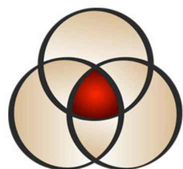

Bearmoor, LLC
Asset Management and Fiduciary Consultants

Regulatory Update
Fall 2008

Introductory Comment: In a word, Wow! The financial markets continue their turbulent ride and government intervention and assistance is being provided at a record pace. Increased regulation is inevitable. In this edition of the Regulatory Update I am outlining some of the new regulatory issues. Included are the SEC's Technical Amendments for Short Sales, as well as a discussion and guidance on accounting and risk-based capital guidelines for money market funds. I have also included PCOAB's proposal on Auditing Standard No. 6. From ESBA I have outlined recent testimony before Congress regarding 401k fees and expenses and the proposed class exemption for the provision of investment advice to participants and beneficiaries of self-directed individual account plans and IRAs.

SEC – Technical Amendments to Short Sale Order

Background

On September 21, 2008 The Securities and Exchange Commission's Division of Trading and Markets approved technical amendments to the Emergency Order banning short selling in financial stocks. The technical amendments were made to ensure the continued smooth operation of orderly markets, and to coordinate to the extent possible with similar actions restricting short sales by foreign regulators.

The technical amendments keep in place the exception contained in the original order for short selling related directly to bona fide market making in derivatives in the securities of any Included Financial Firm. However, this exception now requires that, for new positions, a market maker may not sell short if the market maker knows a customer or counterparty is increasing an economic net short position in the shares of the Included Financial Firm.

The technical amendments thus incorporate concepts included in the limitations on increasing net short positions imposed by the U.K. Financial Services Authority (FSA) in its response to short selling. The provisions are not identical because unlike the FSA, the Commission does not have statutory authority over swap contracts and other non-security over-the-counter derivatives (other than prohibitions on fraud, manipulation, or insider trading regarding securities based swaps).

The technical amendments also provide criteria by which the listing exchanges will select the individual financial institutions with securities covered by the Order. The categories include banks, savings associations, broker-dealers, investment advisers, and insurance companies, whether domestic or foreign, and the owners of any of these entities. Issuers can opt out by notifying the exchange to exclude their securities from the list.

Information
Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934, on September 18, 2008, the Securities and Exchange Commission ("Commission") issued an Emergency Order (the "Order") related to short selling the publicly traded securities of certain financial firms. The Order was effective immediately. The Commission is issuing this amendment to address current and anticipated technical and operational concerns resulting from the requirements of the Order.

A. Included Financial Firms
The Order applies to the publicly traded securities of certain financial firms, which entities are identified in Appendix A to the Order ("Included Financial Firms"). The Commission is amending the Order to modify the list of Included Financial Firms. As is stated in the Order, recent market conditions have raised concerns that short selling in the securities of a wide range of financial institutions may be causing sudden and excessive fluctuations of the prices of such securities in such a manner to threaten fair and orderly markets. Difficulties with the classification criteria led to the omission of financial institutions falling within these categories. In light of the familiarity of the exchanges listing financial institutions with the nature of their respective businesses, the Commission has determined to amend this Order to provide that the listing markets shall select the individual financial institutions with securities covered by the Order. The
Commission expects each national securities exchange listing financial institutions to immediately publish a list, on its internet Web site, of individual listed companies with common equity that will be covered by the Order's prohibition on short sales. The
Commission expects these lists to cover banks, savings associations, broker-dealers, investment advisers, and insurance companies, whether domestic or foreign, and the owners of any of these entities.

To the extent an issuer chooses not to be covered by the Order's prohibition on short sales, the Commission has authorized the applicable national securities exchange to exclude that issuer from its list of covered financial firms.

> It is therefore ordered that, pursuant to our Section 12(k)(2) powers, the Order applies to the publicly traded common equity securities of any issuer identified by any national securities exchange listing such securities as being a financial institution (each a "Covered Security" and collectively, "Covered Securities").

B. Options and Futures Contract Expiration
The Order includes an exception from its requirements to allow short sales that occur as a result of automatic exercise or assignment of an equity option held prior to effectiveness of the Order due to expiration of the option. The Commission amended the Order to also allow short sales that occur as a result of the expiration of futures contracts held prior to effectiveness of the Order.

> It is therefore ordered that, pursuant to our Section 12(k)(2) powers, the requirements of the Order shall not apply to any person that effects a short sale in any Covered Security as a result of automatic exercise or assignment of an equity option, or in connection with settlement of a futures contract, that is held prior to effectiveness of the Order due to expiration of the option or futures contract.

C. Options Assignments

To allow for creation of long call options, the Commission amended the Order to except from its requirements, short sales that occur as a result of assignment to call writers upon exercise.

> It is therefore ordered that, pursuant to our Section 12(k)(2) powers, the requirements of the Order shall not apply to the writer of a call option that effects a short sale in any Covered Security as a result of assignment following exercise by the holder of the call.

D. Market Making and Derivatives

In the Order the Commission included an exception until 11:59 p.m. on September 19, 2008 for any person that is a market maker that effects a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in derivatives on the publicly traded securities of any Included Financial Firm. The Commission amended the exception so that it continues for the duration of the Order. In addition, the Commission is clarifying that the exception applies to all market makers, including over-the-counter market makers, and that it applies to bona fide market making and hedging activity related directly to bona fide market making in exchange traded funds and exchange traded notes of which Covered Securities are a component. The purpose of this accommodation is to permit market makers to continue to provide liquidity to the markets.

To help ensure that this hedging exception does not result in increased short exposure in Covered Securities, the Commission is limiting the exception so that if a customer or counterparty position in a derivative security based on a Covered Security is established after 12:01 a.m. E.D.T on September 22, 2008, a market maker may not effect a short sale in the Covered Security if the market maker knows that the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing an economic net short position (i.e., through actual positions, derivatives, or otherwise) in the issued share capital of a firm covered by this Order.

> It is therefore ordered that, pursuant to our Section 12(k)(2) powers, the requirements of this Order shall not apply to any person that is a market maker, including an over-the-counter market maker, that effects a short sale as part of a bona fide market making and hedging activity related directly to bona fide market making in (a) derivative securities based on Covered Securities, or (b) exchange traded funds and exchange traded notes of which Covered Securities are a component. Provided, however, if a customer or counterparty position in a derivative security based on a Covered Security is established after 12:01 a.m. E.D.T on September 22, 2008, a market maker may not effect a short sale in the Covered Security if the market maker knows that the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing an economic net short position (i.e., through actual positions, derivatives, or otherwise) in the issued share capital of a firm covered by this Order.

All market makers relying on this exception to the limitation on short selling shall, as soon as operationally practicable, publish a notice on their internet Web site that, pursuant to this Order, the market maker may not knowingly effect a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in a derivative security based on a Covered Security, if the customer's or counterparty's transaction will result in the customer or

counterparty establishing or increasing an economic net short position (i.e., through actual positions, derivatives, or otherwise) in the issued share capital of a firm covered by the Order.

E. Sales of Restricted Securities

The Commission also amended the Order to clarify that the Order does not apply to persons that effect sales of Covered Securities pursuant to Rule 144 of the Securities Act of 1933 ("Rule 144 Securities"). This accommodation is necessary because sales of Rule 144 Securities are sales of owned securities.

> It is therefore ordered that, pursuant to our Section 12(k)(2) powers, the Order does not apply to any person that effects a sale pursuant to Rule 144 of the Securities Act of 1933 (17 CFR 230.144) in a Covered Security.

The Commission believes that these amendments are necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets, and to prevent substantial disruption to securities markets.

SEC – Clarification on Accounting Issues Relating to Bank Support of Money Market Mutual Funds

Information

On September 17, 2008 the Securities and Exchange Commission's Office of the Chief Accountant clarified that bank support of money market mutual funds generally does not result in a requirement to present the fund on-balance sheet. As a result of recent market events, it is possible that some money market funds could become exposed to declines in the credit worthiness of troubled assets. To protect investors' principal investment in these funds, sponsoring financial institutions can provide various types of financial support.

The Office of the Chief Accountant has received questions related to whether the actions by these sponsoring financial institutions may result in on-balance sheet accounting for supported money market funds. The Office of the Chief Accountant believes that on-balance sheet accounting for supported money market funds is not required if the sponsoring financial institution does not absorb the majority of the expected future risk associated with the money market fund's assets, including interest rate, liquidity, credit and other relevant risks that are expected to impact the value of the money market fund assets. However, SEC staff would expect adequate disclosure of the nature of the support provided.

In an unusual situation where the nature of the support results in exposing the sponsoring financial institution to a majority of the expected future risk, the Office of the Chief Accountant would encourage consultation on issues associated with presenting money market mutual funds in the financial statements, including consideration of acceptable presentation and disclosure models.

OCC: Interim Final Rule; Risk-Based Capital Guidelines – Money Market Mutual Funds

Background
To reduce liquidity and other strains being experienced by money market mutual funds, the Board of Governors of the Federal Reserve System adopted on September 19, 2008, a special lending facility that enables depository institutions and bank holding companies to borrow from the Federal Reserve Bank of Boston on a nonrecourse basis if they use the proceeds of the loan to purchase certain types of asset-backed commercial paper (ABCP) from money market mutual funds. This lending facility is referenced to as the ABCP Lending Facility. To facilitate the ability of national banks to participate in the program, the Office of the Comptroller of the Currency (OCC) has adopted, on an interim final basis, an exemption from its risk-based capital guidelines for ABCP held by a national bank as a result of its participation in this program. This interim final rule is effective on September 19, 2008. However, comments must be received on or before October 31, 2008.

Information
Introduction; Description of Interim Final Rule: In light of the ongoing dislocations in the financial markets, and the impact of such dislocations on the functioning of the markets for ABCP and on the operations of money market mutual funds, the Board of Governors of the Federal Reserve System adopted the ABCP Lending Facility on September 19, 2008. Under the ABCP Lending Facility, depository institutions and bank holding companies (banking organizations) are able to borrow from the Federal Reserve Bank of Boston on a nonrecourse basis on condition that the banking organizations use the proceeds of the Federal Reserve credit to purchase, at amortized cost, certain highly rated U.S. dollar-denominated ABCP from money market mutual funds. The ABCP purchased must be used to secure the borrowing from the Reserve Bank. The purpose of the ABCP Lending Facility is to assist money market mutual funds to obtain liquidity by enabling them to sell some of their high-credit-quality secured assets at amortized cost. The ABCP Lending Facility will expire on January 30, 2009.

National banks that participate in the ABCP Lending Facility must acquire and hold ABCP on their balance sheet. These ABCP holdings attract regulatory capital requirements under the OCC's regulatory capital guidelines and rules. To facilitate the ABCP Lending Facility, and for the reasons discussed below, the OCC has adopted, on an interim final basis, an exemption from its risk-based capital guidelines for ABCP purchased by a national bank as a result of its participation in the facility. Specifically, the interim final rule amends the OCC's risk-based capital guidelines to permit national banks to assign a zero percent risk weight to ABCP purchased by the national bank as a result of its participation in the facility.

The OCC has determined that the current risk-based capital requirements for ABCP acquired by a national bank pursuant to the ABCP Lending Facility do not reflect the substantial protections provided to the bank by the Federal Reserve in connection with the facility. Because of the non-recourse nature of the Federal Reserve's credit extension to the banking organization, the bank is not exposed to the credit or market risk of the ABCP purchased by the bank and pledged to the Federal Reserve. Therefore, the OCC believes that it would be appropriate—and consistent with the economic substance of the transactions—not to impose risk-based capital requirements on a national bank that serves as an intermediary in the ABCP Lending Facility.

Consistent with generally accepted accounting principles, the OCC would expect national banks to report purchased ABCP as an investment security (for example, held-to-maturity). These

assets would be reflected at the time of purchase at the national bank's best estimate of fair value. The nonrecourse nature of the transaction would impact the valuation of the liability to the Federal Reserve. After reflecting any appropriate discounts on the assets and associated liabilities, national banks are not expected to report any material net gains or losses at the time of purchase.

Effective Date; Solicitation of Comments This interim final rule is effective immediately upon adoption. Pursuant to the Administrative Procedure Act (APA), at 5 U.S.C. 553(b)(B), notice and comment are not required prior to the issuance of a final rule if an agency, for good cause, finds that "notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Similarly, a final rule may be published with an immediate effective date if an agency finds good cause and publishes such with the final rule.

Consistent with section 553(b)(B) of the APA, the OCC finds that good cause exists for a finding that notice and comment is impracticable and contrary to the public interest. As previously described, modification of the risk-based capital guidelines are critical to maintain the orderly functioning of markets and provide market liquidity. Completion of notice and comment rulemaking procedures prior to issuing this interim final rule would delay their implementation. In the current market environment, such a delay is impracticable and inconsistent with the public interest since it may result in undue constraint on national banks' ability to perform critical lending and financial intermediary roles which are necessary for the orderly functioning and liquidity of markets. Issuance of this interim final rule furthers the public interest because it will reduce liquidity and other strains being experienced by money market mutual funds. For the same reasons, the OCC finds good cause to publish this interim final rule with an immediate effective date.

Although notice and comment are not required prior to the effective date of this interim final rule, the OCC invites comments on all aspects of the rule and will revise it if necessary or appropriate in light of the comments received.

PCAOB: Order Approving Proposed Rule on Auditing Standard No. 6, Evaluating Consistency of Financial Statements, and Conforming Amendments.

Background

On September 16, 2008 the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") approved the proposed rule on Auditing Standard No. 6, Evaluation Consistency of Financial Statements ("Auditing Standard No. 6"). PCAOB filed with the Securities and Exchange Commission (the "Commission") on February 1, 2008 the Proposed Auditing Standard No. 6, and Conforming Amendments, pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act") and Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act").

Auditing Standard No. 6 will supersede the PCAOB's interim auditing standard on evaluating consistency, AU section 420, Consistency of Application of Generally Accepted Accounting Principles. Auditing Standard No. 6 will establish requirements and provide direction for an auditor's evaluation of the consistency of financial statements, including changes to previously

issued financial statements, and the effect of that evaluation on the auditor's report on financial statements.

The Board's proposed conforming amendments affect several of the Board's interim auditing standards. Those standards are: AU section 328, Auditing Fair Value Measurements and Disclosures, AU section 410, Adherence to Generally Accepted Accounting Principles, AU section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, AU section 431, Adequacy of Disclosure in Financial Statements, AU section 508, Reports on Audited Financial Statements, and AU section 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report. With the exception of the proposed amendment to AU section 411, the Commission believes the aforementioned amendments are generally technical or conforming in nature, such as updating references in the interim standards to the proposed new standard's paragraph numbers and definitions.

The proposed amendment to AU section 411 will have the effect of removing the hierarchy for accounting principles generally accepted in the United States (the "U.S. GAAP hierarchy") from the PCAOB's auditing standards. The Financial Accounting Standards Board (the "FASB") recently issued Statement of Financial Accounting Standards ("SFAS") No. 162, The Hierarchy of Generally Accepted Accounting Principles, which will include the current U.S. GAAP hierarchy going forward.

Notice of the proposed standard and the conforming amendments was published in the Federal Register on August 5, 2008. The Commission received three comment letters on the proposed rules and amendments. For the reasons discussed below, the Commission is granting approval of the proposed standard and conforming amendments.

Information

The Act established the PCAOB to oversee the audits of public companies and related matters, in order to protect the interests of investors and further the public interest in preparation of informative, accurate and independent audit reports. Section 103(a) of the Act directs the PCAOB to establish auditing and related attestation standards, quality control standards, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission.

On January 29, 2008, the Board adopted Auditing Standard No. 6, Evaluating Consistency of Financial Statements, and amendments to the Board's interim auditing standards. The Board proposed these changes to its auditing standards in response to two actions of the FASB.

First, in May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which superseded Accounting Principles Board ("APB") Opinion No. 20, Accounting Changes. SFAS No. 154 establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to a newly adopted accounting principle. SFAS No. 154 also redefines the term "restatement" to refer only to "the process of revising previously issued financial statements to reflect the correction of an error in those financial statements." Under SFAS No. 154, therefore, the term "restatement" does not refer to changes made to previously issued financial statements to reflect a change in accounting principle.

AU section 420, Consistency of Application of Generally Accepted Accounting Principles, the Board's interim standard on the auditor's responsibilities for evaluating the consistency of the application of generally accepted accounting principles ("GAAP"), generally reflected the provisions of APB Opinion No. 20, which was superseded by SFAS No. 154. To better align the Board's standards with the new accounting standard, the Board adopted a new auditing standard on evaluating consistency, which will supersede AU section 420, and conforming amendments to AU section 508, Reports on Audited Financial Statements, of its interim auditing standards.

Second, in 2005, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, The Hierarchy of Generally Accepted Accounting Principles. The FASB proposed that this standard incorporate the hierarchy found in the current auditing standards into the accounting standards. Historically, a description of the U.S. GAAP hierarchy has resided only in the auditing standards. However, because the current U.S. GAAP hierarchy identifies the sources of accounting principles and the framework for selecting principles to be used in preparing financial statements, the PCAOB and the FASB believed that these requirements are more appropriately located in the FASB's accounting standards. Accordingly, the PCAOB adopted amendments to its auditing standards to remove the U.S. GAAP hierarchy.

In May 2008, the FASB issued in final form, SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 will become effective 60 days from the date of this order approving Auditing Standard No. 6 and conforming amendments.

In addition to proposing Auditing Standard No. 6 and the amendment to AU section 411, the PCAOB proposed amendments to other interim auditing standards and related interpretations. The Commission believes the amendments to AU section 328, Auditing Fair Value Measurements and Disclosures, AU section 410, Adherence to Generally Accepted Accounting Principles, AU section 431, Adequacy of Disclosure in Financial Statements, AU section 508, Reports on Audited Financial Statements, and AU section 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report, are technical or conforming in nature.

As discussed further below, one of the proposed amendments to AU section 431, Adequacy of Disclosure in Financial Statements, proposes to delete footnote 1 to paragraph 4 of AU section 431, which is an application of the AICPA's Code of Professional Conduct regarding the disclosure of confidential client information. In 2003, when the Board adopted certain AICPA rules and ASB standards as interim Board standards, the Board did not adopt Rule 301. Consistent with that action, the proposed amendments would eliminate the reference to Rule 301 that is included in paragraph 4 of AU section Sec. 431.

The proposed Auditing Standard No. 6 and amendments to the Board's interim standards are intended to update and clarify the auditing standards in light of SFAS No. 154 and SFAS No. 162. In particular, these updates and clarifications are intended to enhance the clarity of auditor reporting on accounting changes and corrections of misstatements by distinguishing between these events.

Discussion

The Commission received three comment letters in response to its request for comments on Auditing Standard No. 6 and conforming amendments. The comment letters came from three registered public accounting firms. All three commenters expressed support for the Commission's approval of the proposed standard.

As noted above, the PCAOB's proposed amendment to AU section 431 deletes a reference to Rule 301 of the AICPA's Code of Professional Conduct – a rule the PCAOB did not adopt as part of its original interim standards. Similar to comments made to the PCAOB during its comment period, one commenter believed concerns exist that the Board's action in removing a reference to a rule the PCAOB did not adopt might be construed as minimizing the auditor's responsibilities for maintaining the confidentiality of client information. The commenter requested that the Commission encourage the PCAOB to adopt a rule establishing the auditor's responsibility with respect to maintaining the confidentiality of client information.

In its adopting release, the PCAOB discussed the concerns the comments raised about client confidentiality and noted its awareness of many auditors' legal or professional obligations to maintain the confidentiality of client information, and made reference to the confidentiality requirements included in the provisions of the Uniform Accountancy Act and the provisions of the International Federation of Accountants' Code of Ethics for Professional Accountants.

The PCAOB also noted that its decision to omit Rule 301 from its interim standards was based on a determination that incorporation of that rule was not necessary to fulfill the Board's mandate under Section 103(a)(1) and (3) of the Act at that time, and that it did not reflect a decision that auditor confidentiality requirements imposed by other authorities were inappropriate. Similarly, in amending AU section 431, the PCAOB noted that it seeks neither to modify nor detract from existing confidentiality requirements.

The Commission agrees with the Board's proposed action to remove from its interim standards a reference to a rule it did not adopt. However, the Commission encourages the PCAOB to develop and adopt a rule addressing the auditor's responsibility with respect to maintaining the confidentiality of client information.

Conclusion
On the basis of the foregoing, the Commission finds that proposed Auditing Standard No. 6 and the Conforming Amendments are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

> It is therefore ordered, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that proposed Auditing Standard No. 6, Evaluating Consistency of Financial Statements, and Conforming Amendments (File No. PCAOB2008-01) be and hereby are approved.

EBSA - Testimony Of Bradford P. Campbell Before The Senate Committee On Health, Education, Labor, And Pensions

Background
On September 17, 2008 Bradford P. Campbell testified before the Senate Committee on Health, Education, Labor and Pensions. The testimony focused on 401k plan fees. Below are excepts from Mr. Campbell's testimony.

Introductory Remarks
Good morning Chairman Harkin, Ranking Member Enzi, and Members of the Committee. Thank you for inviting me to discuss plan fees, the Department of Labor's role in overseeing plan fees, and proposals to increase transparency and disclosure of plan fee and expense information. I am Bradford Campbell, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to be here today representing the Department of Labor and EBSA. Our mission is to protect the security of retirement, health and other employee benefits for America's workers, retirees and their families, and to support the growth of our private benefits system.

Ensuring the security of retirement benefits is a core mission of EBSA, and one of this Administration's highest priorities. Excessive fees can undermine retirement security by reducing the accumulation of assets. It is therefore critical that plan participants, directing the investment of their contributions, and plan fiduciaries, charged with the responsibility of prudently selecting service providers and paying only reasonable fees and expenses, have the information they need to make appropriate decisions.

That is why the Department began a series of regulatory initiatives to expand disclosure requirements in three distinct areas:

- Disclosures by plans to participants to assist in making investment decisions;
- Disclosures by service providers to plan fiduciaries to assist in assessing the reasonableness of provider compensation and potential conflicts of interest; and
- More efficient, expanded fee and compensation disclosures to the government and the public through a substantially revised, electronically filed Form 5500 Annual Report.

Each of these projects addresses different disclosure needs, and our regulations are tailored to ensure that appropriate disclosures are made in a cost effective manner. For example,

participants are unlikely to find useful extensive disclosure documents written in "legalese"—instead, it appears from comments we received thus far that participants want concise and readily understandable comparative information about plan costs and their investment options. By contrast, plan fiduciaries want detailed disclosures in order to properly carry out their duties under the law, enabling them to understand the nature of the services being provided, all fees and expenses received for the services, any conflicts of interest on the part of the service provider, and any indirect compensation providers may receive in connection with the plan's business.

We have made significant progress on these projects. On November 16, 2007, we issued a final regulation requiring additional public disclosure of fee and expense information on the Form 5500. On December 13, 2007, we published a proposed regulation requiring specific and comprehensive disclosures to plan fiduciaries by service providers, and held two days of administrative hearings on the proposed regulation on March 31 and April 1, 2008, and we plan to complete a final regulation this year. On July 23, 2008, we published a proposed rule requiring plans to disclose fee and expense, investment return and other essential information to plan participants. This proposal was informed by public comments on participant disclosures we received following a Request for Information published on April 25, 2007. The public comment period on the proposed regulation recently closed, and we are evaluating the comments received from consumer groups, plan sponsors, service providers and others as we work to finalize the proposal.

The Employee Retirement Income Security Act of 1974 (ERISA) provides the Secretary of Labor with broad regulatory authority, enabling the Department to pursue these comprehensive disclosure initiatives without need for a statutory amendment. The regulatory process currently underway ensures that all voices and points of view will be heard and provides an effective means of resolving the many complex and technical issues presented. I hope that as Congress considers this issue, it recognizes the Department's existing statutory authority and takes no action that could disrupt our current efforts to provide these important disclosures to workers. My testimony today will discuss in more detail the Department's activities related to plan fees. Also, I will describe the Department's regulatory and enforcement initiatives focused on improving the transparency of fee and expense information for both plan fiduciaries and participants.

Information

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. EBSA oversees approximately 679,000 private pension plans, including 387,000 participant-directed individual account plans such as 401(k) plans, and millions of private health and welfare plans that are subject to ERISA. Participant-directed individual account plans under our jurisdiction hold over $2.2 trillion in assets and cover more than 65 million participants. Since 401(k)-type plans began to proliferate in the early 1980s, the number of employees investing through these types of plans has grown dramatically. Assets held in these plans are, in real terms, more than 13 times greater than the amount held in 1984 and have increased by 22.5 percent since 2000. EBSA employs a comprehensive, integrated approach encompassing programs for enforcement, compliance assistance, interpretive guidance, legislation, and research to protect and advance the retirement security of our nation's workers and retirees.

Title I of ERISA establishes standards of fiduciary conduct for persons who are responsible for the administration and management of benefit plans. It also establishes standards for the reporting of plan related financial and benefit information to the Department, the IRS and the

Pension Benefit Guaranty Corporation (PBGC), and the disclosure of essential plan related information to participants and beneficiaries.

The Fiduciary's Role: ERISA requires plan fiduciaries to discharge their duties solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their duties, fiduciaries must act prudently and in accordance with the documents governing the plan. If a fiduciary's conduct fails to meet ERISA's standards, the fiduciary is personally liable for plan losses attributable to such failure.

ERISA protects participants and beneficiaries, as well as plan sponsors, by holding plan fiduciaries accountable for prudently selecting plan investments and service providers. In carrying out this responsibility, plan fiduciaries must take into account relevant information relating to the plan, the investments available under the plan, and the service provider, and are specifically obligated to consider fees and expenses.

ERISA prohibits the payment of fees to service providers unless the services are necessary and provided pursuant to a reasonable contract, and the plan pays no more than reasonable compensation. Thus, plan fiduciaries must ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided. Plan fiduciaries must also be able to assess whether revenue sharing or other indirect compensation arrangements create conflicts of interest on the part of the service provider that might affect the quality of the services to be performed. These responsibilities are ongoing. After initially selecting service providers and investments for their plans, fiduciaries are required to monitor plan fees and expenses to determine whether they continue to be reasonable and whether there are conflicts of interest.

EBSA's Compliance Assistance Activities: EBSA assists plan fiduciaries and others in understanding their obligations under ERISA, including the importance of understanding service provider fees and relationships, by providing interpretive guidance and making related materials available on its Web site. One such publication developed by EBSA is *Understanding Retirement Plan Fees and Expenses*, which provides general information about plan fees and expenses. In conjunction with the Securities and Exchange Commission, we also developed a fact sheet, "Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries." This fact sheet contains a set of questions to assist plan fiduciaries in evaluating the objectivity of pension consultant recommendations.

EBSA also has made available on its Web site a model "401(k) Plan Fee Disclosure Form" to assist fiduciaries of individual account pension plans when analyzing and comparing the costs associated with selecting service providers and investment products. This form is the product of a coordinated effort of the American Bankers Association, Investment Company Institute, and the American Council of Life Insurers.

To help educate plan sponsors and fiduciaries about their obligations under ERISA, EBSA conducts numerous educational and outreach activities. Our campaign, "Getting It Right – Know Your Fiduciary Responsibilities," includes nationwide educational seminars to help plan sponsors understand the law. The program focuses on fiduciary obligations, especially related to the importance of selecting plan service providers and the role of fee and compensation

considerations in that selection process. EBSA has conducted 26 fiduciary education programs since May 2004 in different cities throughout the United States. EBSA also has conducted 58 health benefits education seminars, covering nearly every state, since 2001. Beginning in February 2005, these seminars added a focus on fiduciary responsibilities. EBSA will continue to provide seminars in additional locations under each program.

Disclosure To Participants Under Current Law: ERISA currently provides for a number of disclosures aimed at providing participants and beneficiaries information about their plans' investments. For example, information is provided to participants through summary plan descriptions and summary annual reports. Under the Pension Protection Act of 2006, plan administrators are required to automatically furnish pension benefit statements to plan participants and beneficiaries. The Department issued Field Assistance Bulletins in December 2006 and in October 2007 to provide initial guidance on complying with the new statutory requirements. Statements must be furnished at least once each quarter, in the case of individual account plans that permit participants to direct their investments, and at least once each year, in the case of individual account plans that do not permit participants to direct their investments. Other disclosures, such as copies of the plan documents, are available to participants on request.

Additional disclosures may be required by the Department's rules concerning whether a participant has "exercised control" over his or her account. ERISA section 404(c) provides that plan fiduciaries are not liable for investment losses which result from the participant's exercise of control. A number of conditions must be satisfied, including that specified information concerning plan investments must be provided to plan participants. Information fundamental to participants' investment decisions must be furnished automatically. Additional information must be provided on request.

EBSA Participant Education And Outreach Activities: EBSA is committed to assisting plan participants and beneficiaries in understanding the importance of plan fees and expenses and the effect of those fees and expenses on retirement savings. EBSA has developed educational brochures and materials available for distribution and through our Web site. EBSA's brochure entitled *A Look at 401(k) Plan Fees for Employees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments. The brochure answers frequently asked questions about fees and highlights the most common fees, and is designed to encourage participants to make informed investment decisions and to consider fees as a factor in decision making. Last fiscal year, EBSA distributed over 5,400 copies of this brochure, and over 46,000 visitors viewed the brochure on our Web site.

More general information is provided in the publications, *What You Should Know about Your Retirement Plan* and *Taking the Mystery out of Retirement Planning*. In the same period, EBSA distributed over 86,000 copies of these two brochures, and almost 102,000 visitors viewed these materials on our Web site. EBSA's *Study of 401(k) Plan Fees and Expenses*, which describes differences in fee structures faced by plan sponsors when they purchase services from outside providers, is also available.

Regulatory Initiatives: EBSA has completed one initiative and currently is finalizing two others to improve the transparency of fee and expense information to participants, plan sponsors and fiduciaries. We began these initiatives, in part, to address concerns that participants are not receiving information in a format useful to them in making investment decisions, and that plan

fiduciaries are having difficulty getting needed fee and compensation arrangement information from service providers to fully satisfy their fiduciary duties. The needs of participants and plan fiduciaries are changing as the financial services industry evolves, offering an increasingly complex array of products and services.

Disclosures to Participants On April 25, 2007, the Department published a Request for Information, inviting suggestions from plan participants, sponsors, service providers, consumer advocates and others for improving the current disclosures applicable to participant-directed individual account plans. In response to this request, the Department received more than 100 comment letters from a variety of interested parties. Drawing on these comments, the Department developed a proposed rule that will, upon adoption, require fiduciaries of all participant-directed individual account plans – not just plans electing to comply with section 404(c) – to furnish to the plan's participants and beneficiaries important plan and investment-related information. This proposed regulation, published in the July 23, 2008 Federal Register, will ensure that all participants who are responsible for making investment decisions under their plan receive understandable information about their plan and the investments offered thereunder, including information about the fees and expenses that directly affect their retirement savings.

A major challenge in developing the proposal was determining precisely what information plans should be required to disclose to participants. Many commenting on the Request for Information encouraged the Department to keep in mind that, while appropriate disclosures are helpful, simply mandating the disclosure of page after page of legal jargon is actually contrary to the interests of participants, as the quantity of information may be overwhelming to participants and the benefits may not justify the cost, which are likely to be charged against the accounts of participants. Our proposal adopts a disclosure framework that favors quality over quantity, providing plan participants with concise, useful information in a format that facilitates comparative judgments between plans' investment options.

Specifically, the proposal would require that participants be furnished, upon enrollment and at specified intervals thereafter, two general categories of information— "plan-related information" and "investment-related information."

Plan-related information primarily encompasses administrative expenses of the plan, such as legal and accounting fees, and expenses related to the actions of a specific participant, such as a loan processing fee. In addition to requiring descriptions of what and how these fees and expenses are assessed, to be furnished upon enrollment and at least annually thereafter, the proposal requires that the amounts actually charged against a participant's account for such expenses be disclosed quarterly, noting that this quarterly disclosure requirement could be satisfied by including the required information on the participant's quarterly benefit statement.

With respect to investment-related information, the proposal provides for the disclosure of specific information regarding each designated investment option and that such information be disclosed in a form that facilitates comparisons of investments. The proposal also includes a model comparative disclosure form. The specific investment-related information required to be disclosed under the proposal includes:

- The name of each investment option, type or category of the investment (e.g., money market fund, balanced fund, etc.), and whether the investment is actively or passively managed.
- Information about the performance of each investment over 1, 5, and 10 year periods.
- Benchmarks against which each investment may be compared in terms of performance.
- Fee and expense information with respect to each investment – specifically, the total operating expenses, and any shareholder-type fees that might charged directly against the participant's investment.

In addition, a Web site address is required to be provided with respect to each designated investment option for those participants who want additional information about their investment choices. The website would, at a minimum, make available information concerning the principal investment strategies, attendant risks, investments comprising the portfolio, portfolio turnover, etc. – similar to the information that would be contained in more detailed prospectuses.

The comment period on the proposal closed on September 8th. Although we have not yet finished reviewing all of the comment letters, let me just say that we are pleased to see that so many stakeholders under ERISA support simple and short communications between plans and participants as the most helpful and meaningful.

Disclosures to Plan Fiduciaries On December 13, 2007, EBSA issued a proposed regulation amending its current regulation under ERISA section 408(b)(2) to clarify the information fiduciaries must receive and service providers must disclose for purposes of determining whether a contract or arrangement is "reasonable," as required by ERISA's statutory exemption for service arrangements. Our intent is to ensure that service providers entering into or renewing contracts with plans disclose to plan fiduciaries comprehensive and accurate information concerning the providers' receipt of direct and indirect compensation or fees and the potential for conflicts of interest that may affect the provider's performance of services. The information provided must be sufficient for fiduciaries to make informed decisions about the services that will be provided, the costs of those services, and potential conflicts of interest based on fees or compensation. The Department believes that such disclosures are critical to ensuring that contracts and arrangements are "reasonable" within the meaning of the statute. Public comments on the proposed regulation are currently under review and we are working on developing a final regulation.

Disclosures to the Public On, November 16, 2007, EBSA promulgated a final regulation revising the Form 5500 Annual Report filed with the Department to complement the information obtained by plan fiduciaries as part of the service provider selection or renewal process. The Form 5500 is a joint report for the Department of Labor, Internal Revenue Service and PBGC that includes information about the plan's operation, funding, assets, and investments. The Department collects information on service provider fees through the Form 5500 Schedule C.

Consistent with recommendations of the ERISA Advisory Council Working Group, the Department published a final regulation amending the Form 5500, including changes that expand the service provider information required to be reported on the Schedule C. The changes more specifically define the information that must be reported concerning the "indirect" compensation service providers received from parties other than the plan or plan sponsor, including revenue sharing arrangements among service providers to plans. The changes to the Schedule C were

designed to assist plan fiduciaries in monitoring the reasonableness of compensation service providers receive for services and potential conflicts of interest that might affect the quality of those services.

We intend that the changes to the Schedule C will work in tandem with our 408(b)(2) initiative. The amendment to our 408(b)(2) regulation will provide up front disclosures to plan fiduciaries, and the Schedule C revisions will reinforce the plan fiduciary's obligation to understand and monitor these fee disclosures. The Schedule C remains a requirement for plans with 100 or more participants, which is consistent with long-standing Congressional direction to simplify reporting requirements for small plans.

EBSA's Enforcement Efforts: EBSA has devoted enforcement resources to this area, seeking to detect, correct and deter violations such as excessive fees and expenses, and failure by fiduciaries to monitor on-going fee structure arrangements. From FY 1999 through August 2008, we closed 674 401(k) investigations involving these issues, with monetary results of over $131 million.

In carrying out its enforcement responsibilities, EBSA conducts civil and criminal investigations to determine whether the provisions of ERISA or other federal laws related to employee benefit plans have been violated. EBSA regularly works in coordination with other federal and state enforcement agencies, including the Department's Office of the Inspector General, the Internal Revenue Service, the Department of Justice (including the Federal Bureau of Investigation), the Securities and Exchange Commission, the PBGC, the federal banking agencies, state insurance commissioners, and state attorneys general.

EBSA is continuing to focus enforcement efforts on compensation arrangements between pension plan sponsors and service providers hired to assist in the investment of plan assets. EBSA's Consultant/Adviser Project (CAP), created in October 2006, addresses conflicts of interest and the receipt of indirect, undisclosed compensation by pension consultants and other investment advisers. Our investigations seek to determine whether the receipt of such compensation violates ERISA because the adviser or consultant used its status with respect to a benefit plan to generate additional fees for itself or its affiliates. The primary focus of CAP is on the potential civil and criminal violations arising from the receipt of indirect, undisclosed compensation. A related objective is to determine whether plan sponsors and fiduciaries understand the compensation and fee arrangements they enter into in order to prudently select, retain, and monitor pension consultants and investment advisers. CAP will also seek to identify potential criminal violations, such as kickbacks or fraud.

Concerns Regarding Legislative Proposals: While I am pleased that the Department's regulatory initiatives and the legislative proposals introduced in Congress share the common goal of providing increased transparency of fee and expense information, I am concerned that legislative action could disrupt the Department's ongoing efforts to provide these important disclosures. Proposed legislation may not achieve the primary goal of participant disclosures – providing workers with useful and concise information – by mandating very detailed and costly disclosure documents. Excessively detailed disclosures are likely to be ignored by participants even as those participants bear the potentially significant cost of their preparation and distribution. Participants are most likely to benefit from concise disclosures that allow them to meaningfully compare the investment options in their plans. The Department has received many comments highlighting the importance of brevity and relevance in disclosures to participants.

The regulatory process is well-suited to resolving the many technical issues arising as we seek to strike the proper balance in providing participants with cost effective, concise, meaningful information.

I am also concerned by proposals suggesting that specific investment options should be mandated. Requiring specific investment options would limit the ability of employers and workers together to design plans that best serve their mutual needs in a changing marketplace.

Conclusion

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before you today. The Department is committed to ensuring that plans and participants pay fair, competitive and transparent prices for services that benefit them – and to combating instances where fees are excessive or hidden. We are moving as quickly as possible consistent with the requirements of the regulatory process to complete our disclosure initiatives, and we believe they will improve the retirement security of America's workers, retirees and their families.

EBSA: Proposed Class Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Self-Directed Individual Account Plans and IRAs

Background

On August 22, 2008 the Employee Benefits Security Administration presented a proposed class exemption to the Department of Labor (DOL). The proposal is for a class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA, or the Act), and from certain taxes imposed by the Internal Revenue Code of 1986, as amended (Code). If granted, the proposed exemption would permit the provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary in an individual account plan or individual retirement accounts (and certain similar plans), the acquisition, holding or sale of a security or other property pursuant to the investment advice, and the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with such transactions. The proposed exemption, if granted, would affect sponsors, fiduciaries, participants and beneficiaries of participant-directed individual account plans, as well as providers of investments and investment advice-related services to such plans.

Information

Section 3(21)(A)(ii) of the Act includes within the definition of ``fiduciary'' a person that renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys of other property of a plan, or has any authority or responsibility to do so. The prohibited transaction provisions of ERISA and the Code prohibit an investment advice fiduciary from using the authority, control or responsibility that makes it a fiduciary to cause itself, or a party in which it has an interest that may affect its best judgment as a fiduciary, to receive additional fees. As a result, in the absence of a statutory or administrative exemption, fiduciaries are prohibited from rendering investment advice to plan participants regarding investments that result in the payment of additional advisory and other fees to the fiduciaries or their affiliates.

With the growth of participant-directed individual account plans, there has been an increasing recognition of the importance of investment advice to participants and beneficiaries in such plans. Most recently, Congress and the Administration, responding to the need to afford participants and beneficiaries greater access to professional
investment advice, amended the prohibited transaction provisions of ERISA and the Code, as part of the Pension Protection Act of 2006 (PPA), to permit a broader array of investment advice providers to offer their services to participants and beneficiaries responsible for investment of assets in their individual accounts and, accordingly, for
the adequacy of their retirement savings. Specifically, section 601(a) of the PPA added a statutory exemption under sections 408(b)(14) and 408(g) of ERISA. Parallel provisions were added to the Code at section 4975(d)(17) and 4975(f)(8).

Section 408(b)(14) of ERISA provides that certain investment advice-related transactions will be exempt from the prohibitions of section 406 if the requirements of section 408(g) are met. Section 408(g) of ERISA requires that investment advice must be provided by a fiduciary adviser under an "eligible investment advice arrangement" that meets a "level fee" requirement (ERISA section 408(g)(2)(A)(i))or a "computer model" requirement (ERISA section 408(g)(2)(A)(ii)).

However, PPA section 601(b)(3)(C) restricts the general availability of an eligible investment advice arrangement based on utilization of a computer model for certain plans described in Code section 4975(e)(1) (collectively referred to herein as Individual Retirement Accounts or IRAs), unless the Secretary of Labor, in consultation with the
Secretary of the Treasury, determines that there is a computer model investment advice program that may be utilized by an IRA to provide investment advice to the account beneficiary which meets the requirements described in PPA section 601(b)(3)(B).

On December 4, 2006, the Department published two Requests for Information in the Federal Register soliciting information to assist the Department in the development of regulations under ERISA section 408(b)(14) and 408(g), and in making its determination with respect to the utilization of computer models for IRAs. 71 FR 70429; 71 FR 70427.
Concurrent with the publication of this document, the Department reported to Congress its determination that there exist computer models that meet the requirements described in PPA section 601(b)(3)(B). In addition, appearing elsewhere in today's Federal Register, the Department is publishing proposed regulations that would implement the provisions of the statutory exemption for the provision of investment advice to participants and beneficiaries under sections 408(b)(14) and 408(g), and parallel provisions in Code section 4975.

This class exemption is intended to complement the adoption of those implementing regulations by furthering the availability of individualized investment advice to both participants and beneficiaries in participant-directed individual account plans and IRA beneficiaries under circumstances not encompassed in the statutory exemption or
implementing regulations, as described below.

Overview of Proposed Class Exemption: 1. General In general, the proposed class exemption, like the statutory exemption and proposed regulations published thereunder (proposed 29 CFR 2550.408g-1), provides relief from otherwise prohibited transactions relating to the provision of investment advice to the participant or beneficiary with respect to a security or other property available as an investment under a plan or IRA; the acquisition, holding or sale

of a security or other property available as an investment under a plan or IRA pursuant to the investment advice; and the direct or indirect receipt of compensation by a fiduciary adviser or affiliate in connection with the provision of investment advice or the acquisition, holding or sale of a security or other property available as an investment under the plan or IRA pursuant to the investment advice.

Unlike the statutory exemption and proposed regulations, however, the class exemption would provide relief for individualized investment advice to individuals following the furnishing of recommendations generated by a computer model or, in the case of IRAs with respect to which modeling is not feasible, the furnishing of certain investment
education material. The computer generated advice recommendations and investment education materials are intended to provide individual account plan participants and beneficiaries and IRA beneficiaries with a context for assessing and evaluating the individualized investment advice contemplated by the exemption. Also unlike the statutory exemption and proposed regulations, the class exemption, as discussed
below, applies the fee-leveling limits solely to the compensation received by the employee, agent or registered representative providing the advice on behalf of the fiduciary adviser, as distinguished from compensation received by the fiduciary adviser on whose behalf the employee, agent or registered representative is providing such advice.

2. Scope of Exemption--Sections I and II Sections I and II of the proposal define the scope of the class exemption. Section I provides that, with respect to the provision of advice to participants and beneficiaries of individual account plans, the restrictions of sections 406(a) and 406(b) of ERISA and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, shall not apply to the provision of investment advice described in section 3(21)(A)(ii) of the Act by a fiduciary adviser to a participant or beneficiary of an individual account plan that permits such participant or beneficiary to direct the investment of their individual accounts; the acquisition, holding, or sale of a security or other property pursuant to the investment advice; and, except as otherwise provided in the exemption, the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or any employee, agent, registered representative or affiliate thereof) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property pursuant to the investment advice. Section II provides the same relief with respect to the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code, for investment advice to beneficiaries of IRAs.

3. Conditions--Section III Paragraphs (a) through (c) set forth general requirements relating to the arrangements and investment advice covered by the exemption, without regard to whether a fiduciary adviser uses a computer model or levels fees in connection with the providing of individualized investment advice. Paragraph (a) provides that the investment advice arrangement must be authorized by a plan fiduciary (or, in the case of an IRA, the IRA beneficiary) other than: the person offering the investment advice arrangement; any person providing designated investment options under the plan; or any affiliate of either. The terms designated investment options and affiliate are defined in Section IV, described below. Paragraph (a) further provides that for purposes of such authorization, an IRA beneficiary will not be treated as an affiliate of a person solely by reason of being an employee of such person, thereby, enabling employees of a fiduciary adviser to take advantage of the investment advice arrangements offered by their

employer under the exemption. Paragraph (b) requires that the provided investment advice be based on certain generally accepted investment theories. Paragraph (c) requires that the investment advice must take into account information furnished by a participant or beneficiary.

Paragraph (d) of Section III requires that the fiduciary adviser must provide advice in accordance with paragraph (e) or paragraph (f) or both. As discussed below, paragraph (e) generally requires the provision of investment advice generated by a computer model in advance of providing individualized, non-computer modeled advice. Paragraph (f)
requires that investment advice be provided in a manner with respect to which fees or other compensation received by an employee, agent or registered representative providing investment advice on behalf of a fiduciary adviser do not vary based on the investment option selected by the participant or beneficiary. Paragraph (d) also permit the
provision of investment advice using a combination of computer generated advice and fee-leveling.

Use of Computer Models - Paragraph (e) Paragraph (e)(1) requires that, prior to the provision of other investment advice covered by the class exemption, participants and beneficiaries must be furnished with investment recommendations generated by a computer model. The computer model must either meet the requirements of ERISA section 408(g)(3)(B) and (C) \6\ or meet the requirements of section 408(g)(3)(B) and be designed and maintained by a person independent of the fiduciary adviser (and any of the adviser's affiliates) and utilize methodologies and parameters determined appropriate solely by the independent person. If the conditions of section III are satisfied, then the class exemption provides relief, as described in sections I and II, in connection with both the investment advice generated by the computer model and the non-computer model generated investment advice subsequently provided.

In order to satisfy paragraph (e)(1), a computer model must, at least, meet the requirements of section 408(g)(3)(B) and the regulations issued thereunder applicable to a computer model that serves as the basis of an eligible investment advice arrangement under the statutory exemption and related regulations (proposed 29 CFR 2550.408g-1(d)(1)). Additionally, unless the computer model is developed and maintained by a person independent of the fiduciary adviser (and its affiliates), the computer model must be certified, in accordance with ERISA section 408(g)(3)(C) and related regulations (proposed 29 CFR 2550.408g-1(d)(2)), as satisfying those requirements.

Thus, unless the computer model is developed and maintained by an independent person, the model must meet the same requirements, including certification, as under the statutory exemption and related regulations. With respect to the inclusion of independently developed and maintained computer models under paragraph (e)(1), the Department opined in Advisory Opinion 2001-09A (Dec. 14, 2001) (AO 2001-09A) that
an investment adviser providing investment advice regarding investments that pay additional fees to the adviser could avoid prohibited transaction issues under ERISA section 406(b)(1) and (3) by utilizing computer methodologies developed, maintained and overseen by an independent person to generate the advice provided. This continues to
be the view of the Department. However, as with investment advice provided under the statutory exemption, the Department believes that plan participants and beneficiaries may want the flexibility to obtain other investment advice after receiving computer-generated advice, and advisers may be willing to offer such services. Accordingly, paragraph (e)(1) similarly encompasses transactions in connection with investment advice received after investment advice

generated by a computer model developed and maintained by a person independent of the fiduciary adviser and its affiliates. For purposes of this paragraph, the term "independent" is defined in paragraph (h) of Section IV. The Department notes, however, that it continues to believe that what constitutes "independent" for purposes of the analysis in AO 2001-09A is an inherently factual question, and that no inferences should be drawn with regard to the effect of the definition contained in paragraph (h) of section IV on the analysis in AO 2001-09A.

The general requirement for computer model investment advice set forth in paragraph (e)(1) also applies to IRAs, unless the fiduciary adviser determines that the types or number of investment choices available to an IRA beneficiary reasonably precludes the use of a computer model meeting of the requirements of section ERISA 408(g)(3)(B). If the fiduciary adviser so concludes, paragraph (e)(2) of Section III requires that the beneficiary be provided certain investment education-type materials, such as graphs, pie charts, case studies, worksheets, or interactive software or similar programs, that reflect or produce asset allocation models taking into account the age (or time horizon) and risk profile of the beneficiary, to the extent known. Paragraph (e)(2) also sets forth some general standards intended to ensure the reasonableness and objectivity of the materials furnished. These materials, like the investment advice generated by a computer model required under paragraph (e)(1), are intended to provide a means by which a participant or beneficiary may assess the individualized advice provided by the fiduciary adviser, taking into account whether and to what extent the individualized advice deviates from the computer generated advice or education-type materials furnished in advance by the fiduciary adviser.

Paragraph (e)(3) of Section III requires that the investment advice provided does not recommend investment options that may generate for the fiduciary adviser, or certain other persons, greater income than other options of the same asset class, unless the fiduciary adviser prudently concludes that the recommendation is in the best interest of the participant or beneficiary and explains the basis for that conclusion to the participant or beneficiary. Section III(e)(4), described below, imposes a specific documentation requirement with respect to any such advice. Section III(e)(3) does not apply to investment advice generated solely by use of a computer model described in paragraph (e)(1)(A) or (B) of section III.

Paragraph (e)(4) of Section III generally requires that not later than 30 days following the provision of investment advice under paragraph (e), the individual providing the advice on behalf of the fiduciary adviser must document the basis of any investment option(s) recommended to a participant or beneficiary, including an explanation as to how such recommendation relates to the recommendations or information provided or generated pursuant to paragraph (e)(1) or, if applicable, paragraph (e)(2). As an example, in the case of an IRA described in paragraph (e)(2) with respect to which a fiduciary adviser provides several generic asset allocation portfolios prior to rendering investment advice, the documentation required by paragraph (e)(4) must include explanations as to the asset allocation portfolio on which the investment advice is based, including reasons for its selection or deviation from those provided, and how the recommended investments provide the appropriate asset class exposures consistent with the portfolio.

Paragraph (e)(4) further requires that with respect to any investment advice that recommends investment options that may generate for the fiduciary adviser, or certain persons, greater income

than other options of the same asset class, the individual providing the investment advice on behalf of the fiduciary adviser must, not later than 30 days following its provision, document the basis for concluding that the recommendation is in the best interest of the participant or beneficiary. As with the requirements of paragraph (e)(3), this requirement does not apply to investment advice generated solely by use of a computer model described in paragraph (e)(1)(A) or (B) of Section III.

Paragraph (e)(5) provides that the documentation required by paragraph (e)(4) must be retained in accordance with the exemption's record-retention provision, section paragraph (n) of Section III, described below.

Use of Fee Leveling - Paragraph (f) Paragraph (f) of Section III requires that any fees or other compensation (including salary, bonuses, awards, promotions, commissions or any other thing of value) received, directly or indirectly, by an employee, agent or registered representative providing advice on behalf of the fiduciary adviser pursuant to the class exemption do not vary depending on the basis of any investment option selected by a participant or beneficiary. The Department notes that, in contrast to the fee-leveling requirement under the statutory exemption as described above and interpreted in proposed regulations being published in the Federal Register, the fee-leveling requirement under paragraph (f) applies only to the individual who provides investment advice. In this regard, the Department is persuaded that the safeguards provided for in the class exemption are sufficient to permit the application of the fee-leveling requirement at the individual-level, rather than fiduciary adviser-entity level, without compromising the availability of informed, unbiased, and objective investment advice for participants and beneficiaries.

Disclosure--Paragraphs (g)-(h) The disclosure provisions set forth in paragraph (g) of Section III generally track the disclosure provisions of the proposed regulations. In this regard, paragraph (g) of Section III requires that a fiduciary adviser furnish certain information, without charge, to a participant or beneficiary in advance of the initial provision of investment advice under the class exemption, and at least once each year thereafter during which the adviser provides investment advice to the participant or beneficiary under the class exemption.

Pursuant to paragraph (g)(1), a fiduciary adviser is required to provide to participants and beneficiaries a written notification describing:

- The role of any party that has a material affiliation or material contractual relationship with the fiduciary adviser in the development of the computer model described in paragraph (e)(1) or materials described in section paragraph (e)(2) of Section III and in the selection of investment options available under the plan.
- The past performance and historical rates of return of the designated investment options available under the plan or IRA to the extent such information is not otherwise provided.
- All fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property.
- Any material affiliation or material contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property.

The notification also is required to explain the manner, and under what circumstances, any participant or beneficiary information provided under the investment advice arrangement will be used or disclosed, and the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser,
including, with respect to an arrangement that utilizes a computer model pursuant to paragraph (e)(1), any limitations on the ability of the computer model to take into account an investment option that constitutes an investment primarily in qualifying employer securities, as provided for in proposed 29 CFR 2550.408g-1(d)(1)(v). This disclosure of limitations on a computer model's ability to take into account investments in qualifying employer securities parallels a similar requirement contained in the proposed regulations under section 408(g)(3) being published.

In addition to the foregoing, the notification must inform participants and beneficiaries that the fiduciary adviser is acting as a fiduciary of the plan in connection with the provision of the advice, and that the participants or beneficiaries may separately arrange for the provision of advice by another adviser, that could have no material affiliation with, and receives no fees or other compensation in connection with, the security or other property recommended to the participant or beneficiary.

Paragraph (g)(2)(i) provides that the information furnished pursuant to paragraph (g)(1) must be written in a clear and concise manner and in a manner calculated to be understood by the average plan participant and is sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be disclosed. Paragraph (g)(2)(ii) notes that the appendix to proposed 29 CFR 2550.408g-1 contains a model disclosure form that may be used to provide the required notification of information described in paragraph (g)(1)(iii). Paragraph (g)(2)(ii) makes clear that use of the model is voluntary. However, use of an appropriately completed model disclosure form will be deemed to satisfy the requirements of paragraphs (g)(1) and (2)(i) with respect to such information.

Paragraph (g)(3) indicates that required notification may be provided in written or electronic form.

Paragraph (g)(4) requires that the fiduciary adviser provide, without charge, updated information to the advice recipient concerning any material change to the information required to be provided to the advice recipient under section III(g) at a time reasonably contemporaneous to the change in information.

Paragraph (h) requires that the fiduciary adviser provide appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws.

Policies and Procedures--Paragraph (i) Paragraph (i) of Section III requires that the fiduciary adviser adopt and follow written policies and procedures that are designed to assure compliance with the conditions of the exemption. The Department believes that the maintenance of such policies and procedures will help ensure compliance with the exemption, as well as support a finding that, for purposes of section 408(a)(1), the exemption is administratively feasible. In this regard, the Department notes that, as discussed below, the auditor engaged pursuant to paragraph (j) is required to review a fiduciary adviser's compliance with its policies and procedures.

Annual Audit--Paragraph (j) The annual audit requirements of this proposed class exemption generally track the audit requirements applicable to investment advice arrangements offered under the statutory exemption and regulations issued thereunder, appearing elsewhere in today's Federal Register.

Paragraph (j)(1)(i) of Section III of the proposed class exemption requires that, at least annually, the fiduciary adviser engage an independent auditor to conduct an audit, and prepare a report with respect thereto and setting forth its specific findings, to determine compliance with the policies and procedures required under paragraph (i) of Section III and the requirements of the class exemption. The auditor, within 60 days following the completion of the audit, must furnish its report to the fiduciary adviser and, except with respect to an arrangement with an IRA, to the fiduciary that authorized the investment advice arrangement, as required under paragraph (a) of Section III. The audit must be conducted by an auditor who has appropriate technical training or experience and proficiency and so represents in writing to the fiduciary adviser. Paragraph (j)(2) provides that for purposes of paragraph (j)(1), an auditor is considered independent if it does not have a material affiliation or material contractual relationship with the person offering the investment advice arrangement to the plan or IRA or any person providing designated investment options under the plan or IRA.

Paragraph (j)(1)(ii) contains additional requirements that apply with respect to an arrangement with an IRA. Under this provision, the fiduciary adviser, within 30 days following receipt of the report from the auditor, as described in paragraph (j)(1)(i), must furnish a copy of the report to the IRA beneficiary or make such report available on its Web site, provided, however, that with respect to availability on a Web site, such IRA beneficiaries must be provided information, with the information required to be furnished pursuant to section III(g)(1), concerning the purpose of the report, and how and where to locate the report applicable to their account. With respect to making the report available on a Web site, the Department believes that this alternative to furnishing reports to IRA beneficiaries satisfies the requirement of section 104(d)(1) of the Electronic Signatures in Global and National Commerce Act (E-SIGN) that any exemption from the consumer consent requirements of section 101(c) of E-SIGN must be necessary to eliminate a substantial burden on electronic commerce and will not increase the material risk of harm to consumers. Further, in the event that the report of the auditor identifies noncompliance with the policies and procedures required by section III(i) or the conditions of the class exemption, the fiduciary adviser, within 30 days following receipt of the report from the auditor, must send a copy of the report to the Department at the address provided in the class exemption.

Paragraph (j)(3) provides that, in conducting the audit required in (j)(1), the auditor must review sufficient relevant information to formulate an opinion as to whether the investment advice arrangements, and the advice provided pursuant thereto, offered by the fiduciary adviser during the audit period were in compliance with the policies and procedures required under paragraph (i) of Section III and the requirements of the class exemption. Paragraph (j)(3) also makes clear, however, that it does not preclude an auditor from using information obtained by sampling, as reasonably determined appropriate by the auditor, investment advice arrangements, and the advice pursuant thereto, during the audit period.

Miscellaneous Conditions - Paragraphs (k)-(m) Paragraphs (k)-(m) track provisions of the statutory exemption and proposed regulations, appearing elsewhere in today's Federal Register. Paragraph (k) of Section III requires that the sale, acquisition or holding of a security or other property on behalf of a plan or IRA under the exemption must occur solely at the direction of the recipient of the investment advice.

Paragraph (l) requires that the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition or holding of the security or other property must be reasonable.

Paragraph (m) requires that the terms of the sale, acquisition or holding of the security or other property must be at least as favorable to the plan or IRA as an arm's length transaction with an unrelated party would be.

Record Retention - Paragraph (n) Paragraph (n) of Section III provides that the fiduciary adviser must maintain, in a manner accessible for audit or examination, for a period not less than six years after the provision of investment advice any records necessary to determine, explain or verify compliance with the conditions of the class exemption.

<u>4. Definitions--Section IV</u> Section IV defines certain terms that apply for purposes of the class exemption. In general, the definitions applied for purposes of the class exemption comport with the definitions applied to terms under the statutory exemption and the proposed regulations, appearing elsewhere in the Federal Register.

As a threshold matter, this proposed class exemption would be available only in connection with investment advice provided by a fiduciary adviser. Paragraph (a) defines the term ``fiduciary adviser." This definition tracks the statutory definition of that term.

Paragraph (b) defines the term "registered representative" of another entity to mean a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (substituting the entity for the investment adviser referred to in such section).

Paragraph (c) defines the term "individual retirement account" and paragraph (d) defines the term "affiliate" for purposes of the class exemption.

As with the proposed regulations, the proposed class exemption, at paragraphs (e) and (f), respectively, also defines the terms "material affiliation" and "material contractual relationship." Paragraph (e)(1) defines a person with a "material affiliation" with another person as:

- Any affiliate of the other person.
- Any person directly or indirectly owning, controlling, or holding, 5 percent or more of the interests of such other person.
- Any person 5 percent or more of whose interests are directly or indirectly owned, controlled, or held, by such other person.

The Department notes that the definition of material affiliation includes an affiliate, as defined in paragraph (d) of section IV, and that, whereas the definition of affiliate focuses on voting securities owned, controlled or held, the definition of material affiliate focuses not only on the voting interests, but also on any interest. In this regard, paragraph (e)(2) defines the term "interest" for purposes of paragraph (e)(1).

Paragraph (f) provides that persons have a "material contractual Relationship" if payments made by one person to the other person pursuant to written contracts or agreements between the persons exceed 10 percent of the gross revenue, on an annual basis, of such other person. The Department believes that one person's receipt of more than 10 percent of gross revenue from another person is sufficiently significant to be considered material. However, the Department specifically invites comments on whether the percentage test should be higher or lower and, if so, why.

Paragraph (g) defines "control" to mean the power to exercise a controlling influence over the management or policies of a person other than an individual.

Paragraph (h) of Section IV defines, for purposes of paragraph (e)(1) of Section III, the term "independent" to mean a person that is not an affiliate of the other person and does not have a material affiliation or material contractual relationship with the other person.

For purposes of paragraphs (a), (g)(1) and (j)(2) of Section III of the proposal, paragraph (i) of Section IV defines the term "designated investment option" to mean any investment option designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. However, the term "designated investment option" does not include "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

5. Effect of Noncompliance--Section V Section V clarifies that the class exemption will not apply to any transaction (described in section I or II) in connection with the provision of investment advice to an individual participant or beneficiary with respect to which the conditions of the exemption have not been satisfied. In addition, in the case of a pattern or practice of noncompliance with any of the conditions, the exemption will not apply to any transaction in connection with the provision of investment advice provided by the fiduciary adviser during the period over which the pattern or practice extended.

Conclusion

The Department is proposing an effective date for the proposed class exemption which is 90 days after the publication of the final exemption in the Federal Register.