



November 13, 2006

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

Attn: Default Investment Regulations

To whom it may concern:

AARP is writing to comment on the Employee Benefits Security Administration's (EBSA) proposed regulations that would implement fiduciary relief provided by new ERISA § 404(c)(5) and create qualified default investment alternatives for sponsors of participant directed individual account plans. With more than 37 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. Nearly half of AARP members are working either full-time or part-time, and they have a vital interest in participating in employer-sponsored plans, such as 401(k)s, in order to save for a financially secure retirement.

The proposed regulations would provide ERISA section 404(c) relief to fiduciaries of a participant-directed plan that use qualified default investment alternatives (QDIAs) to invest the contributions of participants who do not choose an investment option. Such participants would be deemed to have exercised control over their assets. Consistent with current law, plan fiduciaries would continue to be subject to the fiduciary rules applicable to the prudent selection and monitoring of default investments.

AARP generally supports EBSA's proposed regulations because they provide commonsense guidelines for plan sponsors to establish default investments, not only for automatic enrollment but when there are other changes in plan administration (such as a change in service providers) and participants fail to make an affirmative choice. The rules, as proposed, would encourage the use of automatic enrollment because plan sponsors would have less cause for concern about liability for plan losses if they provided a QDIA, particularly if they use the investments suggested in the proposed regulation. AARP also supports the proposed restrictions on employer securities in the QDIA; this encourages

diversification while recognizing that a complete ban on employer stock would make selecting and monitoring a QDIA difficult.

I. Grandfather Principal Preserving Funds for Automatic Enrollment in Plans that Already Invest in Them

Many plan sponsors that have adopted automatic enrollment in recent years chose stable value or money market funds as the default investments. While the preamble of the proposed regulations makes clear that such investments can be prudent, the exclusion of such investments from QDIA status might discourage the continuation of automatic enrollment by sponsors that adopted principal preservation investments as a default for their automatically-enrolled participants.

Many of these employers counted on principal preserving funds as a legitimate default investment, partly on the strength of EBSA's recent position in the automatic rollover regulation. EBSA's position made it easier for employers to adopt automatic enrollment. The effect of the proposed regulation, in the short run, is to pull the rug out from under these employers. Consequently, AARP suggests:

1. Clarifying that capital preservation investments chosen as the default investment prior to enactment of the PPA and implementation of a final QDIA regulation will be considered prudent.
2. Stating in the final regulations that plan sponsors will have a duty to review their default investments choices based on the requirements in the final rules.

II. Allow Contributions from Automatically Enrolled Participants to be Invested in a Temporary Investment During the 90-day Corrective Distribution Period ("Unwind" Provision)

1. AARP recommends that EBSA add a provision to the final regulations that would allow employers to deposit contributions from automatically enrolled participants into a temporary investment, such as a money market fund, for 90 days to allow time for participants who wish to withdraw from the plan to do so without risk of loss of their money or its liquidity. By so doing, this would ensure that the participant could opt out without losing any principal and it would also help the plan administrator by making withdrawals easier and less expensive.
2. EBSA should consider modifying the proposed regulations to provide plan sponsors with the flexibility to invest the default participants' contributions and assets generally in principal preserving funds for a period of no more than three years after enrollment. This would help shorter term participants preserve their principal. It would help not only those who withdraw during the 90-day retroactive op-out period, but also participants who terminate employment or who

make an in-service withdrawal. The three-year time period for allowing a principal preserving investment would coincide with the three-year vesting period and mark a general passage of the employee from a short-term participant with a small account balance to a longer term employee.

III. Emphasize Fiduciaries' Duty of Prudence in Selecting QDIAs

The proposed regulation should emphasize more strongly the obligation of plan fiduciaries to act prudently in considering and selecting default investments. The regulation specifies three particular types of investment for which fiduciaries can obtain Section 404(c) protection without complying with the more extensive requirements of the preexisting Section 404(c) regulation. As a result, the regulation could be misinterpreted as providing a safe harbor for life cycle and balanced funds and managed accounts in every instance. Emphasizing prudence in the regulation may help to avoid the risk that fiduciaries will be less diligent than they should be in analyzing and comparing potential QDIA investment choices; that QDIAs will be used as a convenient repository for poorly performing funds; or that QDIAs will charge default participants excessive fees and expenses.

Similarly, while the regulation preamble recognizes that the prohibited transaction rules apply to QDIAs as they do to other investments, the regulation should explicitly warn fiduciaries to avoid conflicts of interest relating to their selection of a QDIA, including inappropriate payments from investment funds to plan fiduciaries or to advisers on whom the fiduciaries are relying.

IV. Further Minimize Fees and Expenses

We have several recommendations concerning fees and expenses associated with QDIAs.

1. The regulations should state not only that fees and expenses borne by participants must be reasonable but that, if they are higher than fees and expenses for other comparable investments available on the market, then the fiduciaries must be able to justify choosing that investment for the QDIA. As the proposed regulations recognize, the amount of fees and expenses charged to a 401(k) account can have a significant effect on the accumulation in the account. Moreover, studies have shown that higher fees do not necessarily translate into higher returns. Accordingly, fiduciaries must take care to ensure that plan investments do not entail excessive (or hidden) fees or expenses. This is particularly important in the case of default investments. Participants may scrutinize default investments less critically than investments they explicitly select and QDIA might well account for a large share of total participant investments in many plans.

2. More broadly, the regulations should also affirm that plan fiduciaries are responsible for thoroughly understanding all fees and expenses as well as for disclosing them to participants. Although this should be evident under current law, it bears new emphasis in light of the expanding use of default investments and the Department's new guidance on such investments.

3. The regulations should specifically refer to the use of index funds as a permissible investment choice to encourage the use of lower cost passively-managed funds.

4. AARP recommends that the final regulations provide that fees and expenses charged to participants who decide by default to invest in the QDIA may be no greater than those charged to other participants in the plan who consciously chose to participate in the QDIA. By requiring comparable treatment of these two categories of participants, EBSA would keep the playing field level and help preserve the value of the QDIA for the default participants. If a QDIA is not available to participants in a particular plan except as a default, the fees charged to participants in the QDIA should not exceed those charged to participants in other plans that invest in the QDIA as an active choice. Disproportionately high fees would unfairly reduce smaller and less active accounts.

5. We suggest that EBSA consider building on its previous work on disclosure of fees and expenses by publishing additional fee disclosure guidance. This would help both plan sponsors and participants better monitor the overall cost of investing in the various options and would help fiduciaries exercise their duties more effectively.

V. Improve the Disclosure Requirement

While AARP generally supports the 30-day advance notice requirement in the proposed regulation, we have some concerns and suggestions.

1. The regulation proposes to allow the notice to be given to participants by furnishing them a copy of the summary plan description (SPD) or summary of material modifications (SMM), without any additional or separate notice. AARP recommends that the regulations require the information regarding the default investment to be provided separately along with information about automatic enrollment, if applicable. Otherwise, the information risks being buried in the middle of an SPD and ineffectively disclosed.

2. Materials regarding investments and investment choices, such as election forms and periodic benefit statements, should disclose that participants will be invested in a default investment (along with a description of the investment) unless they explicitly elect something different.

3. In addition, notice should also include the following:
 - a. The procedures for making an explicit election among the other investment alternatives under the plan (including any deadlines and logistics).
 - b. A statement about the right to obtain further information about the default investment alternative and how to get that information.
 - c. A statement about the opportunity to receive investment advice if the plan offers it.
 - d. A description of the fees and expenses associated with the default investment, along with information or an illustration of the potential impact on the return.
 - e. A statement that the plan has no responsibility to determine or take into account the individual participant's risk tolerance, other assets, or preferences with respect to the QDIA.

4. AARP suggests that the Department propose a model notice that plan sponsors could use as a safe harbor. Model notices and/or model language can make it easier for plans to disclose information effectively to a large number of participants and can improve compliance.

VI. Make the Notice Requirement Sufficiently Flexible to Accommodate Automatic Enrollment That Begins on the Date of Hire

For more than eight years, employers have been able to start automatic enrollment with the first paycheck.¹ This approach was taken in the original IRS ruling that recognized automatic enrollment. Under that ruling, employers were required to give eligible employees notice of the automatic enrollment arrangement on date of hire. New employees' opportunity to opt out began immediately and lasted "a reasonable period thereafter." Automatic enrollment took effect with the first paycheck unless the employee opted out beforehand. This notice standard was reiterated in subsequent revenue rulings, and later guidance² did not change it. EBSA's proposed regulations, however, would

¹Guidance predating the proposed regulation has not required notice to be provided a specified number of days before automatic enrollment becomes effective.

² See Revenue Ruling 98-30, 1998-25 I.R.B. 8; Revenue Ruling 2000-8, 2000-7 I.R.B. 617 (which contained a similar footnote from the Department of Labor), Revenue Ruling 2000-33, 2000-31 I.R.B. 1, and Revenue Ruling 2000-35, 2000-2 C.B. 138. See IRS General Information Letter dated March 17, 2004 to J. Mark Iwry; Treasury Regulation Section 1.401(k)-1(a)(3)(ii).

change the rules even though the new Pension Protection Act of 2006 (PPA) includes a 90-day corrective distribution (or “unwind”) provision that supports the current approach.

Although the proposed regulations are intended to encourage automatic enrollment, the 30-day notice requirement applied to the initial pay period could have the opposite effect. Evidence suggests that the choice to save is more attractive and easier to make if it does not appear to reduce take home pay. Employees whose automatic enrollment contributions show up as a smaller paycheck weeks into the job may be more likely to withdraw participation from the plan.

Accordingly, AARP suggests that the proposed 30-day advance notice requirement be made more flexible to allow plan sponsors with immediate enrollment features to provide that notice at hire and allow employers to make an automatic contribution out of the employee’s first pay check. Employees could opt out in time to prevent the automatic contribution from being deducted from the first paycheck. If an employee did not opt out before receiving the first paycheck, the employee still would still have 90 days to do so retroactively under the PPA, if the plan so provided. A 30-day opt out election period would still be required for plans that do not begin automatic enrollment with the first pay check.

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AARP appreciates the opportunity to comment on the proposed regulations to establish a qualified default investment alternative. If you have any questions or need further assistance, please do not hesitate to contact Amy Shannon at 202/434-3768.

Sincerely,



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