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BARCLAYS GLOBAL INVESTORS

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VIA ELECTRONIC FILING

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210
Attn: Default Investment Regulation

Re: Proposed Regulation, "Default Investment Alternatives under Participant Directed Individual Account Plans," RIN 1210-AB10

Barclays Global Investors ("BGI") is pleased to offer its comments regarding the proposed regulation, "Default Investment Alternatives under Participant Directed Individual Account Plans," RIN 1210-AB10 (the "Proposed Regulation"), published by the Employee Benefits Security Administration. BGI is one of the world's largest institutional investment managers, and the world's largest provider of structured investment strategies such as indexing, tactical asset allocation, and quantitative active strategies. BGI manages over US$1.6 trillion dollars in both active and index strategies. Headquartered in San Francisco, BGI is a subsidiary of Barclays Bank PLC, one of the world's leading diversified financial services companies.

As one of the largest managers of assets subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), BGI has a unique perspective to offer on the Proposed Regulation.

Executive Summary

In enacting Title VI of the Pension Protection Act of 2006,[1] Congress recognized that defined contribution savings plans need improvement. At a minimum, the following four concerns demand attention. First, the percentage of eligible workers who actually participate in defined contribution plans must be raised. Second, many who participate do not contribute at a high enough savings rate to meet their retirement needs. Third, many participants do not actively select an investment option. Finally, plan sponsors who auto-enroll participants, or make investment choices for those participants who fail to select an investment option, have historically used capital preservation strategies as their default investment due to concerns

[1] Pension Protection Act of 2006, Public Law 109-280 (the "Pension Protection Act").

about potential liability. This class of investment does not create the return stream necessary to achieve meaningful income replacement for retirees. Implementation of the Pension Protection Act by the Department of Labor (the "Department") will in large part determine how much progress is made in addressing these four concerns and thereby how well participants in defined contribution plans meet their retirement needs.

In Section 624(a) of the Pension Protection Act, Congress gave a specific charge to the Department to address the final concern by requiring the Department to prescribe regulations governing the fiduciary liability of plan sponsors with regard to default investments. The Department has taken an important step in publishing the Proposed Regulation. If drafted and implemented carefully, the Proposed Regulation can help participants in defined contribution plans meet their retirement needs by providing plan sponsors the certainty to move forward with confidence in their decisions about default investment options.

As described in greater detail below, BGI believes the Proposed Regulation can achieve this goal by providing clear guidance as to the appropriate investment vehicles for defaulted participants, by creating a notification process which can be effectively administered by plans which are auto-enrolling their employees or selecting the default investment and by clarifying that the liability protection for plan sponsors provided in the Proposed Regulation extends to those who transfer existing default investments into more appropriate vehicles.

Introduction

Defined contribution savings plans have become the dominant mechanism by which American workers save for retirement, and by which their employers help them do so. As Congress recognized in enacting the Pension Protection Act, these plans need improvement if they are to help participants meet their retirement needs. The Employee Benefits Research Institute estimates that only two-thirds of workers eligible to participate in defined contribution plans sponsored by their employers actually do so. Of those who participate, less than one-tenth contribute at the maximum rate allowed.[2] Given these facts, it is perhaps understandable that median balances in defined contribution plans at retirement are only $44,000; average balances, which give a larger weight to higher income workers, are only $112,000.[3] Not only are these amounts far from what is needed to provide for retirement,

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[2] "Wake Up and Smell the Coffee!," M. Barton Waring and Laurence B. Siegel, Investment Insights, The Investment Research Journal of Barclays Global Investors, June 2006, ("Waring and Siegel"), at 17.

[3] Waring and Siegel at 3.

they are not large enough even to make a significant contribution to retirement when combined with other sources of retirement income.

The failures of participants in defined contribution plans to diversify their investment allocations across asset classes, and to rebalance their portfolios over time, are well documented. Less well known is the fact that at the time they enroll in defined contribution plans, many participants do not select any investment strategy at all. In this situation, their contributions are invested in a default option selected by their employer.

Due we believe to concerns about plan sponsor fiduciary liability, the dominant default investment choices are money market funds and stable value funds. Together, these strategies represent the default investment for 57% of defined contribution plans. Funds that contain a mix of asset classes, including equities (such as balanced funds and lifecycle funds) have been growing in popularity as a default investment choice and represent the default option for 34% of defined contribution plans.[4]

These significant default investments of defined contribution plans in cash and cash-substitutes pose a challenge for both workers and policy makers. Based on historical returns, investments in only cash and cash-substitutes simply will not generate sufficient returns to provide for participants' retirement. The amount of default investments is likely to grow with the increased adoption of automatic enrollment provisions According to the Annual 401(k) Benchmarking Survey conducted by Deloitte Consulting, 23 percent of plan sponsors had adopted automatic enrollment at the end of 2005, up from 14 percent of plan sponsors at the end of 2004.

Comments on the Definition of QDIA

As noted in the Proposed Regulation, contributions of participants in defined contribution plans who do not elect their own investment choices are often placed in default investments that present little risk of capital loss – such as stable value funds and money market funds.[5]

[4] Waring and Siegel at 17. Studies cited in the Proposed Regulation put the share of default investments for defined contribution plans with automatic enrollment at 26.9% for stable value funds and 23.7% for money market funds. 71 Fed. Reg. 56806, fn 4 (Sept. 27, 2006).
[5] 71 Fed. Reg. 56806.

Title VI of the Pension Protection Act amended Section 404(c) of ERISA to provide protection from liability to fiduciaries that invest participant assets in certain types of default assets. Section 624(a) of the Pension Protection Act recognizes that assets selected solely because they emphasize capital preservation cannot provide for plan participants' retirement. Section 624(a) requires the Department to promulgate regulations to guide fiduciaries on selecting appropriate default investments and states that such investments should include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or both.

BGI commends the Department for including "lifecycle funds" as one of the three types of investment products that must be used to qualify for the liability protection. Lifecycle funds feature an asset allocation mix that changes gradually over time, based on the investor's planned retirement date. Lifecycle funds have been gaining in popularity with the sponsors of defined contribution plans. According to the Annual 401(k) Benchmarking Survey conducted by Deloitte Consulting, 44 percent of plan sponsors offered lifecycle funds as an investment option at the end of 2005, up from 28 percent of plan sponsors at the end of 2004. Because lifecycle funds offer participants well diversified, multi-asset class exposure, BGI views these strategies as an ideal choice for defined contribution plan default investments. Lifecycle strategies are unique when compared to balanced funds or target risk funds in that they place and then keep a defaulted participant at the age appropriated position on the efficient frontier of investments.

BGI also believes that it is appropriate to include "balanced funds" within the types of investment products that qualify under the Proposed Regulation.[6] The Department notes that this alternative may be "a 'fund of funds' comprised of various investment options otherwise available under the plan for participant investments."[7] In this context, BGI suggests that plan sponsors need to exercise considerable care in the selection of funds otherwise available, keeping in mind that performance is affected not only by investment management fees, but also by portfolio turnover and other costs. The Department should consider providing additional guidance on the characteristics of available investment options before allowing default investments to be placed in such a synthetic "fund of funds."

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[6] It is important to distinguish *"lifecycle"* or *"target date"* fund from *"lifestyle"* funds. As noted in the Proposing Release, a lifecycle or target date fund changes its asset allocation and associated risk level over time. A "lifestyle fund" is a target risk fund where the asset allocation does not change over time, and is in essence a balanced fund.
[7] 71 Fed. Reg. 56810.

Plan sponsors will require more certainty as to the application of the proposed requirement for the use of balanced funds to take into consideration the demographic composition of all of a defined contribution plan's participants and beneficiaries, as well as "significant changes" to those demographics. We suggest, similar to the 5 or 10 year intervals adopted by the providers of lifecycle funds, that the Department provide additional guidance to plan sponsors that they can determine the demographic composition of the plan on a periodic basis, not more frequently than annually, and absent a shift of the age demographic of 5 (or 10) years, there is no requirement that the plan sponsor effect changes in the balanced plan default option.

The Proposed Regulation also provides for a third category of Qualified Default Investment Alternative ("QDIA") involving the use of an investment management service with respect to which an investment manager allocates the assets of a participant's individual account. In this type of managed account product, the investment manager would be required to be an "investment manager" under Section 3(38) of ERISA. As the plan sponsor is to be given relief from fiduciary liability under the regulation, BGI believes this requirement is a particularly important safeguard for plan participants under this investment alternative[8].

While BGI supports the proposed QDIAs specified by the Proposed Regulation, BGI is concerned that the Department may have unintentionally introduced uncertainty for plan sponsors by its references to money market, stable value and similarly performing funds. The Proposed Regulation states:

> "the limitations of the proposed regulation should not be construed to indicate that the use of investment alternatives not identified in the proposed regulation as qualified default investment alternatives would be imprudent. For example, the Department recognizes that investments in money market funds, stable value products and similarly performing investment vehicles may be prudent for some participants or beneficiaries."[9]

The uncertainty created between the Proposed Regulation which shields plan sponsors from liability and the language cited above will surely lead some plan sponsors to underutilize QDIAs and overutilize money market funds and stable value products. The

[8] BGI agrees with the Department that one of the seminal requirements for relief from fiduciary liability is that the QDIA be a registered investment company or that those responsible for the investment management/asset allocation decisions be investment managers as defined under Section 3(38) of ERISA.

[9] 71 Fed. Reg. 56807.

language runs counter to one of the "major, positive economic consequences" identified by the Department, namely the direction of default investments "toward higher-return portfolios boosting average account performance."[10] Indeed, the Department declined to include money market and stable value funds as QDIAs because "including such instruments would be more likely to erode benefits than to increase them."[11] For that reason, the text appearing in the second sentence of Section 2550.404c-5 (2) of the Proposed Regulation should be deleted in the final regulation and the rationale for the deletion explained in the preamble of the enacting release.

Comments on Transfer of Existing Default Investments

BGI urges the Department to amend the Proposed Regulation to provide explicit protection from liability for the transfer of the existing balances of participants whose default investment preceded the effective date of the regulation. The Department should state explicitly that plan sponsor liability protection for default investments in QDIAs applies not only to new money coming into defined contribution plans but also to existing default investments. This would encourage plan sponsors to move assets from existing default investments to investments that meet the requirements of the Proposed Regulation. In this way, the purpose of the Proposed Regulation to direct default investments "toward higher-return portfolios boosting average account performance" will be advanced.

The Proposed Regulation specifies a number of situations to which it applies:

- Automatic enrollment of participants;
- Failure of a participant or beneficiary to provide investment instruction following the elimination of an investment alternative or a change in service provider;
- Failure of a participant or beneficiary to provide investment instruction following a rollover from another plan; and
- Any other failure of a participant or beneficiary to provide investment instruction[12].

The Proposed Regulation does not explicitly specify that a plan sponsor's protection from liability extends to transfers of existing default investments to QDIAs . In order to ensure plan sponsors and administrators take this step, liability protection should explicitly extend to transfers of existing default investments into QDIAs, provided of course that the other

[10] 71 Fed. Reg. 56811.
[11] 71 Fed. Reg. 56814.
[12] 71 Fed. Reg. 56806 n 5.

requirements of the regulation are met. This is consistent with the purposes and intent of Section 624(b) of the Pension Protection Act .

We understand it may be difficult, or at the very least expensive, for plan sponsors or their recordkeepers to determine whether on a historical basis an individual plan participant has failed to make an investment election. One suggestion would be to use the current industry practices for "mapping" out of one investment option to another. An alternative suggestion is that notices meeting the requirements set out in the Proposed Regulation delivered to plan participants who are currently in the default investment provided by the plan should be sufficient to permit a transfer into the replacement QDIA option without liability to the plan sponsor.[13] The Department should provide specific guidance on how to effectuate such transfers.

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With the Pension Protection Act's provisions promoting automatic enrollment of employees in defined contribution plans, one can expect that the volume of assets subject to default investment provisions will grow in the coming years. The way in which those default assets are invested will help determine the degree of retirement security for millions of Americans. The Proposed Regulation provides an opportunity to encourage the investment of those assets in vehicles intended to provide participants with a risk-return balance appropriate to their retirement horizons. BGI looks forward to discussing its views on the Proposed Regulation with the Department and to joining in a cooperative effort to ensure its careful implementation.

Sincerely,

Kristi Mitchem
Head of US Defined Contribution

[13] Plan sponsors could achieve the same result (the transfer of current default investments) by conducting a re-enrollment for all plan participants, and applying the notice procedures under the Proposed Regulations. Such a re-enrollment exercise, however, is burdensome and costly for the plan, its service providers and the participants.