November 13, 2006

Filed Electronically

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, RIN 1210-AB10

Re: Proposed Default Investment Regulation

Dear Sir or Madam,

The American Benefits Council (Council) appreciates the opportunity to comment on the Department of Labor's proposed regulations on default investment alternatives under participant directed individual account plans. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

We would like to start by applauding the Department for releasing proposed regulations so quickly after the Pension Protection Act of 2006 (and its directive to issue default investment regulations) was enacted. When finalized, the regulations will greatly facilitate automatic enrollment arrangements and materially enhance retirement savings for millions of working Americans and their families. We have a number of suggestions for improving the regulations that are discussed below.

Preemption of State Law

It is critical that the final regulations extend ERISA preemption of state anti-wage garnishment laws to a broader range of default investments. The Pension Protection Act preempts any applicable state law that would preclude an automatic enrollment arrangement but conditions this preemption on the plan investing automatic contributions according to the Department's default investment regulations. As a result, preemption of state anti-wage garnishment laws, including potential criminal prohibitions against payroll withholding without employee consent, depends upon use of a qualified default investment alternative (QDIA).

The proposed regulations provide for only three QDIAs (generally, life cycle funds, balanced funds and managed accounts), although it is clear that other default investments may be prudent defaults. The preamble to the proposed regulations recognizes that the three QDIAs identified in the proposed regulations are not intended to be the exclusive means by which a plan fiduciary may satisfy its fiduciary obligations in selecting a default. In fact, the preamble specifically identifies stable value funds as a prudent default in some circumstances. However, under the proposed regulations, a plan that uses a stable value fund or other non-listed prudent default would not get the benefit of ERISA preemption.

There is no reason to deny a plan sponsor the benefit of ERISA preemption where contributions are invested prudently, and it is essential that all prudent default investments be given equal footing in terms of ERISA preemption. For this reason, the Council recommends revising the list of QDIAs to include a broader range of default investment approaches. As discussed below, we generally believe that expanding the list of QDIAs is appropriate for reasons independent of ERISA preemption. Another approach would be to define QDIAs differently for purposes of ERISA preemption than for purposes of the limited fiduciary relief provided by section 404(c)(5). This could be done by providing that any prudent default investment is entitled to ERISA preemption but that QDIAs are deemed to be prudent.

We recognize that states have not taken enforcement action to date with respect to automatic enrollment features. However, a number of states make anti-wage garnishment laws criminal and it is very difficult for employers to base their plan designs on the good auspices of the states in refraining from enforcing their laws. Unless this issue is addressed, we fear that it will be a substantial impediment to widespread adoption of automatic enrollment arrangements. This would defeat the express Congressional intention of expanding the use of these arrangements and it would simply be bad retirement policy. For these reasons, we strongly urge you to issue final regulations that provide for a more appropriate and broader preemption of state law.

We also recommend clarifying the interaction between the default investment regulations and ERISA preemption. The Pension Protection Act provides for preemption only if "contributions are invested in accordance with regulations prescribed by the Secretary under section 404(c)(5)." The default investment regulations condition fiduciary relief on satisfaction of a number of conditions other than investment in a QDIA, such as providing 30-days advance notice and providing certain required information disclosures. In contrast, the new ERISA preemption provision provides its own advance notice requirement and does not provide for any mandated information disclosure. This strongly suggests that preemption should not depend on satisfaction of all of the default investment regulation requirements. For this reason, the Council recommends clarifying that ERISA preemption does not depend on

satisfaction of any of the requirements of the default investment regulations other than use of a prudent default investment.

In addition, we recommend that the Department address the status of ERISA preemption of state anti-wage garnishment laws during the interim period between the effective date of the final regulations and the enactment of the Pension Protection Act. The Pension Protection Act's new automatic enrollment preemption provision is effective on the date of enactment; however, it requires that plans invest automatic enrollment contributions according to the Department's not-yet finalized regulations on default investments. This raises a question of whether the new automatic enrollment provision is truly effective on the date of enactment. Some companies that were comfortable that general ERISA preemption principles precluded state anti-wage garnishment laws before the enactment of the Pension Protection Act have become concerned about their exposure during the interim period in light of the new specific preemption provision and its additional requirements for preemption. We urge the Department to indicate that state laws that would preclude automatic enrollment arrangements are preempted during this interim period if the contributions are invested in prudent default investments.

Transition Rules

One of the most important issues facing plan fiduciaries under the proposed regulations is transition with respect to both existing default investments (i.e., default investments made before the final regulations are effective) and existing automatic enrollment participants (i.e., participants that are placed into an automatic enrollment arrangement before the final regulations are effective and that continue to have automatic contributions made on their behalf after the effective date). It is critical that final regulations provide a roadmap for how plan fiduciaries may obtain fiduciary relief for both existing defaults investments and existing automatic enrollment participants.

There are two broad categories of existing defaults – defaults that are QDIAs and defaults that are not QDIAs. For plans that have default investments that are QDIAs, it appears that some action following the effective date of the regulations needs to be taken in order for plan fiduciaries to avail themselves of the new fiduciary relief for pre-effective date contributions. We recommend that the final regulations provide that plan fiduciaries are entitled to the fiduciary relief on a going-forward basis if they provide the notice required by the regulations to all participants in the QDIA. This notice would generally indicate that unless a participant elects otherwise, he or she will remain in the defaulted fund. In effect, the relief provided under this transition rule would deem the decision to keep participants in an existing default investment an investment decision covered by the regulations. As a result, the plan fiduciaries would be entitled to the same fiduciary relief that they would have been entitled to if they affirmatively moved existing amounts to a new QDIA. This relief is very modest and it would provide for an orderly transition to the new regulations.

For plans that have a default investment that is not a QDIA, we anticipate that many plans will decide to establish a new default fund. However, it will generally be impractical for these plans to move participants that were previously defaulted to the new QDIA. As a result, plan fiduciaries will generally be able to use the new default fund only for participants that begin automatic enrollment after the effective date or for new non-automatic enrollment default investments. There are three reasons why many plan fiduciaries will often be unable to move existing participants to the new default fund. First, plan fiduciaries will typically be unable to distinguish amounts that are affirmatively invested in the old default fund from amounts that were defaulted into the fund. Plan records are ordinarily not readily available as to the cause of an investment. Second, plan fiduciaries may be unable to distinguish participants that have affirmative investment elections in place from participants that are being defaulted into the existing default fund. Again, plan records will typically not be available that identify which participants are making negative investment elections. Third, there will be a number of situations in which it will not be clear whether a participant should be viewed as having exercised affirmative investment control. Many plans, for example, take separate investment direction with respect to new contributions and existing account balances and we are aware that some participants have asserted investment control over some or all of their existing account balances but have not disturbed their default investment elections. A similar issue is presented where a participant is defaulted into a fund and then instructs the plan to invest half of his or her new contributions into a specified fund but leaves the other half undistributed, i.e., subject to the default.

It is essential that the final regulations provide a workable method of obtaining fiduciary relief with respect to both existing participants and existing defaults that are not QDIAs. To this end, the Council recommends that the final regulations provide transition relief that deems amounts to be held by a QDIA if (1) the amounts were defaulted before the effective date of the regulations into a non-QDIA or (2) the amounts are contributed to a pre-existing non-QDIA default after the effective date on behalf of participants that were put into an automatic enrollment arrangement before the effective date. This relief could be conditioned upon the plan fiduciary's determination that the old default is a prudent default and a notice to all participants that are currently invested in the old default indicating that the participants will remain in the old default (including with respect to new contributions) unless they affirmatively elect otherwise. This would present a practical solution by spurring non-electing participants to exert investment control while minimizing disruption to plans and their participants. It would also recognize that plan fiduciaries should not be forced to disturb prudent decisions that were made before the effective date of the final regulations in order to obtain the fiduciary relief provided by the default investment regulations.

We also recommend relief for contributions that are made after the effective date of the final regulations and before the first day of the first plan year beginning in 2008. As proposed, the final regulations will be effective 60 days after final regulations are issued. The proposed regulations do not provide for reliance before the regulations are finalized and very few plan fiduciaries are willing to begin making changes to their default investments before the regulations are finalized. Once the regulations are finalized, it is clear that 60 days to select and implement a new default fund is not enough time. Accordingly, plan fiduciaries will need transition relief for default investments that are made during the interim period between the effective date of the final regulations and the earliest date that fiduciaries can be expected to reasonably implement a new default. For this reason, we suggest that the final regulations provide that the limited fiduciary relief provided by section 404(c)(5) will extend to default investments made after the effective date and before the first day of the 2008 plan year if the default is prudent and plan fiduciaries provide notice of the default investment.

As a whole, the transition relief described above is important to ensure that the final regulations avoid the potential disruption that could occur if the final regulations do not provide for an orderly transition. In this regard, for example, as mentioned above, we anticipate that many plan fiduciaries who currently use default options that are not listed as QDIAs will seek to move those investments into a QDIA shortly after the final regulations are issued. As a general principle, any wholesale rush out of existing defaults and into QDIAs could have a disruptive effect for plan participants, service providers and even the capital markets. This concern about the effect the regulations may have on the capital markets is particularly acute for stable value where a material divestment could dilute the value of these funds for existing investors (including participants that have affirmatively invested in such funds).

Investment Manager Requirement

The proposed regulations provide that a QDIA must be managed by either an investment manager, as defined in section 3(38) of ERISA, or an investment company registered under the Investment Company Act of 1940. The Council commends the Department for recognizing the importance of collective trusts, separate accounts and other non-mutual fund investments in individual account retirement plans. However, we are very concerned that requiring that a non-mutual fund QDIA be managed by an investment manger is too restrictive and fails to recognize certain prudent, appropriate and common practices, including model asset allocation programs. Accordingly, we recommend that the final regulations require that the QDIA be managed by a plan fiduciary rather than by an investment manager.

Today, many plans offer managed accounts and life cycle “fund of funds” that would qualify as QDIAs but for the fact that these arrangements do not include an investment manager, as defined in section 3(38) of ERISA. These arrangements are structured in a variety of ways, but one common approach is for the plan fiduciary to

purchase an "off the shelf" asset allocation computer program. These computer programs are developed and maintained by independent third-parties that have no direct relationship with any particular plan (and typically no contractual relationship with any particular plan). The computer program may create generic asset allocations (similar to the generic asset allocation portfolios described in Interpretive Bulletin 96-1) and the plan fiduciary selects the funds that fill each asset category (e.g., XYZ as the mid-cap growth fund). Alternatively, the program may provide both the generic asset allocations and select the particular investment funds that are appropriate for each allocation. These arrangements may be based on Advisory Opinion 2001-09A issued to SunAmerica in December, 2001. Yet another approach is for the plan sponsor to develop the generic asset allocations and select the particular funds with the input of an investment adviser. In other words, the model asset allocations are not "off the shelf" products, but rather are tailored to the particular plan. These programs may involve plan sponsor input into asset allocation or even the glide path to retirement.

Under each of these approaches, the plan fiduciary goes through an extensive due diligence process in selecting the computer program or the investment adviser. This process typically involves reviewing the credentials of the investment adviser or financial expert that develops and maintains the program, evaluating the performance of the program or adviser against relevant market and industry benchmarks, and careful consideration of cost. Moreover, the plan fiduciary maintains a residual duty to monitor the performance of the program or adviser and updates its due diligence on a periodic basis.

These arrangements have been very popular and are prevalent among retirement plans. However, the proposed regulations would exclude these arrangements from the list of QDIAs because the financial expert or investment adviser is not an investment manager described in section 3(38) of ERISA. As a threshold matter, it is simply not practical for plan fiduciaries to expect independent third-party financial experts that create "off the shelf" products to assume fiduciary responsibility for the advice given to particular plans where they have no relationship to the plan and will often have no way of knowing which plans have purchased its program. Moreover, even where the investment adviser has a direct relationship with the plan, requiring the adviser to take on fiduciary responsibility for the advice given to participants will simply increase the cost of these programs. Further, some plan sponsors will be unwilling to use an investment consultant as an investment manager because they are unwilling to cede responsibility for developing the asset allocation models. This may be because the sponsor wants to tailor these allocations to the particular plan's workforce.

An investment manager under section 3(38) of ERISA and a registered investment company are persons that are (i) qualified as an investment expert and (ii) acting subject to statutory responsibilities (whether imposed by ERISA or the Investment Company Act of 1940). However, the notion that a QDIA can only be constructed by a person that is both a fiduciary and an investment expert is simply

inconsistent with the basic fabric of ERISA responsibility. It is well-established that plan sponsors (or other fiduciaries) have responsibility for designating and monitoring the investment options that are available under the plan. Similarly, such fiduciaries may exercise active investment management over the underlying assets of the plan. The sponsor must, consistent with its fiduciary obligations, consult with an investment expert but there is no requirement that the sponsor itself must be an investment expert. Similarly, there is no reason under ERISA that a plan fiduciary cannot purchase an off-the-shelf investment product, e.g., a participant-level investment advice computer program, to provide model asset allocations. The plan fiduciary can evaluate the expertise of the party offering and developing the program and the Council sees little reason for requiring a party that makes such a program and has no relationship to the plan to accept in writing that it is a plan fiduciary, as required for investment manager status.

Moreover, the concern addressed by the investment manager requirement – namely that the funds be constructed by an investment expert – is not relevant to the fiduciary relief provided by section 404(c)(5) to QDIAs. The default investment regulations provide relief from fiduciary liability for the selection of a category of default investment, e.g., a life cycle fund, balanced fund or managed account option. It is not relief for the particular life cycle fund, balanced fund, managed account option. If the plan fiduciary that constructs a QDIA, e.g., a life cycle fund, has done a poor job assembling the life cycle fund or picked a poor financial expert to construct a life cycle fund, the fiduciary would remain liable for that failure. However, the fiduciary should be entitled to relief for the category of fund that was selected.

For these reasons, we strongly recommend replacing the investment manager requirement with a requirement that the QDIA be either a registered investment company or be managed by one or more plan fiduciaries. However, if the investment manager requirement is retained notwithstanding our recommendation, we have a number of suggestions for clarifying its application. First, the Council recommends modifying the regulations to accommodate the shared fiduciary responsibilities that are endemic to the retirement plan context. Specifically, the final regulations should make clear that the mere fact that a third-party does not have authority to select the plan's investment options (instead, the plan sponsor makes these choices) does not cause the third party to fail to be an investment manager (if they otherwise meet the investment manager requirements). ERISA provides that an investment manager generally must have "the power to manage, acquire, or dispose of any asset of a plan." Some have questioned whether a person may be an investment manager where they have no control over the selection of the underlying investment options to which a "fund of funds" or managed account program is applied. It is absolutely essential that an investment manager be able to exercise its fiduciary responsibilities after the plan sponsor acting as a plan fiduciary has selected the available investment options. Plan investment menus need to be able to serve two purposes – they need to provide a diverse and quality range of investment options to those who exercise control and they

need to serve as the basis for a managed account option or a "fund of funds." This type of shared fiduciary responsibility is quite common and it would be extremely disruptive to require that one entity have all of the fiduciary responsibilities.

Second, we recommend that the final regulations clarify that the mere fact that a person is a trustee of a collective trust does not preclude the person from treatment as an investment manager. Section 3(38) provides, in relevant part, that "[t]he term 'investment manager' means any fiduciary (other than a trustee or named fiduciary, as defined in section 402(a)(2))" that meets certain qualifications. Some have expressed concern that the parenthetical could mean that the trustee of a collective investment trust cannot be an investment manager. However, the Department has construed the parenthetical language to clarify that a person that is a trustee or named fiduciary and that meets the other requirements of section 3(38) is not an investment manager unless specifically appointed as such.[1] To avoid confusion, we suggest that the Department clarify this point in the final regulations or the preamble to the final regulations.

Third, we recommend that the final regulations clarify that a QDIA may have more than one investment manager, which will be a common arrangement. For example, one investment manager may be responsible for developing a "fund of funds" approach, i.e., an asset allocation. However, another investment manager may be responsible for managing the assets of a particular fund within the fund of funds, e.g., an investment manger of a collective trust that is a component of a collective trust. Similarly, this will often be the case in insurance company separate accounts where the insurer acts as an investment manager under 3(38) of ERISA in determining the subaccount investment funds that are available to plan participants for investment but other investment managers have responsibility for the subaccount investments. It is important that the final regulations recognize that it is permissible to have more than one investment manager.

[1] Advisory Opinion 77-69/70A (September 16, 1977).

Clarification of Financial Penalty Limitation

The proposed regulations provide that a default investment may not impose a financial penalty if a participant chooses to opt out of the default. The Council appreciates and agrees that liquidity is an essential feature of a default investment fund. However, it is important that the final regulations address a range of investment features that, under some readings, might be considered financial penalties. This is particularly important because many plans would like to utilize managed account options and asset allocation models that are based on the underlying investment options of the plan. As a result, many QDIAs will be comprised of a number of different investment funds and it is possible (even likely) that these underlying funds will have some potential restrictions. For "fund of funds" and managed account options to be viable, it is critical that the liquidity requirement in the proposed regulation accommodate a variety of reasonable fees and trading restrictions that are prevalent in the retirement plan marketplace.

Short-Term Trading Fees. Some mutual funds charge a fee to discourage short-term trading in and out of the fund. These fees may be charged to investors who hold their shares for less than a pre-determined period of time (such as 90 days or 120 days). The amount of the fee (e.g., 0.75 percent, 1.5 percent, etc.) varies depending on the fund. The purpose of these restrictions has nothing to do with default investments but rather only with discouraging market timing and short-term trading. These fees should not be considered financial penalties to the extent they are imposed for less than a stated period, such as no more than 180 days.

Equity Wash Restrictions. Another common restriction is an equity wash, which is typically a provision of a stable value fund whereby direct transfers between certain competing funds must be directed to an equity fund or other non-competing fund option of the plan for a stated period of time (usually 90 days) before such transferred funds may be directed to any other plan-provided competing fixed income fund. These requirements are typically imposed by issuers, such as insurance companies, banks, or other approved financial institutions, as a condition for issuing investment contracts to retirement plans to permit stable value contract issuers to underwrite the plan without excessive risk. It is essential that the final regulations clarify that the mere fact that a stable value fund has an equity wash restriction is not a financial penalty. As discussed above, any other answer would effectively preclude the use of "fund of funds" with a stable value component, which will be essential to such approaches.

Redemption Fees. It is not uncommon for a mutual fund to charge a modest fee when a participant redeems or sells mutual fund shares. Modest redemption fees should be disregarded for purposes of the financial penalty rule. Whether a redemption fee that is not a short-term trading fee (e.g., applies for more than a limited period) is modest should be determined based on all the facts-and-circumstances, but the final regulations should clearly indicate that some redemption fees that are not

eligible for the short-term trading fee exemption we recommend above will not be considered financial penalties.

Managed Accounts

We recommend conforming the treatment of managed accounts to the treatment of balanced funds and life cycle funds. It appears from the description of the managed account option in the proposed regulations that a managed account option default needs to take into account a participant's entire account balance. This is different than the other two QDIA alternatives, where it is clear that the fiduciary relief provided by section 404(c)(5) may apply to a portion of a participant's account, e.g., where one fund is eliminated and replaced but the other investments in an account are unaffected.

This apparent distinction is reflected in the treatment of company stock. The preamble provides that a managed account can only be a QDIA if the investment manager has authority to sell the stock acquired as a result of a match. Similarly, it appears that the investment manager must also have authority to dispose of company stock that was acquired pursuant to an affirmative direction (and the participant fails to give direction for some other portion of his or her account). We see no reason for this distinction. All of the QDIAs are single fund solutions that are designed to provide for long-term capital appreciation and a prudently diversified portfolio, and there is no basis for treating managed account options differently. The final regulations should allow managed account options to serve as QDIAs even where the option does not apply to a participant's entire account, e.g., where the employer makes matching contributions in company stock.

Factors Other Than Age

A separate issue is the extent to which a managed account option or the selection of a life cycle or balanced default fund may take into account factors other than the age of the defaulted participant in determining the appropriate investment mix. The better reading of the proposed regulations is that factors other than age may be taken into account in selecting or managing a QDIA. However, without an explicit statement to this effect, the Council is concerned that plan fiduciaries and investment managers will be reluctant to consider other factors.

This issue affects plan sponsors selecting a QDIA and it affects investment managers of managed account options. The issue arises because it is not uncommon for a plan sponsor or the investment manager of a managed account option to have access to other information that is relevant to designing a participant's investment allocation. For example, an investment manager may know that a defaulted participant is also a participant in the employer's defined benefit pension plan, in which case the participant effectively is already invested in a fixed income security and could prudently have a higher equity exposure in the individual account plan. Similarly, the investment

manager may know that a participant is also a participant in an ESOP and therefore that the participant already has a somewhat volatile investment.

We recommend that the final regulations explicitly provide that plan sponsors are allowed, but not required, to take into account other information in selecting a QDIA and to allow investment managers to take into account other information in managing an account. This will help to facilitate the growth of robust and accurate asset allocation and investment strategies. For example, a plan fiduciary should be able (but not required) to select a life cycle fund that is more heavily balanced towards equities if defaulted participants have significant defined benefit plan interests.

Balanced Funds

The Council is also concerned about the requirement that plan fiduciaries match any balanced default fund to the plan's participant population. Under this requirement, it appears that plan fiduciaries would have a duty to prudent select and monitor the particular balanced fund default in light of a wide range of factors, including the age of the participants, whether the participants have a defined benefit plan, company stock investments and conceivably even the financial viability of the plan sponsor. This extremely nebulous analysis would make the fiduciary relief provided by the final regulation cold comfort because plan fiduciaries would have little comfort that they had picked an appropriate balanced fund. As a result, such a requirement would create a strong bias towards other QDIAs. We strongly recommend eliminating this requirement. We see little advantage to tailoring the balanced fund selection to the plan participant population and recommend instead that any fund that falls within a reasonable range should be an acceptable QDIA.

Stable Value Funds and Other Capital Preservation Products

The Council is troubled by the proposed regulations' failure to include stable value funds, money market funds and other capital preservation investments in the list of QDIAs. The statutory provision of the Pension Protection Act that directed the Department to issue regulations on default investments states that such investments should "include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both." As a result, it seems clear that Congress intended that capital preservation vehicles be among the list of qualified default investment alternatives.

Stable value funds, for example, are one of the most prevalent types of default investment funds currently in use and the preamble to the proposed regulations mistakenly suggests that fiduciaries have chosen these funds to minimize their fiduciary liability. To the contrary, many plan sponsors have chosen to use stable value funds because these funds are insulated from volatile market risks, typically have low expense ratios, and are liquid.

The Council appreciates that investing in capital preservation funds, such as stable value funds, means foregoing the potential upside of the equity markets and that these investments may not be right as default funds for some plans. However, as the preamble to the proposed regulations recognizes, there are plans where a stable value or money market fund default is a prudent and sound selection. This may be because of plan demographics, such as a plan that covers younger, higher turnover employees that are likely to elect lump sums or because a plan covers older, near-retirement employees. It may also be the case where a particular plan population, e.g., hospital doctors, are difficult to reach for initial elections but ultimately exercise investment control or where an employer has a proactive human resources department that ultimately cajoles participants into making affirmative investment elections. For these reasons, we recommend that the final regulations include capital preservation investment products in the list of QDIAs.

Fixed and Variable Annuity Contracts

The Council is also concerned by the proposed regulations' failure to include fixed annuity investments in the list of QDIAs. In recent years, many plan sponsors have expressed concern about whether participants are protecting themselves adequately against longevity risk. Some sponsors have chosen to address this concern by adding an investment option that allows participants to purchase during employment a fixed annuity that is payable for the participant's lifetime (or the participant and a beneficiary's joint life) commencing at normal retirement age. These contracts are liquid in the sense that a participant can opt out of the annuity investment at any time and receive the present value of his or her future annuity. Some sponsors have expressed an interest in using this type of an annuity investment as a default fund in part because it works as both a default accumulation vehicle and a default form of payout. The Council believes that a fixed annuity that is liquid should be in the list of QDIAs for many of the same reasons we believe that capital preservation products, discussed above, should be in the list of QDIAs.

The Council also recommends that the final regulations confirm that common features of variable annuity contract investments are consistent with QDIA status. Many plans offer investment funds, including funds that qualify as QDIAs, through a separate account investment in a variable annuity contract. The proposed regulations implicitly provide that a separate account investment may be a QDIA (if it otherwise meets the applicable requirements), although an express statement to this effect would be helpful. However, an issue is raised by the fact that many variable annuity contracts include benefits that are not explicitly reflected in the investment fund. These benefits range from guaranteed death benefits (e.g., a promise that a beneficiary will receive no less than the sum of all premiums paid if the account value is less upon death) to investment guarantees (e.g., a promise that a participant will receive no less than a stated rate of return on the fund if actual investments do not perform as expected).

Some have questioned whether annuity guarantees raise questions under the proposed regulations because a participant would ordinarily forego these guarantees if they choose to opt out of the variable annuity contract. This could arise where the plan offers other investment options, such as custodial account investments or trusteed investment options. Similarly, it may arise simply because a plan may choose to offer non-annuity contract investment options, even if the plan currently does not offer such investment options.

The Council strongly believes that, as a general matter, annuity guarantees should be permissible features of a QDIA. These guarantees provide participants with important protections against market risks and other unanticipated events, such as untimely death. Annuity guarantees come in a wide range of different forms and types. We are not suggesting that every annuity guarantee should be considered an appropriate features of a default investment alternative. However, many (even most) guarantees should be permitted aspects of QDIAs. For this reason, the Council recommends that, depending on the facts and circumstances, insurance guarantees may be permissible features of a default investment.

There is, however, one type of guarantee that is so common and clearly beneficial that the regulations should state that it is a permissible feature of a QDIA – the annuity purchase right. The guaranteed annuity purchase rate, i.e., the right to annuitize the fund at a rate that is stated in the contract and that the insurer cannot change, is perhaps the most common annuity benefit. These purchase rates are often very favorable to participants because they reflect group (as opposed to individual) purchase rates and because they lock in current mortality assumptions. Annuity purchase rights are not irrevocably lost if a participant opts out of the contract. Participants will invariably have the right to invest back into the annuity contract and obtain the same annuity purchase right. The annuity right is not lost in the sense that a fee or other charge on sale is lost. It is merely an aspect of the investment and there is no sense of forfeiture attributable to an election out of a typical annuity contract investment. For these reasons, the Council recommends that the final regulations clarify and indicate that annuity purchase rights are always permitted features.

Scope of Rules

The Council applauds the Department for making its default investment guidance applicable to more than just automatic enrollment arrangements, but also to situations where a participant has failed to make an affirmative investment election, such as where an investment option is replaced or eliminated. It is important, however, that this provision be more prominently reflected in the final regulations. The only clear indication of the broad scope of the proposed regulations is footnote 5 to the preamble and we urge the Department to add language dealing with the scope of the proposal to the text of the final regulations.

We note that there is strong support for a broad scope to section 404(c)(5), in that section 404(c) is generally a transactional provision. That is, it does not provide general fiduciary relief but rather provides limited fiduciary relief for particular investment transactions. As a result, the mere fact that a participant has previously made an investment election with respect to his or her account should not be relevant. Rather, the key question is whether they have made an affirmative election with respect to the particular transaction. In this regard, clarification is requested that section 404(c)(5) applies on an individual transactional basis such that a failure to satisfy QDIA requirements for some participants does not preclude relief for its application to other participants.

More generally, the Council believes that extending the regulation to investment menu changes is good policy because it will encourage plan fiduciaries to make investment menu changes where appropriate. Prior to the Pension Protection Act, fiduciaries were often sensitive to their potential liability for changes in plan investment options because some participants would invariably not respond to notices of the pending change. By providing fiduciary liability protection, plan fiduciaries will be encouraged to take a more active role in supervising available investment alternatives.

Notice Requirements

The proposed regulations require notice of the circumstances under which default investments may be made on behalf of a participant 30 days in advance of the first default investment. This requirement is not mandated by the statute, which merely requires notice a reasonable period in advance of the plan year, and will be impossible to satisfy in many common situations. Accordingly, we recommend that the final regulations include a more flexible notice standard that requires advance notice a reasonable period before cash would otherwise have been paid.

Specifically, we recommend that the Department adopt a facts-and-circumstance approach along the lines taken by the Treasury Department in its guidance addressing automatic enrollment arrangements. In order for a contribution to a 401(k) plan to be treated as an elective contribution (and not as a nonelective employer contribution) for tax purposes, Treasury guidance provides that an employee must receive advance notice of the right to elect to receive cash and must have "a reasonable period before the cash is currently available to make the election."[2] Treasury guidance does not set a fixed advance deadline, but rather establishes a facts-and-circumstances standard that can accommodate a variety of different situations.

This approach is important because it would have the virtue of accommodating plans that provide for immediate participation and have an automatic enrollment feature. In general, it is not possible for plan administrators to provide notice before the

[2] Revenue Ruling 2000-8, 2000-1 CB 617 (January 27, 2000).

date of hire. Typically, the earliest date that plan administrators can provide the notice is on an employee's date of hire. This date will invariably precede the first payroll date for the new hire, but will generally be less than 30 days before the first payroll date. Plan sponsors should not be forced to design their plans to delay participation for all employees (or to have different entry dates for defaulted and affirmatively electing participants) to accommodate the Department's default investment regulations. We believe that the best approach is to allow a more flexible facts-and-circumstances standard that can accommodate different circumstances, including immediate participation. Adopting this approach would also conform the notice timing requirements for automatic enrollment arrangements under the tax rules with the Title I rules and, for that reason, would be a welcome simplification.

Another issue is raised by the separate requirement that each affected participant must receive an annual notice at least 30 days before each plan year. The proposed regulations indicate that these annual notices must include a wide range of information, including a description of the circumstances in which default investments are made, a description of the plan's QDIA and information about the right to invest in other plan investments. Standing in isolation, this information does not appear to be overly burdensome. However, the proposed regulations are simply one element of an increasingly burdensome disclosure regime. Plan sponsors often express concern about the multitude of disclosure requirements under ERISA and the Internal Revenue Code, and the Pension Protection Act has materially expanded the range of mandated disclosures. The most workable mechanism for providing these numerous notices is through the use of electronic communications. In this regard, we strongly encourage you to allow for greater use of electronic delivery of required notices, including allowing for increased electronic posting of information (e.g., on the plan's website). The Department's existing regulations on electronic delivery are extremely restrictive and have been a significant impediment to more effective and efficient plan communications.

A separate issue is raised by the fact that the annual notice (and, to a lesser extent, the notice before a default investment) will often be required for former employees and beneficiaries. These participants are notoriously difficult to locate and we urge you to provide that the notice requirement may be satisfied through reasonable, good-faith efforts in this context.

Information Disclosure

The proposed regulations provide that defaulted participants must be provided with any material provided to the plan after the participant has been defaulted, including prospectuses, proxy voting material and other information. The Council recommends that the Department reconsider the information disclosure requirement articulated in the proposed regulation and imposed under section 404(c)(5).

As a general matter, we see no policy rationale for a special disclosure regime for default investments. There are no explicit disclosure requirements under part 4 of Title I of ERISA beyond the general fiduciary duty to disclose material information. It does not seem appropriate for the Department to impose a special disclosure requirement for default investments that is applicable after the investments have been made and that is not generally applicable to individual account plans. Even for plans that satisfy the extensive disclosure requirements under the Department's 404(c) regulations, the affirmative disclosure requirement described in the proposed regulations present additional burdens. For example, plans that satisfy section 404(c) are only required to pass through mutual fund proxy voting material to the extent such rights are passed through to participants. However, the proposed regulation would appear to require affirmative disclosure of proxy voting material in all circumstances, even where proxy voting rights are not passed through to participants.[3]

Further, the disclosure regime reflected in the proposed regulations is particularly troublesome because it would appear to require affirmative delivery of a wide range of materials that are typically simply made available to participants under prevailing practices. Accordingly, we recommend that the Department require only that information be available to participants upon request and that the plan administrator disclose the availability of such information. This would strike the right balance between minimizing administrative burdens (and participant costs) and ensuring that participants are able to exercise meaningful investment control.

Fees

The preamble to the final regulations notes that "[l]ike other investment alternatives made available under a plan, a plan fiduciary would be required to carefully consider investment fees and expenses in choosing a qualified default investment alternative for purposes of the proposed regulation. To the extent that a plan offers more than one investment alternative that could constitute a qualified default investment alternative, the Department anticipates that fees and expenses would be an important consideration in selecting among alternatives."

[3] DOL Reg. § 2550.404c-1(b)(2)(i)(B)(1)(ix).

The Council agrees that fees are an important consideration in selecting a default investment. However, it is essential that plans consider fees relative to the services or features that are being purchased, and not in the abstract. For example, an actively managed balanced fund will typically have higher fees than a passively managed (i.e., index fund), but the fees are purchasing active management, which is intended to allow the fund to obtain returns in excess of the passively managed fund (so-called alpha). Similarly, an insurance company product may provide that a participant is entitled to the greater of two rates of return – a market-based rate of return and a fixed rate of return. This type of guarantee invariably costs more than an investment that has not such guarantee but the mere fact that it costs more should not preclude its use as a default investment. For these reasons, we urge the Department to clarify in the preamble to the final regulations that fees and expenses need to be considered relative to the investment features of the default fund.

Innovation

As a more general comment, the Council is concerned that the default investment regulations will serve as a barrier to innovation in financial products and to the use of default investment alternatives that are tailored to particular participants. The proposed regulations are unusual in that they identify the characteristics of qualified default investments and essentially blesses three categories of QDIAs – life cycle funds, balanced funds and managed accounts. Under the proposed regulations, each of these funds must be broadly diversified, i.e., it must reflect an underlying mix of equity and debt investments. We appreciate that the Department has attempted to craft the proposed regulations in a manner that accommodates a range of existing investment funds. However, by identifying the range of permitted default funds, the proposed regulations could easily prove to be a barrier to future innovation in investment products and default investment strategies. For these reasons, we urge the Department to reconsider its basic approach of defining the universe of qualified default investment alternatives.

Consider, for example, an employer that maintains a robust defined benefit pension plan with a supplemental 401(k) plan that provides for automatic enrollment. Given that a participant's interest in the defined benefit plan is effectively a form of fixed income investment, it would clearly be prudent for a plan fiduciary to provide that the 401(k) plan default investment is an equity fund or at least a fund that is heavily weighted towards equity. Similarly, consider an employer that maintains a large ESOP in addition to a 401(k) plan. In that setting, a prudent financial adviser might well recommend a fixed income default option in the 401(k) plan. By way of yet another example, consider a participant that is invested 60 percent in equities and 40 percent in a stable value fund. If the plan fiduciary eliminates the stable value fund, any diversified default fund, e.g., a balanced fund, could overweight the participant towards equity investments. In each of these cases, the proposed regulations would handcuff the ability of plan fiduciaries to select a default investment that best provides

plan participants with a diversified investment portfolio. This is obviously not the right answer from a public policy perspective and we suggest that the final regulations provide a more flexible standard that includes a wider range of qualified default investments, including both greater equity and fixed income exposures.

It is also clear that the landscape for retirement plan investments is evolving at a rapid place. The 401(k) plan and the growth of participant-investment control are relatively new phenomena with the former arriving on the landscape in meaningful numbers only in the mid-1980s. Similarly, the development and growth of life cycle funds is a very recent development and we wonder whether these funds would have been considered qualified defaults if the Department had developed its default investment regulations as recently as ten years ago. It would be a mistake if the default investment regulations served to freeze or impede the development of new investments alternatives. For these reasons, we suggest that the Department's selection and description of QDIAs be flexible and based on general criteria rather than specific conditions. At a minimum, we recommend that the final regulations provide that the Department has authority to issue pronouncements that add new QDIAs to the list in the final regulations without engaging in the full-blown rulemaking process.

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Again, we appreciate the opportunity to comment on the proposed default investment regulations. We believe that the American Benefits Council offers an important and unique perspective of the employer sponsors of, and service providers to, retirement plans and we look forward to working with you on these important changes.

Sincerely,

Jan M. Jacobson
Director, Retirement Policy