

Spurgeon, Melissa - EBSA

From: Guy Muranaka [Guy@alphapoint.net]
Sent: Tuesday, June 26, 2007 1:37 AM
To: EBSA, E-ORI - EBSA
Subject: 401(k) Fee Comments Attached
Attachments: DOL Submission.pdf

Guy Muranaka
Accredited Investment Fiduciary™

AlphaPoint, Inc.
Institutional 401(k) Consulting & Information Services
An SEC Registered Investment Advisor

6621 East Pacific Coast Highway, Suite 240
Long Beach California 90803
p 562.430.2454 f 562.795.6954 e guy@alphapoint.net
c 714.390.4762

This e-mail message is intended only for the use of the individual or entity to which it is addressed, and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If you are not the intended recipient, any dissemination, distribution or copying of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by reply email to guy@alphapoint.net and delete or destroy all copies of the original message and attachments thereto.

1. What basic information do participants need to evaluate investment options under their plans? If that information varies depending on the nature or type of investment option (options offered by a registered investment company, options offered under a group annuity contract, life cycle fund, stable value product, etc.), please include an explanation.

Participants have access to enough information about the characteristics of the investments, including objectives, style, management, etc., as well as investment expenses. However, this information is overwhelming for plan participants because it is included in lengthy prospectuses and group annuity contracts. In addition, the variability of investment expense formats - fund share classes, wrap fees, advisor compensation, and other expenses that are paid from plan assets or by plan participants - are not disclosed properly to participants and many times are confusing to even plan fiduciaries themselves.

Participants should be provided with and have a right to an annual report showing all levels of investment expenses including the lowest cost share class alternatives (even if not used by the plan), pricing without advisor compensation and with, if applicable, and net of all other expenses that are paid from plan assets, so that they can understand all the components, services, and optional service provider fees that increase their investment expense.

401(k) advisor fees, if paid by plan assets, and services should be full explained, including the cost and the dollar amount generated by the plan, impact on plan expenses and a report of the services and value provided to the plan and plan participants over the past year.

2. What specific information do participants need to evaluate the fees and expenses (such as investment management and 12b-1 fees, surrender charges, market value adjustments, etc.) attendant to investment options under their plans? If that information varies depending on the nature or type of option, or the particular fee arrangement relating to options (e.g., bundled service arrangements), please include an explanation.

Participants should be provided with and have a right to an annual report showing all levels of investment expenses including the lowest cost share class alternatives (even if not used by the plan), pricing without advisor compensation, and net of all other expenses that are paid from plan assets, so that they can understand all the components, services, and optional service provider fees that increase their investment expense.

The Plan Sponsor and its fiduciaries should demonstrate a thorough understanding of these fees and in the annual report and benchmark their plan's fees against other alternative products and benchmarks (Morningstar and Lipper averages for examples).

401(k) advisor fees, if paid by plan assets, and services should be full explained, including the cost and the dollar amount generated by the plan, impact on plan expenses and a report of the services and value provided to the plan and plan participants over the past year.

3. To what extent is the information participants need to evaluate investment options and the attendant fees and expenses not currently being furnished or made available to them? Should such information be required to be furnished or made available by regulation or otherwise? Who should be responsible for furnishing or making available such information? What, if any, additional burdens and/or costs would be imposed on plan sponsors or plans (plan participants) for such disclosures?

Plan fiduciaries that are responsible for understanding and managing investment fees are outmatched by service providers, advisors and other selling and service organizations. There are a number of steps that can be taken: 1. Services providers, including 401(k) advisors, pension administrators, etc., should automatically become fiduciaries to the plan, 2. Plan fiduciaries should provide to participants an annual report showing all levels of investment expenses including the lowest cost share class alternatives (even if not used by the plan), pricing

without advisor compensation, and net of all other expenses that are paid from plan assets, so that they can understand all the components, services, and optional service provider fees that increase their investment expense., and 3) If you do not eliminate 12b-1 fees and any other fees paid to registered representatives, registered investment advisors, etc. from plan assets – require that plan fiduciaries bear the cost of a plan’s advisor – It is their decision to use a 401(k) advisor. This cost, like that of company contributions, will force fiduciaries to more carefully evaluate products, fees, and the choice of an advisor and their services to the plan. A last option, 4) would be that the retirement plan offer two share classes of funds—One share class that does not have 401(k) advisor compensation and another with compensation. It is not fair for all participants to bear the cost of an advisor, when not all participants need the services of an advisor. Participants can choose from a fund with no compensation or a fund with compensation. This way, each participant is informed of the cost of the advisor and has the right to decline or elect the advisor’s services.

With the Pension Protection Act’s automatic enrollment and lifestyle features and more and more employers putting their plans on auto-pilot, the use an advisor and the increased cost may not be justified.

4. Should there be a requirement that information relating to investment options under a plan (including the attendant fees and expenses) be provided to participants in a summary and/or uniform fashion? Such a requirement might provide that: A) all investment options available under a participant-directed individual account plan must disclose information to participants in a form similar to the profile prospectus utilized by registered investment companies; or B) plan fiduciaries must prepare a summary of all fees paid out of plan assets directly or indirectly by participants and/or prepare annually a single document setting forth the expense ratios of all investment options under the plan.³ Who should be responsible for preparing such documents? Who should bear the cost of preparing such documents? What are the burden/cost implications for plans of making any recommended changes?

Prospectuses and group annuity contracts are too complicated and lengthy for both plan fiduciaries and participants. Already these documents include language about incentive programs, preferred producer payments, etc. that may cause conflicts of interests for fiduciaries – however, fiduciaries don’t read prospectuses.

A simple annual report prepared by the plan’s fiduciaries with full fee disclosure, revenue sharing, and benchmarking information is the most effective piece for plan participants, and this information will require fiduciaries to at least annually revisit their fees.

However, the two most direct and simplest solutions would be, 1) Eliminate all forms of 12b-1 fee and other compensation paid to advisors. Advisors should be not paid from plan assets but rather by the plan’s fiduciaries. It is their decision to use a 401(k) advisor. This cost, like that of company contributions, will force fiduciaries to more carefully evaluate products, fees, and the choice of an advisor and their services to the plan.

The second solution, if advisors can be paid from plan assets, would be retirement plan offer two share classes of funds. One share class would not have 401(k) advisor compensation and another would include compensation. It is not fair for all participants to bear the cost of an advisor, when not all participants need the services of an advisor. Participants can choose from a fund with no compensation or a fund with compensation. This way, each participant is informed of the cost of the advisor and has the right to decline or elect the advisor’s services.

The cost for this kind of communication is not a burden or a new issue for plan fiduciaries as it is a practice that they should be performing for the benefit of their plan participants anyway. In fact, either solution would clear up any confusion over investment fees and advisor compensation and the impact on investment fees.

5. How is information concerning investment options, including information relating to investment fees and expenses, communicated to plan participants, and how often? Does the information or the frequency

with which the information is furnished depend on whether the plan is intended to be a section 404(c) plan?

In my experience, most plan fiduciaries do not understand the various components of their investment expenses and whether these fees are reasonable. Information is available through fund summaries, prospectuses, group annuity contracts, etc. However, the fee disclosure information is buried in lengthy documents and the average person does not have the time or expertise to delve into investment fee understanding. Financial service organizations have made it too difficult for fiduciaries and investors to understand and manage expenses, especially those 401(k) providers who distribute their investments through advisors. Features that complicate and confuse consumers include the variety of different share classes of the same mutual fund or separate account, the ability of some providers to charge an additional asset based fees, advisor choice of and use of a wide range compensation levels that incurred by plan participants, finder's fee commissions, extra payments such as preferred producer payment incentives offered by 401(k) vendors, etc. All these contribute to a sales-oriented environment that generally does not serve the interests of the fiduciaries and their participants.

Very simply, those mutual fund companies whose pricing is very easy to understand are those that do not have 12b-1 fees and do not pay commissions to sell their products – Vanguard and Fidelity. Not surprisingly, their investment fees are far below those 401(k) vendors who distribute their products through 401(k) advisors.

404(c) should not be an option – offering a diversified investment lineup, understanding and managing investment expenses and providing information so that their participants can make informed decisions are principles of a prudent fiduciary. With or without 404(c), fiduciaries are responsible for understanding and managing expenses.

7. What changes, if any, should be made to the section 404(c) regulation, to improve the information required to be furnished or made available to plan participants and beneficiaries, and/or to improve likelihood of compliance with the disclosure or other requirements of the section 404(c) regulation? What are the burden/cost implications for plans of making any recommended changes?

Make 404(c) compliance mandatory. In regards to investment fees, a simple annual report prepared by the plan's fiduciaries with full fee disclosure, revenue sharing, and benchmarking information is the most effective piece for plan participants, and this information will require fiduciaries to at least annually revisit their fees.

In addition, eliminate all forms of 12b-1 fee and other compensation paid to advisors. Advisors should be not paid from plan assets but rather the plan's fiduciaries should pay the advisor fee, no matter what type of advisor is used by the plan – registered representative, registered investment advisor, commission or fee. A second option would be to offer two share classes of funds if the plan offers an advisor—one share would not include advisor compensation, another optional share class would include compensation. Plan participants can then elect the share class that meets their needs. Plan fiduciaries should not assume that all participants want to pay 401(k) advisor fees.

The cost for this kind of communication is not a burden or a new issue for plan fiduciaries as it is a practice that they should be performing for the benefit of their plan participants anyway. In fact, plan fiduciaries and plan participants will have a better understanding of their investment fees.

8. To what extent should participant-directed individual account plans be required to provide or promote investment education for participants? For example, should plans be required or encouraged to provide a primer or glossary of investment-related terms relevant to a plan's investment options (e.g., basis point, expense ratio, benchmark, redemption fee, deferred sales charge); a copy of the Department's booklet entitled "A Look at 401(k) Fees" (www.dol.gov/ebsa/publications/401k_employee.html) or similar publication; or investment research services? Should such a publication include an explanation of other investment concepts such as risk and return characteristics of available

investment options? Please explain views, addressing costs and other issues relevant to adopting such a requirement.

Yes, but most 401(k) vendors make educational pieces available and they will continue to do so to meet client needs. More fee disclosure is required. An annual fee report prepared by and distributed by the plan's fiduciaries will help keep the plan fiduciaries accountable for understanding and managing fees.

9. What information is currently furnished to participants about the plan and/or individual administrative expenses charged to their individual account? Such expenses may include, for example: audit fees, legal fees, trustee fees, recordkeeping expenses, individual participant transaction fees, participant loan fees or expenses.

Many times these fees are not properly disclosed to participants. For example, many group annuity providers show the expense of the separate account, but do not effectively disclose the wrap charge that increases total investment fees and reduces net investment returns. For those investment providers offering various share classes, many times the fiduciaries and participants are not aware of alternative, lower expense, share classes.

10. What information about administrative expenses would help plan participants, but is not currently disclosed? Please explain the nature and usefulness of such information.

Interestingly, more and more 401(k) providers can waive administration charges either because the plan generates enough investment fee revenue so there is no need to bill the plan sponsor, or, the 401(k) provider can increase investment costs through either more expensive funds or share classes or apply a wrap fee so that the investment revenue is sufficient so that the 401(k) provider does not need to send an invoice to the plan sponsor.

401(k) providers have great pricing flexibility using a variety of investment features. This flexibility is confusing to both 401(k) advisors selling products, as well as plan fiduciaries and especially plan participants. This pricing flexibility can create wide cost disparities among plans using the same investment provider.

The first step would be to eliminate 12b-1 fee or any other 401(k) advisor compensation from plan assets. The amount of this compensation can vary greatly even within the same product/401(k) vendor. Eliminating this compensation or additional fee will eliminate one confusing component of plan costs.

A second option would be to offer two share classes of funds if the plan offers an advisor. One share would not include advisor compensation; another optional share class would include compensation. Plan participants can then elect the share class that meets their needs. Plan fiduciaries should not assume that all participants want to pay 401(k) advisor fees. In both cases, plan fiduciaries and plan participants will know and can compare net investment fees.

Third, plan fiduciaries should be required to benchmark their 401(k) provider fees by:

1. Showing total investment fees on both a plan and per participant basis, compare these fees to alternative 401(k) vendors and industry benchmarks (Morningstar and Lipper).
2. Show revenue sharing – disclose how much of the investment fees are being paid to their 401(k) provider, other money managers, pension administrators, etc.

11. How are charges against an individual account for administrative expenses typically communicated to participants? Is such information included as part of a participant's individual account statement or furnished separately? If separately, is the information communicated via paper statements, electronically, or via website access?

This is a difficult question to answer, since investment providers have many methods to charge for plan services, including using various share classes to absorb service fees and advisor compensation. Investment

providers also have great pricing flexibility that can create wide disparities in the amount plan participants pay when using the same investment provider. For example, one mutual fund company offers five different share classes of the same fund for its 401(k) plan product. The cost of the most expensive share class is 3 times the cost of the lowest expense share class.

12. How frequently is information concerning administrative expenses charged to a participant's account communicated?

It depends on the 401(k) provider's recordkeeping system. Many times these payments are not disclosed to plan participants. Some 401(k) vendors do not have the customization ability in their recordkeeping platforms to report and disclose these payments to participants, as the cost may vary by customer. Other vendors can show the expense as a line item every quarter on the participant's accounts.

Investment providers have many methods to charge for plan services, including using various share classes to absorb service fees and advisor compensation. Investment providers also have great pricing flexibility that can create wide disparities in the amount plan participants pay when using the same investment provider. For example, one mutual fund company offers five different share classes of the same fund for its 401(k) plan product. The cost of the most expensive share class is 3 times the cost of the lowest expense share class.

Proper or full-fee disclosure does not guarantee reasonable investment fees.

13. What, if any, requirements should the Department impose to improve the disclosure of administrative expenses to plan participants? Please be specific as to any recommendation and include estimates of any new compliance costs that may be imposed on plans or plan sponsors.

Plan fiduciaries should prepare an annual fee disclosure report to plan participants identifying all fees paid by the plan participants including fund and separate account expenses – where the various components of these fees are paid, 401(k) advisor fees, administration, all other expenses paid from plan assets, then show the investment cost without all these expenses so that plan participants understand their lowest potential cost and actual cost.

Consider eliminating advisor compensation generated by plan assets. If the plan fiduciaries elect to use the services of an advisor, then the plan fiduciaries or sponsoring organization should bear the cost.

Or, require that plans that do use the services of an advisor offer two share classes of the same fund – one with and one without advisor compensation. Plan participants should have the right to elect the share class that suits their needs. It is not fair to require all participants to bear the cost of an advisor.

14. Should charges for administrative expenses be disclosed as part of the periodic benefit statement required under ERISA section 105?

Yes. Plan fiduciaries are responsible for understanding and properly disclosing all fees.

15. What, if any, distinctions should be considered in assessing the informational needs of participants in plans that intend to meet the requirements of section 404(c) as contrasted with those of participants in plans that do not intend to meet the requirements of section 404(c)?

Make 404(c) a requirement. This should not be optional. The inherent requirements of 404(c) are fiduciary responsibilities that would benefit plan participants.

16. What (and what portion of) plan administrative and investment-related fees and expenses typically are paid by sponsors of participant-directed individual account plans? How and when such information is typically communicated to participants?

Unfortunately, there is not such thing as a typical expense in retirement plan because of the various methods that can be used in pricing plans and paying advisors. That is the problem and challenge for consumers. In addition, many plans don't receive an invoice for administration services – the revenue generated from money management is more than enough to cover administration services.

Expenses depend on a variety of factors including plan size, service delivery, use of a 401(k) advisor who is paid from plan assets, size of plan, average account balance, breadth of services, etc. 401(k) vendors have pricing flexibility and are underwriting 401(k) business and the fees for clients may vary dramatically.

These pricing methods and flexibility can cause great disparities in pricing even among the same investment provider. So much so, that if you compared pricing, you would not think they were of the same investment provider.

17. How would providing additional fee and expense information to participants affect the choices or conduct of plan sponsors and administrators, and/or that of vendors of plan products and services? Please explain any such effects.

Through proper disclosure plan fiduciaries will better understand and more effectively manage fees, which will benefit plan participants. . Eliminate 12b-1 fees and any other 401(k) advisor payments from plan assets and required annual fee disclosures will bring down investment expenses significantly. Fiduciaries should pay for the advisor services – it is their decision to use an advisor, and fiduciaries should bear the cost, not plan participants. Overall, fiduciaries will make more informed and careful decisions since they will need to better disclose fees and pay for 401(k) advisor services. Plan fiduciaries can already obtain or negotiate enrollment and education services from their 401(k) providers.

18. How would providing additional fee and expense information to participants affect their plan investment choices, plan savings conduct or other plan related behavior? Please explain any such effects and provide specific examples, if available.

First plan fiduciaries would be responsible for understanding and managing fees, will help control fees for the benefit of plan participants. . Eliminate 12b-1 fees and any other 401(k) advisor payments from plan assets and require annual fee disclosures should bring down expenses.

Unfortunately, plan participants do not understand their investments or their fees. Plan fiduciaries should be responsible for understanding and managing fees. If you do not eliminate 12b-1 fee compensation or any other 401(k) advisor compensation from the plan entirely, then require 401(k) providers to offer products where this extra fee can be waived on a per participant basis.

The Pension Protection Act's automatic enrollment and lifecycle default investment option was a great step to helping fiduciaries and participants. If lifecycle funds as well as automatic enrollment are adopted by the plan, then you can argue that participant education and enrollment services are not as vital – thus the cost for these services, provided by the 401(k) provider or 401(k) advisor should be reduced or eliminated. I believe if you eliminated 12b-1 fees and other advisor fees from plan assets, and a plan were to adopt automatic enrollment and lifecycle investing, plan fiduciaries will probably not need to pay the current levels of fees to a 401(k) advisor.

Lastly, require that plans offer two share classes of the same fund. One share would include advisor compensation, the other would not. Plan participants should have the right to elect and pay for advisor services. I believe you would find that most participants would not elect the services of an advisor, simply select the most appropriate lifecycle fund, choose automatic features offered by the plan provider, and more effectively manage their plans and increase wealth accumulation.

19. Please identify any particularly cost-efficient (high-value but inexpensive) fee and expense disclosures to participants, and to the contrary any particularly cost-inefficient ones. Please provide any available estimates of the dollar costs or benefits of such disclosures.

There are two simple options that would easily clarify the investment fee problem.

One option would be to eliminate advisor compensation from plan assets. If plan fiduciaries elect to use or offer an advisor, then the fiduciaries or sponsoring organization must pay for the service.

If you do not eliminate advisor compensation from plan assets, then you could require that plans offer two share classes of the same fund. One share would include advisor compensation, the other would not. Plan participants should have the right to elect and pay for advisor services. I believe you would find that most participants would not elect the services of an advisor, simply select the most appropriate lifecycle fund, choose automatic features offered by the plan provider, and more effectively manage their plans and increase wealth accumulation.

These are easy solutions and would put more clarity around investment fees and proper disclosure, as well as give participants the right to select the level of services they need for their retirement. We should not assume that all plan participants need or want to pay for the services of an advisor.

There would be no significant dollar cost of these options. In regards to eliminating advisor compensation from plan assets, there are a number of plans not using advisors, as well as successful 401(k) providers (including the largest) that does not pay advisors from plan assets.

In regards to the second option of offering two share classes (if the plan fiduciaries elect to offer an advisor); there should be no additional cost to plan fiduciaries or participants. There could be a cost for certain recordkeepers to adjust to this requirement. However, most systems should be able to accommodate this feature. Recordkeepers that offer open-architecture platforms – access to any fund – have the ability to offer two share classes of the same funds now.

Guy Muranaka
AlphaPoint, Inc.
6621 E. Pacific Coast Highway, Suite 240
Long Beach CA 90803
562.430.2454
guy@alphapoint.net