AMERICAN BENEFITS COUNCIL

Testimony of Allison Klausner
Assistant General Counsel – Benefits
Honeywell International Inc.
on behalf of the American Benefits Council

Hearing on Fiduciary Responsibilities Update
and Revenue Sharing

Working Group on Fiduciary Responsibilities Update
and Revenue Sharing Practices
ERISA Advisory Council
on Employee Welfare and Pension Benefit Plans
U.S. Department of Labor
Washington, DC

September 20, 2007

My name is Allison Klausner and I am the Assistant General Counsel – Benefits for Honeywell International Inc. ("Honeywell"). Thank you very much for the opportunity to testify today on an issue of great interest to Honeywell and to me.

I am here today on behalf of the American Benefits Council (the "Council"). The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. Honeywell serves on the Council's Board of Directors and actively participates both directly and through the Council in public policy discussions regarding benefits issues confronting our country.

The topic I will be addressing today is 401(k) fees. This discussion can be broken down into two distinct areas. First, the dialogue between plan sponsors and participants, and second, the dialogue between service providers and plan sponsors.

The objective of Honeywell and other members of the Council very simply is to maximize benefits for our employees within the parameters of our 401(k) plan designs as well as the contribution and other limitations established by the Internal Revenue Code. This very simple objective helps us analyze very effectively a whole set of complicated issues relating to both dialogues. This, of course, includes evaluating whether 401(k) fees charged by service providers are reasonable; determining whether the selection of service providers is appropriate; analyzing whether the relationship between the fees and the services being provided is reasonable, including the use of revenue sharing as it relates to the specific plan; and evaluating what information will be most useful to plan participants to ensure that participants are able to make the best choices amongst those offered by the plan. The flexible framework that ERISA provides for plan sponsors to structure their contractual arrangements is critical to achieving our goal of maximizing benefits for plan participants. It is therefore very important that any enhanced disclosure requirements not interfere with the important aim of 401(k) plans – encouraging adequate savings for retirement.

Plan Sponsor and Participant Dialogue

I want to begin the discussion with the critically important dialogue between plan sponsors and participants as it relates to plan fees. As a large plan sponsor, I am keenly aware that communication with 401(k) plan participants is much broader than fees and that communication is at the core of achieving sufficient levels of participation and adequate levels of savings by participants. However, participants need to understand the fees they are paying within the context of the services they are receiving and the overall impact on the investment funds available to them. Disclosure of revenue sharing payments or detailed or granular information does not help plan participants at all in these respects. Moreover, participants must recognize that fees are only one factor to

consider in choosing an investment fund. Fee disclosure must not be elevated in a manner that discourages plan participants from considering potential or expected investment returns, personal horizon, risk tolerance and other factors when making investment fund decisions, as well as decisions regarding participation in, contributions to and distributions from the plan.

Honeywell believes strongly that any requirement regarding fee disclosure must be carefully crafted so that participants are not inadvertently led to think that selecting an investment fund with the lowest fee is always the right choice. As we know, an investment fund with low fees may generate higher or lower net investment returns relative to an investment fund choice with higher fees. Overly detailed or granular disclosure requirements may actually result in even higher fees for plan participants or more limited choices.

Specifically as to revenue sharing payments, Honeywell believes that disclosure of such payments would at best provide participants with useless information; at worst the complexity of financial transactions could mislead participants or dissuade them from even trying to understand the plan or the available investment funds. And the cost of communicating this useless, complicated information would likely be borne by the very participants who derive little or no benefit from the information. In other words disclosure of revenue sharing payments to participants is a lose-lose proposition for participants.

In general, as a large plan sponsor and on behalf of the Council, I offer the following thoughts regarding participant-level fee disclosure:

- Disclosure should include key information important to a participant, including, for example, the investment objectives, risk level, fees and historical returns of investment options. Undue emphasis on fees will only mislead participants by elevating fees above other equally or more important facts.
- The disclosure needs to be short, simple, and easy to understand. Examples based on prior year data may be helpful in this regard.
- Reform of existing rules regarding electronic communication is needed to facilitate less expensive, more efficient forms of communication, including the use of internet and intranet postings.
- Participant-level disclosure rules should apply to all participant-directed plans not just 404(c) plans.
- Fee information should be updated annually and provided upon enrollment.
- Fee information should be disclosed in the manner in which fees are charged. Artificial division of a single fee into components that are not available separately serves no purpose.
- Where disclosure of exact dollar amounts would be costly, the use of estimates or examples based on prior year data should be permitted.

- Plan fiduciaries should retain flexibility to determine the format for disclosure based on the nature, expectations and other attributes of their workforce.

Service Provider and Plan Sponsor Dialogue

With respect to service provider to plan sponsor disclosure, we believe policymakers would be pleased by the changes that are already happening in the market place. The Council's members, both plan sponsors and service providers, report that plan fiduciaries are taking extensive steps to ensure that fee levels are fair and reasonable for their participants. In a recent survey done by Hewitt, 77% of employer plan sponsors surveyed were either very or somewhat likely to undertake a review of fund expenses, revenue sharing and disclosure of these to participants.[1] Like many other plan sponsors, at Honeywell, we have asked and will continue to ask hard questions about plan services, fees charged and other compensation earned or paid to plan service providers. The information we are getting is giving us the tools we need to confirm that fees charged are appropriate and reasonable or to negotiate effectively for lower fees and excellent services. Likewise, this information is helping us to provide meaningful information to our plan participants.

Honeywell's 401(k) plan is one of the larger 401(k) plans with over 75,000 participants and more than $9 billion in assets. Approximately 90 percent of our active employee population is enrolled in and contributing to the plan. Our plan participants are quite pleased with our 401(k) plan and we are proud of its success. We are proud of the plan design and we are proud of the manner in which we handle our fiduciary duties with regard to the plan – including our duties to ensure that plan fees and expenses directly and indirectly paid to service providers are reasonable and appropriate. Honeywell's plan fiduciaries have implemented processes to ensure that providers' fees and expenses are reasonable and appropriate relative to industry benchmarks and relative to the type, quantity and quality of services provided. Clearly as a large plan sponsor my comments are geared somewhat towards that market. However, input to the Council reflects that in the small plan market, heightened awareness of existing fiduciary responsibilities already is helping small employers shop more effectively among service providers.

However, the Council members, including Honeywell, believe that we need to strive to make the fee disclosure system even better. In this regard, we are proud of the efforts the Council has taken to improve fee disclosure between service providers and plan sponsors, which include working in a constructive manner with the Department in its efforts to improve fee disclosure. For example, during 2006, the Council as part of a group of associations submitted to the Department of Labor an extensive list of fee and

---

[1] Hewitt Associates, "Hewitt Hot Topics in Retirement 2007" (http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/Hot%20Topics%20in%20Retirement%202007.pdf)

expense data elements that plan sponsors can use effectively with their service providers.

The data element list developed by the Council is designed to cover the full diversity of services and investment products provided to defined contribution plans and to allow meaningful comparison among and between these products, services and bundled arrangements. A list, such as the one previously submitted to the Department and which is attached, provides useful fee disclosure regardless of the specific investment product or service and helps ensure a level playing field in the marketplace among different service providers and financial services industries. We believe such a list is extremely useful to plan sponsors when negotiating with or shopping for service providers. The tool also accommodates the innovations expected in defined contribution plan products and services market and fosters competitiveness. It thus preserves the critical marketplace element of pricing which will help to keep prices as low as possible for the highest quality of services.

We believe that many plan sponsors, providers and consultants follow an approach to disclosure today that elicits important information about the array of potential services included in the total cost to the plan, identifies services that can be purchased separately and obtains the costs of those services that can be purchased a la carte. We do not believe the current system of fee disclosure between plan service providers and plan sponsors is broken. Indeed, while the plan fiduciaries, service providers and consultants represented by the Council agree that additional 408(b)(2) guidance that clarifies existing fiduciary responsibilities could be helpful, we are concerned about the prospect of complex and burdensome new disclosure requirements that could result in impeding the effectiveness of the marketplace by constricting the flexibility ERISA provides fiduciaries to negotiate. For example, new requirements that increase liability exposure or compliance costs in a significant way could lead to less choice among service providers and could result in employers making plan design choices based on the structure of fees rather than on benefits and services for plan participants. We trust the Department will weigh carefully the costs and benefits of any new disclosure requirements as part of its 408(b)(2) guidance project. The marketplace negotiation process must not be put in a straightjacket that reduces or eliminates its effectiveness.

I am aware that you are very interested in how plan sponsors might approach the specific issue of "revenue sharing" and I would like to share with you the Council's view on this issue. The practice of one service provider paying a subcontractor or affiliate for services rendered to the fund is not uncommon. There is nothing inherently wrong or even problematic regarding inter-service provider fees and the current law prohibited transaction rules preclude inter-service provider arrangements that would create conflicts of interest. However, plan sponsors, like Honeywell, take their fiduciary responsibility to maximize the benefits of plan participants, within the parameters of the selected 401(k) design and the limitations of the Internal Revenue Code and ERISA

very seriously. Plan sponsors, including Honeywell, do evaluate fees within the context of our plan design choices and shop for services accordingly.

Employers have a duty to both understand the services being provided and to ensure that the services are consistent with the plan design that they have selected as in the best interest of the plan participants overall. We understand that the costs for those services have to be reasonable. The costs should be evaluated in the aggregate, with respect to the services being supplied for that cost. Sponsors must ask, "Are these the services that are needed for the plan?" Plan sponsors also must ask " Is purchasing the services as a bundled product the best way to get those services?" The plan sponsor has to consider these questions first and determine whether the availability and quality of individually purchased services is better for their specific plan. Costs of individually purchased services, by nature of their being purchased separately, each have to be reasonable. But, in many instances services can be obtained most cost effectively for a particular plan through the purchase of services that involve revenue sharing while in others it does not make sense. Thus, in matching the plan design to the services at a reasonable cost, the employer should be permitted to evaluate whether revenue sharing is appropriate as a way of obtaining services for their particular plan design. In order for the plan sponsor to make these determinations, service providers should be required to disclose whether any material amount of core services are being performed by other entities and if so who they are. Furthermore, any affiliation with any "subcontractor" must be disclosed.

While the law today is perfectly clear to many companies, such as Honeywell, we agree clarification of these general fiduciary obligations will help stimulate greater dialogue between service providers and plan sponsors. We believe that through enhanced dialogue in the marketplace between service providers and plan sponsors the needed services can be efficiently and cost effectively matched to the plan design. Matching the design to the appropriate services is core to maximizing the effectiveness and desirability of the plan and thus to maximizing the participants' benefits. Specific to that dialogue, there should be enhanced disclosure of revenue sharing from plan service providers to plan sponsors. However, such disclosure should be prospective and thus should be provided in connection with entering into, or renewing, a service agreement. The form of that disclosure should be a part of the dialogue as the plan fiduciaries seek to maximize the participants' benefits. In short, if the cost of a specific dollar amount disclosure outweighs its benefit, the plan sponsor should clearly be well within its fiduciary duty to not incur the expense.

Allocation of Revenue Sharing Credits

Finally, I want to touch briefly on the issue regarding how fiduciaries should allocate revenue sharing amounts that are credited back to a plan. In many cases this question is and will be moot because some companies are moving away from fee systems involving revenue sharing, and other companies simply use revenue sharing to negotiate a lower

price from a service provider. Still other companies may have or adopt plan provisions which are specific as to how to allocate any such credits thus minimizing the fiduciary issue. So for many companies, the plan fiduciaries will have little need for guidance regarding the allocation of revenue sharing credits.

Where a fiduciary issue does arise we would urge the Department to confirm that there is not a single permissible method of allocation. For example, a fiduciary should consider allocating revenue sharing credits back to participants who generated those payments. However, consistent with other guidance from the Department, the fiduciary should be permitted to decide that the cost of such an allocation system dictates that another more efficient allocation system be used. In fact, we would anticipate that, in most cases, it will be most efficient simply to treat the credits as an offset against fixed costs and allocate the costs on a per capita basis. We recognize that special circumstances may require a different result, but we urge the Department not to move in the direction of creating any inflexible rule or even the presumption that would work against what we see as the most efficient means of allocating revenue sharing credits.

The Council very much appreciates the opportunity to testify today, as do I. We also thank all of you for your time and hard work with respect to these important issues and I am happy to answer any questions.