408(B)(2) PLAN SPONSOR SOLUTIONS TRANSCRIPT

Part E: What will the DoL be looking for in a prudent process?

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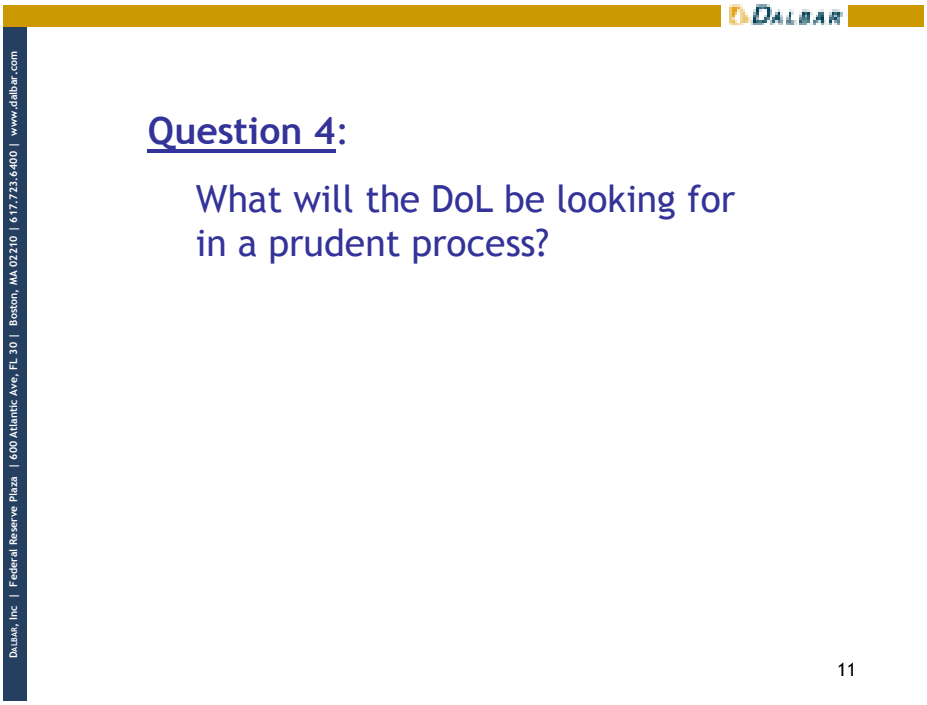
Webinar Panel:

Moderator: Edward M. Lynch, Jr., Founder and Chief Executive Officer of Fiduciary Planned Governance, LLC. ("Ed")

Panelists: Mary Rosen, Associate Regional Director of the Department of Labor EBSA in Boston. ("Mary")

Louis S. Harvey, Founder and Chief Executive Officer of DALBAR, Inc. ("Lou")



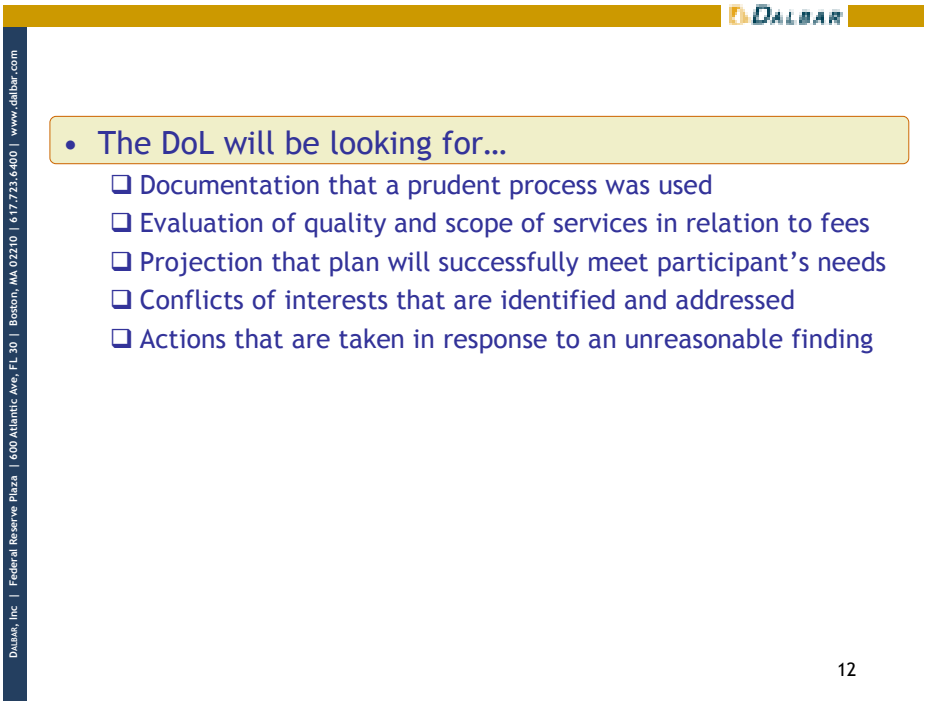
Ed:

Okay, we'll come back to that in the moment, that leads me now to pose a different question and I'll direct this to Mary to begin.

So, July 1st comes and goes, we're now in the 408(b)(2) disclosures phase and we're in that sixty-day window, during which plan sponsors have to prepare and make disclosure to their participants under the terms of 404(a)(5). Now we get past Aug 30th, which is sixty days from July 1st, and we're now into an enforcement period by the Department of Labor.

You've already made the point, Mary, that what needs to be done on the part of the plan sponsor is they need to execute a prudent process with regard to the fees and services being rendered to the plan.

What will the department be looking for in the way of evidence of a prudent process in that post-disclosure realm?



Mary:

Whenever we look at whether the fiduciary engages in a prudent process, Ed, first of all it will vary by task.

So we want to look at the particular task involved and in this particular situation, what is involved?

It's making the determination that the contract is necessary, the services are necessary, and that the compensation is reasonable.

In making that determination, the sponsor would want to evaluate the quality and the scope of the services being provided in relation to the fees being charged.

What we want to see is comparison between and among different services, that the sponsor has actually made comparisons, and selected the best service in relation to the quality and scope and the fees being charged.

Really, the way we look at prudence is it's not a result-oriented concept— for instance, you could have a successful investment that may not be necessarily a prudent one, or an unsuccessful investment that may be not necessarily be imprudent.

It's the process that defines the prudence. So, if we see that the plan sponsor has gone through a process and evaluated what he has to evaluate to arrive at a decision, then that would be considered a prudent process.

Lou:

I'd like to address one question that somebody asked here.

When we're talking about a fiduciary here, there's some confusion as to whether that means a Registered Investment Advisor who is a fiduciary to the plan and maybe we could just clarify a little bit about who is the responsible fiduciary.

Mary:

The responsible fiduciary in this case, under the regulation, is the plan sponsor.

Lou:

Right, okay, so we just wanted to clarify that we're not talking about someone else acting in a fiduciary role, you know, a 3(38) manager, or a 3(21) fiduciary, but the plan sponsor who is the "responsible fiduciary"—that's the party we're talking about.

Ed:

Let me use one of the questions that came in prior to today to perhaps illustrate this whole notion of a prudent process more clearly, as well as the issue of necessary and reasonable, and Lou, I'm going to direct this to you. I'm going to basically read this to you, and you have a look at it as well, but I want the listeners to hear.

> An advisor says: "I have a 400 participant plan in a group variable annuity that includes layers of tools, web interfaces, and call centers, so a pretty good service package, In the vender's annual review, these services were reported to be utilized twenty times, and parenthetically they add it's by the same participant. Since the other 399 [participants] are paying for plan services that are not being utilized, do future payments become prohibited transactions since the sponsor first, has found the services are not necessary, and two, the fees are therefore, logically, not reasonable?"

Lou:

That's a great question.

We've developed an algorithm to calculate what fee is reasonable or not, taking into consideration a number of factors that are nonnumeric, so we look at value, usage, and things like that.

In the example that we have here, the service that's used by only a few people will have a low value to the plan as a whole, so there will be points lost, if you will, deducted by virtue of the fact that the value is low.

That is not a stand-alone decision **--** one has to look further at it in the context of all the other factors affecting the plan. If in that same plan, where that usage of the service is low and you have a deduction, there is also a wonderful participation and people are diversified in their investments and they're getting terrific service from the plan service provider who has a wonderful website and answers their telephone on the first ring and the fees are reasonable.

After you consider all of those factors, then that would sort of just be included in the package. If on the other hand, the plan was marginal, that element possibly could push it into a range that would make it unreasonable.

So the issue is not any particular item, but how it fits within the broader context of the plan.

Ed:

So once again, a much more precise example of what components of a prudent process would look like and a structured process to evaluate it, as opposed to sort of a seat-of-the-pants, "well you know overall they're doing a good job and maybe people aren't using this but the whole package is pretty good."

You've developed a methodology that you can reduce that to essentially to a weighted scoring system to give that appropriate allocation and consideration.

Let me put out another one here, and this is something that I've had some discussions with people about and there's been some debate about, and is another question that came in.

> This basically says that the primary group annuity provider in our region, and we don't know who the provider is or the region from which this came in, is trying to bypass this entire process of disclosure by introducing a new share class that bakes in all fees into the expense ratio, so they don't have to be disclosed separately.

I think what's being alluded to here is the practice that in some cases, people have been doing where they create a share class that doesn't break things down into administration-related or 12B-1-related expenses or that sort of thing. It's simply a single share class and therefore the disclosure would be appropriate, which is while the investment adviser or broker is paid 25 or 40 or 50 basis points and we retain X for another portion from the expense ratio and 33 basis points goes to investment management up to say 180 basis points.

Mary, I understand that there was a guidance issued recently by the department with regard to issues of this type. I believe there was a bulletin issued on May 7th. Does it in fact address some of these issues regarding that? Or Lou if you'd like to address the question, feel free.

Lou:

Let me jump in on that question, Ed.

There are two aspects of this. One aspect of it is complying with the regulation. In other words, if somebody groups services together in such a way that they're not breaking out the level of detail that's required by the regulation, that's a violation. After the 90 day clock for notice runs out the failure is reportable to the Department of Labor. If this "bundling" that you describe includes the burying of required information, that's generally not a good idea and will get the service provider in trouble.

The second aspect, I think, is a positive side. If by doing this, the service provider can provide the required information but reduce the volume of paperwork; I'd say that's terrific. In fact, that's a benefit to the plan if they're structuring the share classes in such a way that less paperwork is produced. There's no reason to have a telephone book level disclosure if you can condense it down to a more meaningful level.

That's the pro and con.

In terms of whether the arrangement is reasonable, the more you aggregate, the less you'll be able to discriminate. Think about it this way, if you have one aspect of the plan that is not particularly valuable to the plan, and the thing is so bundled that you can't take it apart, then the risk that service providers take is that they're going to get fired because the total package may in fact be too expensive.

Ed:

So in a sense what we want to say to a plan sponsor or to an advisor who is assisting appropriately with some of this in terms of gathering information:

> Look at all the parties involved and all of the services that are being performed and come up with a list. Then, look for disclosures that specify all of that- if there are third party administration services, custodial services, and record-keeping services. If there's an advisor or broker involved, obviously they're being paid because none of this comes for free. There should be enough detail so that you can fill in each of those line items with all the disclosure you receive and if you can't fill in those line items, it may be that something isn't being provided to you and you need to look further.

Lou:

I think that's a fair representation.