



June 19, 2007

The Honorable Elaine L. Chao
Secretary of Labor
Frances Perkins Building
200 Constitution Avenue, NW
Washington, DC 20210

Dear Secretary Chao:

I understand that the Department of Labor is developing a regulation under the Pension Protection Act that would provide a safe harbor for employers who select a qualified default investment alternative (QDIA) for those of their employees who do not make investment selections in connection with their 401(k) defined contribution investments.

Although this seems a relatively simple objective, there are pitfalls. The Department cannot and should not specify any particular investment vehicle, so the choice will inevitably have to be left to employers and plan fiduciaries. When a choice is involved, employers and fiduciaries may be concerned about legal liability, even though the objective of the regulation is to create a safe harbor. Under these circumstances, the tendency of employers may be to choose a portfolio that assures capital preservation, since this seems the course that is least likely to involve them in legal disputes.

However, while capital preservation may be a desirable objective for investors who already have a "nest egg" for retirement that they wish to preserve, it may not adequately serve the needs of the ordinary employee. The contributions made by employers on behalf of that ordinary employee are savings for the future; they defer the present consumption that most working families would find desirable, in exchange for a future return. That is what Congress appears to have wanted by allowing automatic enrollment, and in adopting the Pension Protection Act. It would be quite disappointing and unfair if that future return were not to materialize, with the employee receiving only a return of little more than his or her invested capital.

This is not to say, of course, that employers should be able to make use of the QDIA safe harbor to make risky investments on the part of the employee, but only that the portfolio chosen should be balanced among equity and fixed income choices so as to produce both diversification and some degree of the equity risk necessary to produce capital appreciation. Employers should not, under the regulation, be left free to choose the most conservative investment—one that would preserve capital but do nothing to enhance the quality of the employee's retirement.


The Department's regulation, in my view, correctly defines a QDIA as an investment that involves *both* diversification *and* a growth component. Indeed, the language of the regulation might be improved somewhat if it stated clearly at the outset of the QDIA definition that a QDIA must have both of these elements. A portfolio that is diversified

but offers only capital preservation will not be a QDIA and hence not eligible for the safe harbor.

It should be noted that the regulation, as drafted, will still not prevent highly risk-averse employers or plan fiduciaries from choosing the most conservative investments for their employees. These plan fiduciaries might take the position that by specifying the most conservative possible investment they do not need a safe harbor. This possibility might be addressed by including a new section in the notice provision of the regulation (2550.404c-5(d)), or elsewhere, requiring the plan fiduciary to notify the plan participant that the portfolio chosen will preserve capital but will not offer significant opportunity for capital appreciation.

Thank you for consideration given to the points in this letter.

Sincerely,

A handwritten signature in black ink, appearing to read 'Peter J. Wallison', written over a circular stamp or mark.

Peter J. Wallison
Senior Fellow