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Office of Regulation and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210
Attn: Default Investment Regulation

RE: Comments on proposed regulation on Default Investment Alternatives Under Participant Directed Individual Account Plans, 29 CFR Part 2550

Ladies and Gentlemen:

Financial Engines respectfully submits the following comments in response to the Department of Labor's proposed regulation entitled *Default Investment Alternatives Under Participant Directed Individual Account Plans* published in the September 27, 2006 Federal Register. Financial Engines Advisors L.L.C., a wholly owned subsidiary of Financial Engines, Inc., is a registered investment adviser that provides personalized investment advice and management services directly to plan participants in 401(k) and similar plans. Financial Engines is the leading provider of independent advisory services to large plan sponsors, working with many of the nation's largest employers and retirement service providers.¹

The proposed regulation and ERISA §404(c)(5) will play an important role in increasing both retirement plan participation and improved outcomes for participants. Specifically, the proposed regulation clarifies the circumstances under which a participant of a self-directed individual account pension plan will be deemed to have exercised control over assets in his or her account and sets forth the conditions upon which ERISA §404(c)(5) relief may be afforded to plan fiduciaries who have complied with the proposed regulation. Financial Engines strongly supports the Department's effort. By providing for an ERISA §3(38) investment manager, the proposed regulation affirms the appropriate fiduciary structure in the context of retirement plan investments where fiduciary relief is being granted to the plan fiduciary. It also confirms the requirement for a strong fiduciary process around the consideration, selection and monitoring of Qualified Default Investment Alternatives ("QDIAs") just as is required for any other plan investment alternative. The Department has identified default investment alternatives which, by providing capital appreciation, are more appropriate long-term investments over the course of an employee's career than other common "default" investment

¹ Financial Engines currently offers investment advice and management services to over 5.7 million plan participants through leading employers and financial institutions, including 88 *Fortune* 500 companies.

alternatives, such as money market and stable value funds, which primarily emphasize preservation of principal. Finally, the proposal is designed to achieve its intended purpose by encompassing situations beyond automatic enrollment. It is clear that the proposed regulation will help to further the goals of national retirement policy.

The following comments are intended to assist the Department in clarifying several key elements of the proposed regulation to further advance the goals of increasing plan participation and increasing retirement savings.

I. QDIA requirements should not preclude consideration of factors other than age

A. QDIA criteria

Demographics (such as age). In determining the criteria which will govern the asset allocation decisions for each of the three QDIAs, the Department has properly considered the age, life expectancy, or target retirement date of individual participants, as well as plan-level target risk information. The major advantages of using demographic information, such as age, are that age significantly impacts the appropriate asset allocation *and* it is readily available information. The existing language of the proposed regulation, however, could be interpreted to allow consideration of age only.

Plan Design Features. Age is not the only objective and readily available information relevant to making an investment decision on behalf of plan participants. Plan design features can significantly impact a participant's asset allocation and the information is often readily available to plan fiduciaries and QDIA managers. In some circumstances, the QDIA within a defined contribution plan will be only a part of an employer's array of pension benefits. For example, retirement benefits may also include employee stock purchase plans, stock option plans, restricted stock, matching contributions made in employer securities and/or a pension such as a cash balance plan.

Impact on Participants. A QDIA that considers age, but ignores significant company stock holdings, will create a QDIA allocation that is too aggressive.² Similarly, an employee may be entitled to benefits under an employer sponsored cash balance plan. In this situation, a QDIA that considers age, but ignores the fact that a portion of the portfolio is in a conservatively invested cash balance plan, will

² By way of illustration, an employer that has a \$0.50 match in company stock for every \$1.00 contributed by the employee could lead, after one year, to employee portfolios that consist of one-third company stock and two-thirds QDIA (a less diversified and higher risk asset allocation). Similar diversification issues can arise from ESOP plans, ESPP plans, restricted stock and in-kind profit sharing contributions of employer securities.

construct a portfolio that is too conservative for the circumstances³. The impact of considering readily known additional factors may vary by degree from plan to plan or participant to participant, but the resulting investment decisions will typically represent more efficient portfolios than those constructed based solely on age criteria and should better serve the long-term interests of the participants.

Fiduciary Obligations. A plan fiduciary charged with selecting the appropriate QDIA for its retirement plan should consider plan design information.⁴ The Department has noted in Regulation §2550.404a-1(b) that a fiduciary must give appropriate consideration to facts and circumstances that the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or particular investment course of action plays in that portion of the plan's investment portfolio for which the fiduciary has some responsibility. In addition, the final regulation should expressly permit consideration of such factors by a QDIA manager.

B. Recommendation

The Department should confirm the importance of considering readily available plan design information in the QDIA selection process and suggest that plan fiduciaries should consider whether the QDIA can accommodate plan design features such as employer securities and other employer sponsored plans (cash balance, profit sharing, etc.) in its investment allocation. The guidance contained in the Supplementary Information, and the final regulation itself, should reassure plan fiduciaries that a QDIA will not fail as such if it takes into consideration, as appropriate, other factors such as plan design information.

II. QDIA fiduciary requirements are appropriate

A. Investment management

Section 3(38) investment manager. Under the proposed regulation, a non-investment company QDIA must be managed by an investment manager as defined in ERISA §3(38). Financial Engines agrees with the Department that investment management decisions on behalf of plan participants should be made by investment professionals who have acknowledged their fiduciary status under ERISA. Should the Department wish to allow for additional types of permissible managers, it should only do so for a fiduciary under ERISA §3(21) who acknowledges its status in writing to the plan.

³ For example, an employee with 20% of their assets in a cash balance account, who is defaulted into a QDIA allocation appropriate for a 50-year old, would have to achieve the overall asset allocation appropriate for a 62-year old due to the extra cash and short-term fixed income exposure.

⁴“The most basic of ERISA's investment fiduciary duties is the duty to conduct an independent investigation into the merits of the particular investment.” In re Unisys Savings Plan Litigation, 74 F.3rd 420, 435 (3rd Cir.), cert denied 510 US 810 (1996).

Investment company/investment manager status. In construing the proposed regulation, there may be a mistaken belief that the QDIA requirements have been met if each constituent fund in a “fund of funds” structure is a registered investment company or is managed by an ERISA investment manager.⁵ If the party making the allocations lacks §3(38) status, the investment alternative should not qualify as a QDIA. The potential risk to plan participants from inappropriate allocations is too great to allow for any structure which does not require the fiduciary managing the QDIA to acknowledge its status under ERISA in writing to the plan (thus committing to be free from conflicts of interest).

B. Recommendation

Financial Engines supports the proposed regulation in its current form with respect to the criteria for a QDIA manager. However, the Department should clarify that the entity making investment allocation decisions for either an individual participant, such as a managed account QDIA, or for a pooled vehicle, such as a balanced fund or “custom lifecycle fund” QDIA, must be an investment manager meeting the requirements of ERISA §3(38).

III. Fiduciary safe harbor should be available beyond auto-enrollment to include situations involving existing plan participants

A. Conditions for fiduciary relief – opportunity to direct

Applicability to existing plan participants. Under the proposed regulation, a plan fiduciary may obtain fiduciary relief if “the participant or beneficiary on whose behalf the investment is made had the opportunity to direct the investment of the assets in his or her account but did not direct the investment of the assets.” This is consistent with section 404(c)(5) of ERISA, which does not limit fiduciary relief to automatic enrollment situations, thus giving plan fiduciaries the opportunity to offer a new, qualified default to existing employees by means of a process conforming to the proposed regulation. Although Footnote 5 in the Supplemental Information provides some guidance to plan fiduciaries, clarity is needed in the final regulation itself. The impact of the regulation on current participants in terms of improved outcomes is significantly greater than that on automatically enrolled new hires, especially in the short and intermediate term. For example, sponsors often make changes to their fund line-up, eliminate funds, change record keepers or engage in other common plan maintenance activities that require participants to make some investment election. A QDIA is an effective way to support those activities.

⁵ For example, a plan fiduciary may wish to select a default investment alternative which consists of an array of bank collective trust funds, each managed by an §3(38) investment manager, but allocated to individual participants by a party not qualified under §3(38).

B. Recommendation

Financial Engines recommends that the Department clarify that the intent of the regulation is to include situations where a participant has been given an opportunity to direct the investment of his or her account, but has failed to provide the direction, so long as all other regulatory conditions are satisfied, to make it clear that existing employees as well as new hires may benefit from the regulation. The Department should insert clarifying language similar to that contained in the Supplemental Information into the final regulation itself.

IV. Additional Comments

Financial Engines has noted the following items in the proposed regulation and offers these general comments, many of which we believe will be more fully addressed by other commentators.

A. *Duty to prudently select QDIA*. The Department should clarify that the QDIA selection process is a fiduciary decision separate from the decision to choose an investment alternative for the plan. Some sponsors are confused as to whether each decision is a separate fiduciary decision.

B. *Consideration of Fees and Expenses*. The Supplementary Information appropriately states that a plan fiduciary would be required to carefully consider fees and expenses in choosing a QDIA. The reference to fees and expenses will certainly be taken as important guidance shaping the selection criteria and processes adopted by plan fiduciaries in response to the regulation. The fact that it was mentioned to the exclusion of other important selection criteria may infer that it is dispositive in the evaluation process. The Department should clarify that the fees and expenses of a QDIA are not the sole determining factor in the selection process. Further, there are a variety of different fees relevant to prudent selection, such as underlying fund expenses, management fees, recordkeeping fees, etc. Some sponsors and industry experts are confused about which fees are most relevant to prudent selection. The proposal should clarify that the relevant fee for consideration should be the “all-in” or total fee paid by participants, taking into account both the fees associated with the core investment funds and any applicable management fee, wrap fee, recordkeeping fee or the like.

C. *ERISA §405(c)(2)*. The Supplementary Information notes correctly that similar relief to that provided under the proposed regulation is obtained, by plan trustees, under ERISA §402(c)(3) and §405(d). To avoid further ambiguity, the Department should clarify further that a named fiduciary who appoints an investment manager under ERISA §402(c)(3) is relieved from liability for the acts or omissions of the investment manager as provided in ERISA §405(c)(2).

D. *Provision of material to participants*. The type of information which must be passed through to defaulted participants should be clarified. The proposed regulation calls for “any material” relating to a participant’s default investment to be given to the participant.

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The final regulation should be explicit in limiting this requirement to information about the investment itself such as is normally contained in a prospectus or proxy statement. Otherwise, there may be confusion as to which material to pass through, or information properly intended for the plan fiduciary may be widely distributed, causing conflict with securities laws.

E. Notices for newly hired employees. The notice requirements in the proposed regulation should be clarified to allow for immediate automatic enrollment of newly hired employees, rather than creating a "30 day waiting period" if the current notice rules were to remain operative. A newly hired participant who has been placed in a QDIA always retains the ability to opt-out of the QDIA or out of the retirement plan itself.

Conclusion

Financial Engines appreciates the opportunity to comment on the proposed regulation and may provide additional comments as we continue to evaluate the proposal and discuss its impact with our plan fiduciary clients. We welcome the opportunity to work with the Department and to provide any further assistance that may be required. Please contact us should you have any questions.

Very truly yours,



Anne S. Tuttle
Vice President and General Counsel

cc: Bradford Campbell, Acting Assistant Secretary, Employee Benefits Security
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