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November 13, 2006

***Submitted electronically via [www.regulations.gov](http://www.regulations.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

Re: Request for comments related to Proposed Rule on Default Investment Alternatives under Participant Directed Individual Account Plans

Hewitt Associates (Hewitt) welcomes the opportunity to submit for consideration our comments on the Department of Labor's (Department's) proposed rule on default investment alternatives under participant directed individual account plans that was published in the *Federal Register* on September 27, 2006.

With more than 60 years of experience, Hewitt Associates ([www.hewitt.com](http://www.hewitt.com)) is a leading global provider of human resources outsourcing and consulting services. The firm consults with more than 2,400 companies and administers human resources, health care, payroll and retirement programs on behalf of more than 350 companies for millions of employees and retirees worldwide. Our outsourcing services process customer interactions from nearly 20 million employees and retirees annually.

Hewitt commends the Department for its creation and timely issuance of the proposed rule and for its request for comments on this proposal. Accordingly, Hewitt has identified some areas of the proposed rule that require further clarification or modification. A proposed solution related to each identified issue is included to help the Department in its effort to establish final guidance.

- 1. The final regulation should eliminate the requirement that a Qualified Default Investment Alternative (QDIA) can only be managed by either an investment company registered under the Investment Company Act of 1940 or an investment manager as defined by ERISA section 3(38).**

Increasingly, plan sponsors are looking toward target-risk and target-age/maturity funds to meet the needs of their plan default investment alternatives, and we expect this interest to increase in light of the Pension Protection Act of 2006 (PPA) and the Department's proposed regulation. To date, employers have varying ways to implement these funds. They can be "off the shelf" funds such as mutual funds or collective trusts, or employers can create customized portfolios out of the plan's

Office of Regulations and Interpretations

Page 2

November 13, 2006

underlying core investment options (such as was implemented by the highly publicized Fed Thrift plan in 2004). Increasingly, larger employers are opting for this latter option and are utilizing their strong-performing, low-cost core fund options to create customized portfolios for their plan population. The customization relates to both (a) which funds are included, and (b) how the roll-down schedule is implemented (it may be different if a plan has a pension plan, etc.). Customized strategies tend to be significantly lower cost, better performing, and easier for the participant to understand. Cost savings to participants through the use of customized funds versus “off the shelf” funds range from 20 to 60 percent, with most typical cost savings from 30 to 40 percent. Currently, nearly 25% of Hewitt’s clients utilize this approach for either target-risk or target-age/maturity portfolios, and that number is growing significantly. Employers may utilize varying techniques to create these portfolios, including in-house expertise, use of an outside investment consultant, or use of an investment manager.

Proposed Regulation section 2550.404c-5(e)(3) provides that, in order for an investment to qualify as a QDIA, it must be managed by either an investment company registered under the Investment Company Act of 1940 or an investment manager as defined by ERISA section 3(38). In its preamble to the proposed regulations, the Department notes its belief that, because of the fiduciary relief provided by this provision, “those responsible for the investment management/asset allocation decisions must be investment professionals who acknowledge their fiduciary responsibilities and liability under ERISA.” Plan sponsors that do not otherwise meet the requirements of a registered investment company or an ERISA investment manager may still be able to satisfy this criteria. Plan sponsors who manage their own investment alternatives, including the customized portfolios discussed above, are already subject to the fiduciary responsibilities and liabilities under ERISA, so they do not need to be ERISA section 3(38) investment managers to have those fiduciary obligations imposed upon them. Also, as a part of those fiduciary obligations, plan sponsors must determine that they have the underlying investment expertise to manage any such investments. Accordingly, the restriction created by the proposed rules would unnecessarily exclude some plan sponsors from managing their own QDIAs and/or utilizing traditional investment consultants to do so. This would result in a limitation on the default investment alternatives available to participants, including the customized portfolios described above, and an increase in the QDIA-related costs they may incur.

Office of Regulations and Interpretations

Page 3

November 13, 2006

**2. The final regulation should include a provision permitting the application of these provisions to the transfer of previously defaulted amounts into a QDIA.**

The Department should clarify in the final rule that, provided the requisite notice and other requirements of the rule are met, the protections offered under ERISA section 404(c)(5) apply to previously defaulted amounts that are subsequently moved from either (a) a prior default investment that was not a QDIA into a QDIA, or (b) a QDIA to an alternative QDIA.

The final rule should also provide that these protections would apply in the event that the plan sponsor chooses to move all participant amounts (not just those attributable to previously defaulted amounts) invested in the fund which was previously used as a default fund (e.g., a stable value fund) into a QDIA (or a new QDIA), provided the requisite notice and other requirements of the rule are met. As a result of changes in service providers and plan sponsorship, plans may not always be able to differentiate between those participants who were defaulted into the prior default option and those who affirmatively elected to invest in that fund. Prior to the recent guidance under PPA and the Department's proposed rule on default investments, many plan sponsors chose to use capital preservation funds as their designated default funds. Clarifying that the protections of 404(c)(5) can be extended to this situation would remove any hesitancy on the part of plan sponsors to move participants from a prior default fund into a QDIA.

We also request that the Department clarify its statement in the preamble to the proposed rule where it notes that the section 404(c)(5) fiduciary relief may be provided with respect to investments in QDIAs which occurred before the adoption of the final regulation. For example, the DOL should clarify (a) if the relief would apply only for default investments occurring on or after January 1, 2007 or if it could be applied to default investments occurring before that date; and (b) if compliance with the proposed regulation is sufficient for this retroactive relief or if the default investment will have to satisfy the QDIA requirements of the final regulation, as well.

**3. The final regulation should include an exception to the 30-day requirement for the initial default investment notice for situations when 30 days' notice may not be administratively practicable.**

Proposed Regulation section 2550.404c-5(c)(3) requires that notice of the default investment must be provided "within a reasonable period of at least 30 days" before the first default investment occurs. There are a number of events where default investments are used, but a 30-day advance notice is not always practicable,

Office of Regulations and Interpretations

Page 4

November 13, 2006

including: immediate enrollment in an automatic enrollment program, rollovers into the plan, and asset transfers to the account of an alternate payee under a qualified domestic relations order. There are also reasons why delaying these default investments for 30 days may not be possible or desirable from a policy perspective, for example:

- With respect to automatic enrollment, many employers believe that participants are less likely to opt out of an automatic enrollment program if the 401(k) contributions start being deducted from a participant's first paycheck. This way, the participant doesn't see the contribution as a take-away from his or her pay, and thus it maximizes the benefit of automatic enrollment.
- In the event of a rollover contribution, participants only have a 60-day window to perform an indirect rollover, so a plan-level administrative delay to provide default notice could limit a participant's ability to complete the rollover in a timely manner.

Accordingly, the final rule should permit this notice to be provided at least 30 days before the initial default or, if later, as soon as administratively practicable.

We also recommend that the final rule specify that, in the event the notice is provided as soon as administratively practicable, the protections of ERISA section 404(c)(5) apply to that initial default investment. In the alternative, the Department should clarify in the final rules how the protections will be applied if the notice is not provided at least 30 days before the initial default investment (for example, in an automatic enrollment program where there will be a series of default investments). We recommend that the Department establish that the protections will apply to the next available default investment.

By easing the initial notice requirements, the Department will make the protections of ERISA section 404(c)(5) more accessible to plan sponsors, and, accordingly, plan sponsors will be more willing to embrace the use of QDIAs in their plans. Thus, we encourage the Department to consider these administrative issues when finalizing the rule. Because new ERISA section 404(c)(5)(B), as created by PPA, does not require an initial notice and does not require a 30-day period for such notice, we believe that the Department has the ability to balance the intent of Congress with the administrative concerns raised above when finalizing this rule.

**4. The final regulation should clarify that the annual default investment notice requirement does not apply with respect to one-time default investment events.**

Proposed Regulation section 2550.404c-5(c)(3) states that the required notice must be provided “at least 30 days in advance of each subsequent plan year.” The proposed rule does not specify if this is intended to apply to situations where (a) a default investment on behalf of such a participant is expected to occur within that upcoming plan year or (b) a default investment on behalf of such a participant occurred at any time in the past. We recommend that the Department clarify in the final rule that the annual default investment notice requirement only applies to ongoing default investment scenarios (e.g., automatic enrollment or profit-sharing contributions) where default investments will be occurring in the upcoming plan year. Accordingly, the annual notice requirement would not apply to one-time default investment scenarios (e.g., rollover contribution into the plan, QDROs) or default investment scenarios that have ceased (e.g., participants who have opted out of an automatic enrollment program).

**5. The final regulation should specify that the fees and expenses required to be included in the default investment notice are limited to redemption fees and trade restrictions.**

Proposed Regulation section 2550.404c-5(d)(2) requires the default investment notice to include a description of the “fees and expenses attendant to the investment alternative.” The Department should clarify in the final rule that this is not meant to be interpreted broadly, but instead that the notice would only have to include the fees and expenses that could be assessed against the participant, such as redemption fees. Defining all fees and expenses attendant to an investment alternative would be too complex and cumbersome to incorporate into this notice. Instead, the participant should be able to be directed to the fund prospectus or any other relevant plan or fund materials where such information is provided.

**6. The final regulation should clarify the investment-related material that needs to be provided to a participant who is defaulted into a QDIA and indicate that direction of participants to that material is sufficient to satisfy that requirement.**

Proposed Regulation section 2550.404c-5(c)(4) provides that any materials received by the plan must be provided to defaulted participants “under the terms of the plan.” The final rule should clarify what, if any, materials need to be provided to participants in order to satisfy the requirements of this rule and in what manner such materials must be provided. For example, is the Department suggesting that the

plan document must contain a provision that defines when and how such materials are to be provided to defaulted participants? Or is that language intended to mean something else?

Instead of requiring a plan to distribute any such materials to defaulted participants, we recommend that the final rule include a provision which permits this requirement to be satisfied by including a statement in the initial and ongoing notice (comparable to the one required under proposed section 2550.404c-5(c)(4)) which directs participants to where they can obtain investment information about the default investment option (e.g., summary plan description or plan Web site), including any required materials.

In the alternative, we recommend that the Department clarify that the material that is required to be provided under this rule be comparable to the requirements of existing regulation sections 2550.404c-1(b)(2)(B)(1)(viii) and (ix), and section 2550.404c-1(b)(2)(B)(2). Specifically, the Department should indicate that a prospectus (or profile under DOL Advisory Opinion 2003-11A) would be provided immediately before or after the initial default, but all other materials, including updated prospectuses, can be made available upon request. Ultimately, investment-related information for defaulted participants should be able to be provided in the same manner as that information is provided to all other participants under a plan.

**7. The final regulation should specify that redemption fees or other transfer restrictions that are applied to a QDIA at the fund level do not constitute financial penalties or other restrictions that are not permitted under the rule.**

Proposed regulation section 2550.404c-5(c)(5) requires that a participant must be able to transfer out of a QDIA and into another investment alternative “without financial penalty” and proposed section 2550.404c-5(e)(2) provides that a default investment will not constitute a QDIA if it imposes a financial penalty or otherwise restricts the ability of a participant to transfer out of the default investment. The final rule should clarify that these limitations only apply to plan-level penalties and restrictions—not those imposed at the fund or fund manager level. Because industry standards and the marketplace will generally guide what types of funds are subject to transfer fees and other restrictions, excluding investment options with fund-level restrictions and penalties could unnecessarily limit a plan sponsor’s available options for selecting a QDIA. Instead, the Department should leave this at the discretion of the plan fiduciaries who must already consider fund-level penalties and restrictions when exercising their fiduciary duty of prudence in the selection of the plan’s QDIA (this is consistent with the direction of proposed section 2550.404c-5(b)(2)).



Office of Regulations and Interpretations

Page 7

November 13, 2006

8. **The Department should not provide regulations under new ERISA section 514(e), as created by the PPA, but instead clarify that 514(e) is not meant to preclude 514(a) ERISA preemption of state laws impacting automatic enrollment programs.**

PPA creates new ERISA section 514(e) that provides for ERISA preemption of state law which prohibits or restricts the inclusion of a participant in an automatic contribution arrangement. Section 514(e) also defines an automatic contribution arrangement and requires that a notice requirement be complied with in order for the preemption to apply.

Thus, this provision appears to hinge ERISA preemption for automatic enrollment programs on administrative compliance. We recommend that instead of providing regulations under ERISA section 514(e), the Department provide regulations or guidance under ERISA section under 514(a) to confirm the Department's existing view that state laws which would otherwise prohibit or restrict the inclusion of a participant in an automatic contribution program generally "relate to an employee benefit plan" and are preempted by ERISA. The Department should clarify that new ERISA section 514(e) does not limit the application of Section 514(a) to an automatic enrollment program but, instead, creates a "safe harbor" preemption scenario for automatic contribution arrangements meeting the requisite criteria.

We hope that you will address the issues noted above in the expected final regulations. If you have any questions or comments, please contact the undersigned at the telephone number or electronic mail address provided below.

Sincerely,

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