided at least annually, and within 30 days of any material change. Section 111(a)(7).

SPARK Institute Observations - We are concerned that this requirement is needlessly burdensome. Service providers should not be required to produce the required plan specific dollar disclosures or estimates annually unless they materially change their rates or their compensation from third parties changes materially. We note that ERISA already limits a plan fiduciary’s ability to unilaterally increase the compensation it receives from a plan. A more appropriate alternative may be that service providers should only be required to update their plan sponsor disclosures when there are material changes relating to (i) the amounts charged by the service provider to the plan sponsor, the plan or plan participants, or (ii) the compensation the service provider may receive from others, including third parties and the funds that are used by the plan.

H. Availability of required disclosures - The written disclosure statement must be made available to plan participants upon request, and must be posted on the plan sponsor’s website or, we presume, by the service provider for the plan sponsor. Section 111(a)(8).

SPARK Institute Observations - We are concerned that the proposed disclosure requirements include proprietary and confidential information that service providers should not be forced to provide to plan participants. Given the specific plan participant disclosure requirements, the role of the plan sponsor, and the nature of the required plan sponsor disclosures, the information that is included in the plan sponsor disclosure statement is of little value to plan participants. Moreover, the information that will be included in such statement will be

complex, will confuse the vast majority of participants, and will be subject to misinterpretation. Plan sponsors and service providers should not be put in a position of having to explain this information to participants who have no control over the plan sponsor level decisions that such information is intended to facilitate. Moreover, by requiring such information to be provided to participants and posted on websites, the confidential and proprietary information included in such statements will easily become available to each service provider's competitors. Additionally, we are concerned that the confidential and proprietary information will become readily available to plaintiffs' lawyers and will create fertile ground for frivolous and costly lawsuits brought by such lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations.

III. Participant Investments and Fees Disclosures

A. Advance notice of investment options - Generally, participant directed plans must provide a written notice to participants at least annually, no less than 15 days before each plan year, regarding the plan's investment options. Such notice must also be provided in advance of any change in investment options, or when an employee begins participation in the plan. Section 111(b)(1). The proposal includes a long and detailed list of information that must be included in the participant notice. Section 111(b)(2).

SPARK Institute Observations - We are concerned that these mandated detailed disclosures are inconsistent with the guiding principles that The SPARK Institute believes should be taken into account in connection with the development of any new rules and regulations relating to participant fee disclosure. Among the problems with the notice requirement are that the notice will overwhelm and confuse participants instead of enlightening them, and will be costly to produce and maintain.

B. Required information - The Bill requires the notice to include the following information regarding each investment option: name, investment objectives, level of risk, whether the option is a comprehensive solution, historical performance, historical fees, an explanation of the difference between asset-based and annual fees, comparative benchmark information, and how to get additional information. The notice must include a cautionary statement about relying too much on fees as the basis for investment decisions. Additionally, the notice must include a fee menu in an easy to understand format for the average participant. The fee menu must include such information that the DOL determines is necessary to allow participants to evaluate the services that may be provided in connection with the investment options and the fees that could be charged. Fees must be categorized among the following three categories: (i) fees that vary based on the investments selected by the participant (e.g., expense ratios), (ii) fees that vary based on the total assets in the participants account regardless of the investment option, and (iii) administration and transaction based fees (e.g., loan origination fees). The notice must also include a description of the purpose of each fee, including whether such fee is for investment management, commissions, administration or record keeping. The notice must include information about potential conflicts of interest that any person receiving fees may have. Sections 111(b)(2) & (3). Estimates can be used if the actual amounts are not known. Section 111(b)(5).

SPARK Institute Observations - We are concerned that these disclosure requirements are extremely and needlessly complex, and as noted above, the information is likely to confuse

participants rather than enlighten them. Many of the concepts required to be disclosed cannot be explained in a short, easy to understand format that the average participant will understand. In order to preclude after the fact claims by plaintiffs' lawyers that such disclosures were not understandable or insufficient, most notices will become lengthy and detailed with technical disclosures intended to mitigate the risk of litigation. This will make the disclosures useless to the vast majority of participants.

The requirements do not take into account the fact that the list of information may not be available for or apply to non-mutual fund investment options (e.g., expense ratios for annuity products). Additionally, many plans offer plan specific asset allocation funds or portfolios to plan participants as investment options. Such plan specific portfolios are typically not mutual funds, but they may use mutual funds as their underlying investments. We are concerned that suitable benchmarks may not always be available for such portfolios. The list of required disclosures also excludes some information that should be provided, such as the identity of the type of security (e.g., mutual fund, annuity, etc.), the identity of the investment manager or guarantor (in the case of guaranteed products), and non-performance factors for insurance type products.

The purpose of the proposed expense categories is unclear, such categories will require fees to be disclosed in awkward ways, and will create confusion. For example, mutual fund expense ratios would be disclosed under category "i" because they vary based on the investment selected, but redemption fees associated with a fund presumably would have to be disclosed under category "iii" because they are transaction based.

Plan sponsors and service providers should not be required to develop and provide specific disclosures of the underlying components of the investments fees (e.g., mutual fund expense ratio components) and the purpose of such fees. Such disclosure should be available upon request only and should be provided through materials otherwise available from a fund (e.g., profile prospectus or a full prospectus).

Plan sponsors should not be required to provide potential service provider conflict of interest disclosures to plan participants when such information has no direct impact on participant decisions. For example, a potential conflict of a broker that is properly disclosed to a plan sponsor should not have to be disclosed to participants who will never come in contact with such broker. In such cases the information will only create needless confusion and potential suspicion. However, if the potential conflict is that the broker's compensation may vary based on how participants invest their accounts and the broker may talk to participants about their plan investments, then such disclosure may be meaningful. However, such disclosure should be included in more appropriate documents (e.g., investment education materials used by the broker) instead of a mandated annual disclosure form.

C. Model notice - The DOL is directed to issue a model notice for the foregoing disclosures. Section 111(b)(4).

SPARK Institute Observations - We are concerned that the DOL is being directed to accomplish the impossible. As we have stated before in other documents, a one size fits all disclosure form that is suitable for and acceptable to the various retirement plan services and investment providers, takes into account all of the products and investment structures, maintains the competitive balance in the affected industries, and is cost effective to produce, will

be virtually impossible to create. Although we recognize that service providers would not be required to use the model, we are concerned that some plan sponsors may demand it.

IV. Annual Participant Benefits Statement

A. In addition to providing the participant investment notice discussed above, participant directed plans would be required to provide an annual benefits statement that discloses very specific and detailed fee information. The statements would have to be provided within 90 days of the close of each plan year. Most of the required information, or similar information, is already provided on quarterly participant statements. However, the proposal requires detailed dollar disclosure of the fees charged against the participant's account for each investment, including the underlying investment fees (e.g., expense ratios and trading costs), loads, total asset-based fees (including variable annuity charges), mortality and expense charges, guaranteed investment contract fees, employer stock fees, directed brokerage charges, plan administration fees, participant transaction fees, total fees, and total fees as a percentage of current assets. Section 111(c)(2). The statement must compare the performance of the investment options to a nationally recognized market-based index. Estimates can be used if the actual amounts are not known. Section 111(c)(4).

SPARK Institute Observations - We are concerned that these requirements are in many respects extremely complex, and in certain other respects, duplicative to existing quarterly participant statement requirements. We are also concerned that providing this statement is impractical and will be expensive. Plans already provide quarterly participant statements. However, most record keeping systems are not designed to produce a single cumulative annual statement. Additionally, most systems are not currently able to gather, calculate and present the detailed fee information required under the proposal. Most of the information related to the fees of the underlying investments is embedded within the underlying investment funds. In the case of mutual funds, the information that plan sponsors would have to provide is simply not on the record keeping systems because such information by its very nature is embedded in the investment fund. It is not clear whether rate disclosures would be sufficient under the proposal when the participant level dollar disclosures are not readily available, even if they could be calculated at a cost. The detailed items that must be disclosed to participants will also have to be explained to them and will most likely confuse instead of enlighten. Concerns about potential litigation among plan sponsors and service providers will cause the statement content to expand, become complex and ultimately, be overwhelming for the average participant. In summary, the proposal will, if implemented, result in the creation of a statement that is more confusing than anything that plan participants currently receive or have access to regarding any of their investments.

Additionally, redesigning record keeping systems to produce the statements and complying with these requirements on an ongoing basis will be expensive. Such costs will ultimately be borne by participants for little or no perceived benefit because, for the vast majority of participants, the information will either be ignored or will not motivate better participant saving and investment behavior.

B. The DOL is directed to issue a model notice for the foregoing disclosures. Section 111(c)(5).

SPARK Institute Observations - As we noted previously, we are concerned that the DOL is being directed to accomplish the impossible.

V. Other Disclosure Provisions

A. The disclosure requirements are not intended to limit or serve as a basis for any inference regarding a plan fiduciary's responsibility to discharge its duties with respect to the plan for the purpose of, among other things, defraying the reasonable expenses of administering the plan (see ERISA Section 404(a)(1)(A)(ii)). Section 111(d).

SPARK Institute Observations - As noted previously, we are concerned that these disclosure requirements will create fertile ground for frivolous and costly lawsuits brought by plaintiffs' lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations.

B. The disclosure requirements of the Bill would be effective for plan years beginning after enactment.

SPARK Institute Observations - We are concerned that the service providers that will be expected to facilitate compliance with the plan sponsor and other disclosure requirements will need significantly more time to prepare for such requirements. For example, the system functionality that would be necessary in order to produce the annual participant statements does not exist today and will take a significant amount of time to develop. Additionally, we are concerned that the plan sponsor disclosure requirements will apply to existing service agreements. Service providers will be overwhelmed with having to provide customized plan specific disclosures for thousands, and for some providers, tens of thousands of plans that they service.

VI. Index Fund Requirement

Participant directed plans must include at least one investment option which is a nationally recognized market-based index fund which offers a combination of returns, risk and fees that is likely to meet the retirement income needs at adequate levels of contributions. Section 402(c).

SPARK Institute Observations - We presume that the intent of this provision is to make "low cost" investment options available to plan participants. However, we are concerned about the potential misconception that requiring such options to be added will meet its objective. Requiring such funds to be added will not change the economics of servicing a plan. Regardless of which funds are used in any plan, plan service providers must have a source of revenue to get paid. If an index fund offers a class of shares that provides revenue sharing to unaffiliated plan service providers, such class will most likely be used when necessary to generate adequate revenue for the service providers. Service providers may choose to only offer funds that provide such adequate revenue. Alternatively, record keepers can assess additional asset-based charges to fund accounts to generate the necessary revenue. In both cases the plan sponsor and service provider can agree to fee arrangements that maintain the current revenue and economics of the plan. We note that plan sponsors will have the option,

which they have today, to pay for most plan fees out of their own assets or impose such fees on plan participants. Consequently, mandating the use of index funds will not meet the presumed objectives and seems unnecessary.

Additionally, the requirement that the index fund is one that “offers a combination of returns, risk and fees that is likely to meet the retirement income needs at adequate levels of contributions” is too subjective. Reasonable investment experts are likely to disagree on which funds satisfy such requirements. The subjective nature of the requirement makes it untenable. Plan sponsors should not be required to select a fund based on such criteria. Additionally, we are concerned that these subjective requirements will inevitably expose plan sponsors to after the fact claims from plaintiffs’ lawyers that the fund selected did not or will not generate enough income for participants.

Finally, we are unaware of any existing rules or regulations that require a plan to include a specific fund as an investment option.² Index funds should not be mandated through legislation and given a Congressional “seal of approval” as an investment option. Additionally, we note that the index fund mandate will not change participant behavior. Participants who are not otherwise engaged in making investment decisions will not become engaged as a result of having this option available. Participants who are otherwise engaged and investment savvy will simply consider this option among the others available to them and will evaluate it based on its merits, which will include many factors other than fees. However, plan sponsors should not be forced to include such funds in their plans. Instead, market forces and the suitability of such funds for use in plans should be allowed to drive plan sponsor decisions.

VII. Advisory Council

The Bill would establish the Advisory Council on Improving Employer-Employee Retirement Practices. Section 519. The Council would have 12 members, half of whom will represent the interests of plan participants and the other half will represent employers.

SPARK Institute Observations - Setting aside whether or not such Council is necessary, beneficial or will be effective, we are concerned that the proposal does not include any representation from the retirement services and investment products industries. Long-term improvement to retirement plan and investment products ultimately requires the products, support and services from such industries. We believe that any council of this type would be more productive, effective, and benefit from the inclusion of appropriate industry experts.

VIII. Conclusion

Although The SPARK Institute supports and encourages greater fee transparency, we are concerned that the Bill will be unduly burdensome for plan sponsors and service providers. We believe that the proposal will impose significant additional burdens on plan sponsors, and create needless complication that could have a detrimental effect on the voluntary employer sponsored retirement plan system.

The required disclosures place too much emphasis on fees, will be lengthy, complex and intimidating for participants. Such disclosures will likely not be read and will not change the

² Existing regulations under ERISA Section 404(c), and the proposed qualified default investment alternative regulations are safe-harbors that plan sponsors are not obligated to comply with.

behavior of the vast majority of plan participants. The proposal also appears to rely on paper-based notices instead of promoting the use of the internet and other electronic means of disclosure.

Additionally, we are concerned that service providers' proprietary and confidential information will become readily available to their competition. The requirements will expose plan sponsors and service providers to new types of frivolous and costly lawsuits brought by plaintiffs' lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations. Such requirements, among others of the Bill, will disrupt the competitive balance in the retirement plan and investment industries.

We are also concerned that the proposed rules are in certain respects duplicative with existing requirements under ERISA, and in certain other respects, may be inconsistent with requirements under rules and regulations of other regulatory agencies. Duplication and inconsistencies make compliance more complicated and costly for everyone involved.

The SPARK Institute believes that regulators, such as the DOL and Securities and Exchange Commission, should be permitted to address and resolve the perceived disclosure issues under existing law through their regulatory authority. If regulators believe that additional laws are needed in order to facilitate solving such concerns, then Congress should adopt legislation that fills the "gaps" identified by the regulators.

On behalf of The SPARK Institute, I thank the Committee for the opportunity to share our views on this important issue.