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SENT VIA EMAIL (e-ori@dol.gov)
HARDCOPY VIA FEDERAL EXPRESS
Office of Regulations and Interpretations
U.S. Department of Labor
Employee Benefits Security Administration
200 Constitution Avenue, N.W.
Room N-5669
Washington, DC 20210

Re: **Comments on the Default Investment Alternatives Under Participant Directed Individual Account Plans; Proposed Rule (29 CFR Part 2550.404c-5)**

Ladies and Gentlemen:

I am writing to submit a single, focused comment on your proposed regulation under ERISA §404(c)(5), as adopted by the Pension Protection Act of 2006.

Summary

The provisions of the proposed regulation are unclear as they relate to the application of the investment management requirement for age-based and risk-based model portfolios. For example, it is unclear whether an investment manager satisfies the section 3(38) requirement that it have "the power to manage, acquire, or dispose of any asset of a plan" when it makes the decision to modify or to not modify the asset allocations within a model portfolio. This situation commonly arises where the primary plan fiduciaries select the mutual funds to be included in the plan, but an independent party is engaged to determine the allocations of the model portfolios among those investment options. When the independent party determines the asset allocations for the modern portfolios, it necessarily results in the acquisition, disposition of or holding of the underlying investments. However, because that decision is the result of an asset allocation decision, it could possibly be viewed as not being a direct decision to acquire or dispose of the underlying assets, even though it obviously has that effect. As a result, clarification is needed that the third party who determines and manages the asset allocations qualifies as an investment manager under ERISA section 3(38)(A). Further, it should be clarified that, even though the independent party is a fiduciary investment manager for purposes of the qualified default investment alternative (because of the discretionary management of the asset allocation), the independent party does not, because of that activity, become a fiduciary for the purpose of selecting or monitoring the investment options in the plan.

Background

The proposed regulation provides at section 2550.404c-5(e)(5) that a qualified default investment alternative (QDIA) must be:

> "(i) An investment fund product or **model portfolio** that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as the normal retirement age under the plan) or life expectancy . . .
>
> (ii) An investment fund product or **model portfolio** that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole . . .
>
> (iii) An investment management service with respect to which an investment manager allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy."
> [Emphasis added]

The proposed regulation also provides at section 2550.404c-5(e)(3) that the QDIA must be either (i) managed by an investment manager as defined in section 3(38) of ERISA, or (ii) an investment company registered under the Investment Company Act of 1940 (that is, a mutual fund). It is noteworthy that the requirement for an investment manager is not limited to the third alternative, that is, the alternative for an investment management service. Instead, it appears that an investment manager may also be used for the model portfolios described in the first and second categories of investment vehicles.

Section 3(38) of ERISA defines an investment manager as:

> "The term 'investment manager' means any fiduciary (other than a trustee or named fiduciary, as defined in section 402(a)(2))--
>
> (A) who has the power to manage, acquire or dispose of any asset of a plan;
>
> (B) who (i) is registered as an investment adviser under the Investment Advisers Act of 1940; (ii) is not registered as an investment adviser under such Act by reason of paragraph (1) of section 203A(a) of such Act, is registered as an investment adviser under the laws of the State (referred to in such paragraph (1)) in which it maintains its principal office and place of business, and, at the time the fiduciary last filed the registration form most recently filed by the fiduciary with such State in order to maintain the fiduciary's registration under the laws of such State, also filed a copy of such form with the Secretary; (iii) is a bank, as defined in that Act; or (iv) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and
>
> (C) has acknowledged in writing that he is a fiduciary with respect to the plan."

Among the requirements in the statutory definition of an investment manager is that the manager actually manage plan assets. Where an investment manager directs the purchase, holding or sale of specific assets, the concept of management is easily understood and applied. However, in cases where asset allocation models or model portfolios are used (both of the risk-based and age-based varieties), the primary plan fiduciaries (for example, the plan's investment committee) may select the underlying investment options for the plan. That is, the investment options used in the model portfolio are those that have previously been selected, and that are continuously monitored, by fiduciaries other than the investment manager. In that sense, when using a model portfolio, an investment manager would not select the specific investments that are bought, sold or held in connection with the implementation of the model portfolios or in connection with adjustments to those portfolios as a result of the management of the asset allocation models.

On the other hand, the investment manager would (i) determine the asset allocation model or models, (ii) be subject to a fiduciary standard for that determination, (iii) have the responsibility to continuously monitor the asset allocation percentages (and modify them as appropriate), and (iv) thereby determine when the holdings in the underlying investment options should be increased or reduced to adjust for changes in the allocations to the component asset classes. The natural consequence of a decision to maintain the status quo of the model, to increase the allocation to certain asset classes within the model, or to reduce the allocations to asset classes within the model, would be to cause the continued holding, or the purchase or sale, of underlying investments. As a result, it appears that the role of the manager of the asset allocation model would be that the manager was a fiduciary because of the ability to manage the decisions concerning the holding, selling or purchasing of assets in proportion to the investment allocation models. Thus, if the other section 3(38) criteria for an investment manager were satisfied, such a manager would be an investment manager under that section and, accordingly, the managed model would qualify under subsections (e)(3) and (5).

Request for Clarification

Accordingly, I request the following clarifications in the final regulation itself or, if not there, in the preamble for the final regulation:

1. Each of the three alternatives under subsection (e)(5) can be satisfied through the use of an investment manager as described in subsection (e)(3).

2. The manager of an asset allocation model or model portfolio would qualify under section 3(38) of ERISA (if the other criteria in that subsection were satisfied) because the determination of the allocations of an asset allocation model or model portfolio necessarily result in decisions concerning the holding, purchase or disposition of the underlying investments, which would satisfy the requirement that an investment manager manage the assets of a plan.

3. Unless the investment manager is otherwise a fiduciary related to the selection and monitoring of the investments offered by the plan for participant direction, the investment manager of an asset allocation model would be a fiduciary for asset allocation decisions (that is, for the QDIA), but would not be a fiduciary with responsibility for the selection and monitoring of the underlying investments, and the written acknowledgment of this limited scope would satisfy (C) under section 3(38) of ERISA.

Thank you for your consideration of these comments.

Very truly yours,

Fred Reish

C. FREDERICK REISH

CFR:shm