

December 19, 2006

*Via electronic submission*  
[e-ORI@dol.gov](mailto:e-ORI@dol.gov)

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5669  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

Attn: Default Investment Regulation

Dear Sirs:

Sutherland Asbill & Brennan LLP (“Sutherland”) appreciates the opportunity to submit comments on the Department of Labor’s proposed regulations on default investment alternatives under participant directed individual account plans (71 Fed. Reg. 56806) (the “proposed regulations”). Sutherland represents both plan sponsors and financial services companies that will apply the final default investment regulations to retirement plans that cover thousands of employees. Accordingly, Sutherland and its clients have a strong interest in the effectiveness of the default investment rules.

These comments focus on a specific requirement found in § 2550.404c-5(e)(3) of the proposed regulations, which provides that a qualified default investment alternative (QDIA) is an investment alternative that is managed by an investment manager, *as defined in section 3(38) of the Act*, or is an investment company (emphasis added). We are concerned that the use of the definition of investment manager in section 3(38) of the Employee Retirement Income Security Act (“ERISA”) effectively precludes either a plan’s trustee or a named fiduciary under a plan from managing the plan’s QDIA even if the trustee or named fiduciary would otherwise satisfy the requirements to be an investment manager under ERISA. We assume that it was inadvertent that the proposed regulations were drafted to preclude a plan’s trustee or named fiduciary from managing a QDIA if the fiduciary could otherwise be an investment manager, but, in any event, we believe such a rule is unnecessarily restrictive and will increase costs by forcing plan fiduciaries to hire outside investment managers, even when plan trustees or named fiduciaries have the expertise to provide such services.

## **Background**

The proposed regulations will, upon adoption, implement section 624(a) of the Pension Protection Act (P.L. 109-280), which provides that a participant in a participant directed individual account plan will be deemed to have exercised control over his or her account (for purposes of ERISA section 404(c)(1)) if, in the absence of investment direction from the participant, the plan invests the participant's account in a QDIA. In addition, a fiduciary of a plan that complies with the final rule will not be liable for any loss or by reason of any breach that occurs as a result of such investment. The proposed regulations describe the types of investments that will qualify as QDIAs and include several requirements for a QDIA and for notice to participants.

The requirements of the proposed regulations include a provision which states that a QDIA must either be managed by an investment manager, as defined in section 3(38) of ERISA, or must be an investment company registered under the Investment Company Act of 1940. Section 3(38) generally defines an investment manager as a fiduciary who is a registered investment adviser, a bank, or an insurance company who has the power to manage, acquire, or dispose of any assets under the plan and has acknowledged in writing that he is a fiduciary with respect to the plan; however, the definition of the term "investment manager" explicitly excludes any fiduciary who is a trustee or named fiduciary, as defined in ERISA section 402(a)(2). In the context of the proposed regulations, the use of this definition of investment manager has the effect of prohibiting any trustee or named fiduciary of a plan from managing a QDIA for the plan.

The preamble to the proposed regulations notes the Department's concern with insuring that participants who are defaulted into a QDIA benefit from the investment management expertise of investment professionals who understand their role as plan fiduciaries: ". . . when plan fiduciaries are relieved of liability for underlying investment management/asset allocation decisions, those responsible for the investment management/asset allocation decisions must be investment professionals who acknowledge their fiduciary responsibilities and liability under ERISA (71 Fed. Reg. 56810)." Investment professionals who are either plan trustees or named fiduciaries have both the necessary expertise and the understanding of their fiduciary duties to perform these important investment management functions; however, the proposed regulations could be read to imply that these plan trustees and named fiduciaries, who are, of course, already bound by their fiduciary duties under ERISA, may be incapable of providing such quality investment management. We believe that no such implication was intended and that the use of the defined term "investment manager" was not intended to prevent investment professionals from providing these management services to plans for which they act as either a trustee or a named fiduciary. Moreover, we believe that any such implication would not be justifiable.

### Discussion

Prohibiting plan trustees and named fiduciaries who are registered investment advisers, banks, or insurance companies from acting as investment managers for a QDIA does not advance the Department's goal of ensuring that a QDIA is professionally managed, and is unwarranted and inappropriate for several reasons. First, the exclusion of trustees and named fiduciaries from the definition of investment manager under section 3(38) of ERISA does not reflect that trustees or named fiduciaries cannot or should not provide investment management services to a plan, but merely reflects that other definitions and provisions of ERISA adequately establish the authority, responsibilities, and obligations of trustees and named fiduciaries under ERISA. Thus, it would be superfluous to include trustees and named fiduciaries in the definition of investment manager under section 3(38) of ERISA because doing so would not alter their authority or duties in any respect. In contrast, using the defined term "investment manager" in the proposed regulations has the effect of precluding investment advisers, banks and insurance companies that act as trustees or named fiduciaries for plans they maintain for their own employees or otherwise from managing a QDIA. This result cannot have been intended. These fiduciaries are highly sophisticated, extremely qualified investment professionals who are fully cognizant of their fiduciary duties to plan participants and beneficiaries. Given that ERISA provides that plan trustees are responsible for the management of plan assets unless that authority is delegated to an investment manager or other named fiduciary, a presumption that a trustee may be an inappropriate manager of a QDIA would run counter to the clear intent of ERISA. *See* ERISA section 403(a). Furthermore, many insurance companies and banks act as the named fiduciary with respect to the plans maintained for their own employees. Historically, it is common for banks to invest the assets of the plans they maintain in collective investment funds or common trust funds managed by the bank that may or may not be registered investment companies. Similarly, insurance companies may invest plan assets in separate accounts managed by the company or in other managed funds for plans for their own employees. It would be anomalous if such a bank or insurance company was able to manage these funds as a QDIA for customers that utilize its investment services for the customers' plans but was not able to use the same fund or investment or similar funds as a QDIA in a plan maintained for its own employees because the bank or insurance company was the named fiduciary of that plan.

Second, under the proposed regulations, named fiduciaries and trustees who act as investment managers will still have an overarching duty to act in the best interest of plan participants and their beneficiaries if plan assets are invested in the QDIA. Section 2550.404c-5(b)(3) of the proposed regulations clearly states: "Nothing in this section shall relieve an investment manager...from its fiduciary duties under part 4 of Title I of ERISA, or from any liability that results from a failure to satisfy these duties, including liability for any resulting losses." Thus, the fiduciary has an existing duty not to overreach and is bound to act solely in the interest of participants and beneficiaries. This existing responsibility affords participants and beneficiaries protection against an investment manager/fiduciary who might seek to benefit its own account through the management of the plan's QDIA. With respect to these obligations, there is no valid distinction that can be made between a third-party investment manager and an

investment professional that also plays the role of plan trustee or named fiduciary that would justify restricting the investment management authority of the latter in connection with a QDIA.

Third, the proposed rule provides for a series of checks against the investment manager/fiduciary's ability to manage either the QDIA or a plan's general investment options in a manner that does not benefit the participant: the participant has the right to direct or redirect investments at any time, and transfer assets to other investments without cost; the plan sponsor is required to offer a broad range of investment alternatives within the meaning of 29 CFR §2550.404c-1(b)(3); assets must be properly diversified in order to minimize the risk of large losses; and the default investment is limited to one of the three types of "safe harbor" investment portfolios listed in the regulations. These safeguards provided to participants under the proposed rule and under ERISA render unnecessary any prohibition against named fiduciaries or trustees who are investment professionals acting as investment managers of a QDIA.

In addition, financial services companies that sponsor plans for their own employees are often able to provide investment management services to the plan at a lower cost than an outside investment manager. As currently written, even if the plan sponsor is a nationally recognized investment adviser, bank, or insurance company, if the plan sponsor is also a named fiduciary with respect to the plan, the proposed rule would prohibit the plan sponsor from offering its own high quality investment management services to participants in its plan at a comparatively lower cost. If the regulations effectively bar such investments, participants in QDIAs in those plans will be forced to bear higher costs (potentially for lower quality products) than participants who affirmatively choose the plan sponsor's lower cost investment alternatives. Ironically, QDIA participants will, in effect, experience comparatively reduced retirement savings, a result which runs counter to the stated intent of both the statute and the proposed rule.

While we applaud the Department's attempt to insure that participants invested in a default investment vehicle are serviced by high-quality investment managers, prohibiting named fiduciaries and trustees who are registered investment advisers, banks, or insurance companies from acting as investment managers for a QDIA is unwarranted and will raise plan costs and reduce overall retirement savings. Plan trustees and named fiduciaries who otherwise meet the definition of investment manager under ERISA section 3(38) should be afforded the opportunity to offer their own investment management services to the QDIA. These fiduciaries have the necessary investment expertise and understanding of their obligations to satisfy the Department's expressed goal of ensuring that QDIAs are professionally managed. They are also bound by their overarching fiduciary duty to act in the best interest of participants and their beneficiaries both under ERISA and under the proposed regulations. Moreover, the proposed regulations provide adequate protections against any potential overreaching by a trustee or named fiduciary acting as an investment manager. Accordingly, the final rule should explicitly state that, the parenthetical language of section 3(38) of ERISA notwithstanding, plan sponsors, trustees, and

named fiduciaries who are registered investment advisers, banks, or insurance companies are permitted to act as investment managers for a QDIA.

Respectfully submitted,

Carol A. Weiser

Vanessa A. Scott