Morgan Stanley

February 6, 2007

The Honorable Bradford Campbell
Acting Assistant Secretary
Employee Benefits Security Administration
Suite S-2524
U.S Department of Labor
200 Constitution Ave., N.W.
Washington, D.C. 20210
VIA CERTIFIED MAIL, RETURN RECEIPT REQUESTED

Re: **Response to Request for Information Regarding Computer Models for the Provision of Investment Advice to Individual Retirement Accounts.**

Dear Acting Assistant Secretary Campbell:

On behalf of Morgan Stanley, I am writing to respond to the Department's Request for Information ("RFP') concerning "the feasibility of the application of computer model investment advice programs for Individual Retirement Accounts and similar types of retirement plans" ("IRAs") as required by Section 601 of the Pension Protection Act of 2006 (Pub. L. 109-280) (the "PPA") and as requested both in the Federal Register[s] and in a letter to John Mack, Chairman and Chief Executive Officer of Morgan Stanley from the Department, dated as of December 12, 2006. We appreciate the opportunity to offer our views on this important topic.

Background on Morgan Stanley

As background to the request, Morgan Stanley is a global financial services firm organized under the laws of Delaware and headquartered in New York, and combines the strength of innovative financial products and services with a powerful distribution capability to individual and institutional clients. Morgan Stanley's products and services include underwritten public offerings of securities, mergers and acquisitions and other financial advisory services, securities sales and trading, research, consumer credit and investment, asset management, and consulting services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals around the world.

Various affiliates of Morgan Stanley provide brokerage, custodial, and investment-related services to IRAs. Through Morgan Stanley's Global Wealth Management Group (our retail brokerage unit), Morgan Stanley serves as a non-bank

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[']Department of Labor, Employee Benefits Security Administration, "Prohibited Transaction Exemption for Provision of Investment Advice to Individual Retirement and Similar Plans," 71 Fed. Reg. 70,427 (December 4, 2006).

IRA custodian for more than 1.45 million IRAs as of December 31, 2006, that are invested in a wide range of products - corporate stocks and bonds, more than 2,200 open-end mutual funds in over 100 fund families (both those advised by Morgan Stanley affiliates such as Van Kampen and Morgan Stanley Investment Management, Inc, and other non-affiliated advisers, such as Fidelity, BlackRock, OppenheimerFunds, PIMCO and Eaton Vance), electronically traded funds ("ETFs"), corporate and governmental bonds and debt instruments, structured notes, "alternative investments" (partnerships, limited liability companies, managed futures, and hedge funds), fixed and variable "non-qualified" annuities issued by leading insurers for which Morgan Stanley also serves as a general insurance agent (such as The Hartford, Prudential, and Nationwide) and "foreign" investments (including American Depository Receipts ("ADRs") of non-US companies trading on US securities exchanges), totaling approximately $122.9 billion. Through Morgan Stanley's Institutional Management Group, IRA assets are also either managed (as part of pooled investment vehicles, mutual funds, or otherwise) through Morgan Stanley Investment Management, Inc, an affiliate of Morgan Stanley that is an investment adviser registered under the Investment Advisers Act of 1940, or held or custodied in mutual fund-only IRA accounts offered by our affiliate, Van Kampen, with State Street Bank and Trust Company as IRA custodian (the latter comprising approximately 465,000 additional IRA accounts, with an aggregate value of approximate $ 4.3 billion as of December 31, 2006). Morgan Stanley, in the aggregate, has assets under management ("AUM") of more than $690 billion for these and other clients (as of November 30, 2006).

Given the size of our retail and investment related operations providing products and services to IRAs and other investors, we believe that we are well positioned to add to the debate on the feasibility of applying "computer model investment advice programs"/ asset allocation computer models to apply to IRAs, as described under Section 601 of the PPA. We appreciate the opportunity to respond to this RFI and look forward to continuing to work with the Department as it completes its required review of computer models for investment advice under section 601 of the PPA.

Request for Information

1. Are there computer model investment advice programs for the current year and preceding year that are, or may be, utilized to provide investment advice to beneficiaries of plans described in section 4975(e)(1)(B)-(F) (and so much of subparagraph (G) as relates to such subparagraphs) (hereinafter "IRA') of the Code which:
(a) Apply generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time;
(b) Utilize relevant information about the beneficiary, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments;
(c) Operate in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser;

(d) Take into account the full range of investments, including equities and bonds, in determining the options for the investment portfolios of the beneficiary; and
(e) Allow the beneficiary, in directing the investment, sufficient flexibility in obtaining advice to evaluate and select investment options.

<u>Response:</u> Morgan Stanley believes that, while a wide range of investment advice programs (both those developed at the firm as well as elsewhere) could generally satisfy the requirements specified in 1(a), (b), and (c), none of the computer modeling tools which we use, or are aware of, can take into account the full range of investments, including equities and bonds, in determining the options for the investment portfolios of the beneficiaries, and, therefore, limit the client's ability to fully evaluate and select all potential investment options.   Our response is based both on our view that the intellectual underpinnings of most asset allocation modeling tools -- the pioneering work of Professors Harry Markowitz and William Sharpe -- does not lend itself to specific product-level recommendations outside of the mutual fund context, as well as a review of the current computer modeling tools that Morgan Stanley employs.

<u>Background on Asset Allocation</u>

Virtually all computer-based models are based on the intellectual premise that diversified and efficient asset allocation of an investment portfolio offers clients the ability to analyze and choose either the highest return possible for a stated risk level or lowest risk level for a stated required rate of return. The establishment of asset allocation as a basic investment tool began in the early 1950s at the University of Chicago through the work of Professor Markowitz, who developed several groundbreaking theories around asset allocation, the most notable of them the idea of "Mean Variance Optimization" (defined below) and the "efficient frontier."

The basic goal of asset allocation is to diversify away some of the inherent risk of investing in just one or two asset classes. Through asset allocation it is possible to reduce the overall volatility of an investment portfolio by introducing different asset classes that have different performance and volatility characteristics. Asset allocation offers investors two primary alternatives - the ability to structure his or her investments to either achieve the greatest investment return possible for a given level of risk (i.e. standard deviation) or if the required rate of return is known, structure a portfolio with the greatest potential to achieve that return but that will expose the portfolio to the least amount of risk possible. These alternatives are produced by creating estimates for:

- How individual asset classes are expected to perform over time into the future (that is, future investment returns);
- How volatile these asset classes will behave over time into the future (the "standard deviation"); and
- The relationship between an individual asset class's return and volatility as compared to other asset classes over time (referred to as "correlation").

An important application incorporating the three estimates noted above is "Mean Variance Optimization." Mean Variance Optimization takes into consideration all of the individual asset classes identified in the particular investment pool (which may vary depending upon (a) how a particular vendor defines an asset class (e.. "equities" as an asset class can be sub-divided into small, medium or large capitalization equities, domestic or foreign, or "sector investments" that are equity instruments issued by corporate and related entities in various business lines) or (b) whether the particular vendor includes, or excludes, certain types of asset classes (M. high-yield debt instruments (also referred to as "junk" debt), investments in particular jurisdictions) for possible inclusion into an investment portfolio (with their corresponding expected future returns, volatility and correlations, based largely on historical data) and calculates all of the possible mixes of asset classes into portfolios with their own expected returns and standard deviations. Optimization is the process of identifying those portfolios among all the possible mixes that have the highest possible expected return for a given level of risk, or the lowest possible risk for a given level of expected return. The resultant portfolios are the "most optimal" from a risk / reward spectrum and thus most rational to investors. Every possible asset combination produced by Mean Variance Optimization can be mathematically plotted (along a standard x/y graph, with the horizontal bar representing increments of risk, and the vertical bar generally representing increments of return), and the collection of all such possible portfolios produced can be plotted along this graph, using both the available investment classes, as well as the investor's personal risk/return requirements. If the algebraic line connecting the "upper" edge is plotted on that graph, that line is known as the "efficient frontier." Combinations along this line represent portfolios for which there is lowest risk for a given level of return. Conversely, for a given amount of risk, the portfolio lying on the efficient frontier represents the combination offering the best possible return.

Morgan Stanley believes that it is important to describe both these concepts, and that most asset allocation tools are constructed using these concepts, for the following reason. The model portfolios themselves are comprised of asset classes, not specific investments, and the economic theories underpinning the models require, in effect, aggregate historical rates of return and volatility (risk) for such classes. When the range of investment options offered to a particular client is both constrained and constructed to mirror the broad investment classes (for example, including only mutual funds registered under the Investment Company Act, with each fund representing (a) a pool of individual investments that (b) generally fits within broad asset categories (, large cap growth, small cap equity), the portfolio models generated by various asset allocation programs are useful tools that plan participants can use to apply "efficient frontier" analysis to their retirement plans. If, however, you permit investments by the participant (either in an IRA or in, for example, a self-directed brokerage "window" within a 401(k) plan) that are individual instruments - individual stocks, bonds, annuities or alternative investments - that either (a) do not clearly correlate to a particular asset, or (b) if individual instruments by a single issuer may be inherently more "volatile" than an index or pooled vehicle due to each individual instrument's specific unsystematic or "idiosyncratic" risk, the models are not designed to "choose" particular investment products or solutions and, even if they

do produce particular "recommendations" (that is, lists of available products), cannot adequately ensure that these solutions are "optimal" within the "efficient frontier" framework.

<u>Review of Specific Asset Allocation Tools</u>

Morgan Stanley's Global Wealth Management Group [2] currently employs a number of computer-based asset allocation programs and tools that are used to analyze client assets (including IRA assets) as generally described below: [3]

(i)<u>Firm-Sponsored Tools:</u>

- <u>Morningstar/lbbotson:</u> Morningstar/Ibbotson Associates-based computerized asset allocation models and data are used in conjunction with various advisory programs offered through Morgan Stanley and its affiliates. Such models combine standard investor questionnaire descriptions quantifying the client's risk profile and tolerances, timeframes for investment, with various portfolio fulfillment options that vary depending upon the specific advisory products offered. Certain programs (e , Morgan Stanley DW Inc.'s "AdvisorOne^{sm}" process) provide options for clients to consider among various advisory programs, such as:

  - Morgan Stanley Portfolio Architect (proprietary mutual fund advisory program);
  - Morgan Stanley Fund Solution (non-proprietary mutual fund advisory program), -
  - Personal Portfolio Account ("open architecture" program combining mutual funds, ETFs, and separately managed accounts ("SMAs"));
  - Custom Portfolio (discretionary asset management, with a primary focus on individual stocks, bonds, and some ETF and mutual fund exposure); or
  - ICS Access (SMAs managed by affiliated and non-affiliated managers).

- <u>iALM ("Individual Asset Liability Modeling)/Morgan Stanley LifeView^{sm}</u>: Currently under development, Morgan Stanley LifeView^{sm} is a diagnostic tool that allows the client or prospect to take a comprehensive look at their financial lives from both an

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[2] Morgan Stanley's various affiliates either do not currently employ specific asset allocation computer tools to be utilized in IRAs (e.g., Van Kampen), or may use proprietary analytical tools designed for institutional customers that are beyond the scope of this RFI. Please note, however, that we believe the following materials to be an accurate general description of what IRA owners may utilize at Morgan Stanley.

[3] Please note that the various applications described below delineate the current asset allocation resources and applications available within Morgan Stanley's Global Wealth Management Group. Unless otherwise described by the third party vendors, these "asset allocation" resources are structured to comply generally with the Department's guidance on asset allocation models not being constituted as "investment advice" (see Department of Labor Interpretative Bulletin 96-1, codified at ERISA regulations Section 2509.96-1), and, as specific tools, are not generally intended to constitute stand-alone "financial plans" as generally described under the Investment Advisers Act of 1940.

investing and spending perspective. Like other financial tools, LifeView enables the client to examine the implications of how they are currently invested and how they will invest in the future. But what makes LifeView different is that it integrates and models the liability (cash outflow) side of the equation, assessing the risk of both planned and unplanned client obligations for future expenses. LifeView does allow for incorporating increasing levels of income over the simulation period as well as accommodating a variety of asset allocation mixes for evaluation purposes. The client would also have the option not to change their original asset allocation. Incorporating additional asset allocation mixes would be at the sole discretion of the client. LifeView does not offer suggestions or advice on how clients could change the mix of their assets to achieve better probability results or close any potential gaps in a client's assets or liabilities. Clients may, however, choose to alter the timing and amount spent on a particular goal to see the impact on the goal attainment probabilities.

- Asset Scan: Morgan Stanley's Asset Scan (powered in part by Morningstar) is a Web-based asset allocation application that analyzes our client's current investments, and then generates an easy-to-understand, graphically illustrated report classifying such investments by reference to model asset portfolios to generate a snapshot of the client's overall asset allocation. (A related application permits, with the client's permission, the inclusion of external holdings outside the firm on such scans.) The tool permits the Financial Advisor and the client to analyze the actual or hypothetical portfolio, and to see how hypothetical changes to a prospect's or client's investments might affect their overall asset allocation. Asset Scan will analyze individual stocks, bonds, cash instruments as well as mutual funds, variable annuities, and ETFs, but does not specifically cover/analyze non-traditional asset class products (i.e. private equity, hedge funds, managed futures, structured products) These "non-traditional" assets will all show up as "unclassified" or "other" on Asset Scan. Further, the tool does not attempt to "pick" particular investments to make recommendations for purposes of the allocation (although it does analyze whether or not the particular investments selected by the client and the Financial Advisor fall within the hypothetical portfolio).

- Account Evaluator: Morgan Stanley's Account Evaluator allows Morgan Stanley Financial Advisors, with the client's consent, to pull in client account information from the client's Morgan Stanley accounts and categorizes the account based on Morgan Stanley's Equity Research methodologies using the major asset classes (Equities, Fixed Income and Cash.) Account Evaluator will also break down the equity holdings by industry sector (GICS). Fixed income is broken down by type - treasury, mortgages, and corporate debt, and Financial Advisors can enter assets held away into Account Evaluator. Account Evaluator does not, however, classify account for mutual funds, variable annuities, or non-traditional asset class products (i.e. private equity, hedge funds, managed futures, structured products) These will all show up as "other" on an asset scan.

(ii) <u>Selected Desktop Asset Allocation "Tools":</u> The following are examples of computer based models that may be used by Financial Advisors in connection either with brokerage or advisory IRA clients, and are developed and controlled by parties independent of Morgan Stanley.

- <u>Frontier Analytics/SunGard:</u> [4]

    - <u>Allocation Master:</u> AllocationMaster is an Internet-based client profiling capability which embodies the client's current portfolio, risk tolerance, and financial goals and resources. Mean Variance Optimization is used to compute the optimal combination of asset classes that maximize return at each risk level. Once a proposed asset class mix is selected, an analysis of future projections can be made with the Financial Forecasting and Monte Carlo' Simulation components. After the levels of individual allocations to each asset class have been determined, the advisor can then assist the client in selecting investment products which most closely match the expected investment return and volatility levels of each of the respective asset classes required to achieve the asset allocation plan.

    - <u>FactMaster:</u> FactMaster offers hypothetical model portfolio analysis, evaluating and presenting up to ten different investment products for implementation. The performance measurement capabilities in FactMaster let you analyze the historical returns on thousands of indices. Or, use the returns-based style optimization to calculate the style benchmark for any fund, analyze style drift, and compare performance against the benchmark. FactMaster also includes a fact-based questionnaire for determining the suitability of different investment alternatives for your client

    - <u>Investment Plus:</u> Investment Plus is an asset allocation tool designed specifically for investment consultants and plan sponsors of institutional investment funds.

- <u>Morningstar/Ibbotson Associates</u>

    0 <u>Portfolio Strategist:</u> With Morningstar® Portfolio Strategist®, advisors can construct optimal portfolios by determining the asset mix most likely to achieve the highest return for a given risk level through the utilization of Mean Variance Optimization. Asset allocation recommendations are communicated using either major and sub-asset classes or individual

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[4] <u>Source:</u> SunGard Website.
[5] "Monte Carlo" simulations are a mathematical term involving random sampling of returns, and are used for a number of different mathematical disciplines, including, but not limited to, computerized asset allocation. By adjusting variables (such as, in the modeling scenario, risk tolerance, spending needs, age, market conditions), retirement age, etc.), these "randomization" factors help create results in the asset allocation models that are more accurate, and predictive, than modeling techniques without these inputs.

mutual funds. Advanced features like efficient frontier graphing and Monte Carlo wealth forecasting help create individualized asset allocation strategies based on a client's risk tolerance, current assets, future needs, and other factors.[6] Asset allocation recommendations again, however, are not communicated through a focus on individual stocks, bonds or other non-mutual fund investments.

- Financeware

    - Wealthcare: Financeware's Wealthcare and AASim software products are online probability analysis tools that financial advisers can use to identify an investor's lifetime goals and develop asset allocation strategies to reach them. The system uses Monte Carlo methodology, which factors in years of historical market returns (indices only) to develop a series of possible outcomes, to explore the likelihood that the investor will reach those goals. The process enables financial advisors to model thousands of potential investing and economic scenarios   with a client's unique circumstances in   mind. These characteristics   may include cashflow requirements, planned savings, financial objectives, estate goals, and even deeper, emotions-based understandings of the compromises and comfort levels clients are willing to accept throughout life.

All of these products, to greater or lesser degrees, attempt to model asset allocation strategies using variations of Mean Variance Optimization, and provide clients and their financial advisers with various detailed projections on potential investment outcomes determined in part through the use of Monte Carlo modeling techniques. However, these asset allocation tools, as generally described above, suffer from the following limitations:

- The models tend to evaluate portfolios by asset classes and readily-available indices (such as the various global indices on equity, fixed income and emerging hedge fund indices developed by Morgan Stanley Capital International Inc. ("MSCP')), and attempt to fit the instruments held in a client's portfolio within those categories. Not all asset allocation tools, however, uniformly characterize the investments as falling within a particular asset class.

- To the extent particular models offer fulfillment options for clients, the "recommendations" made largely focus on mutual fund options or a "fixed universe" of investment options offered within a particular advisory program. There are no programs of which we are aware could either properly evaluate, or make specific recommendations for, the following

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[6] Source: Morningstar Website

instruments, especially in a "brokerage" context, with the wide variety of potential investments described below:

- Individual stocks listed in the Wilshire 5000 Index (note that most asset allocation programs within the 401(k) context specifically advise against particular concentrations in individual stocks, including, but not limited to, "employer" securities);
- Individual corporate bonds;
- Foreign debt or equity securities;
- Currency instruments or currencies;
- Futures;
- Annuities (whether fixed or variable);
- Options trading;
- Limited partnerships, LLCs (including but not limited to specific hedge fund investment recommendations); or
- Group or collective trusts.

o Separate and apart from the difficulty of offering specific fulfillment options, we would also note that the mathematical premises of the modeling techniques used generally relate to portfolios, rather than specific investments. Using particular bonds, or individual stocks, to comprise an asset "class" or to wholly fulfill an asset class allocation recommendation would introduce an unacceptable level of unsystematic or "idiosyncratic" risk that would substantially understate the potential for volatility in the model, and would, we believe, mislead the client into believing that a particular portfolio is "optimized" for risk/return purposes.

2. If currently available computer models do not satisfy all of the criteria described above, which criteria are presently not considered by such computer models? Would it be possible to develop a model that satisfies all of the specified criteria? Which criteria would pose difficulties to developers and why?

Response: As described in the response to Question 1 above, Morgan Stanley's view is that no current computer models offered in the IRA or 401(k) market would be able to meet criteria (d) and (e) of the five criteria specified in question 1, and while it is theoretically possible for these models to be developed, we think it is unlikely for the following reasons:

- The cost of creating a model with the data span necessarily to cover all potential individual investments is, we believe, extremely high and would require computer functionality in excess of what we believe most laptop-based solutions would currently support, which would be a cost that neither Morgan Stanley nor other providers of which we are aware is currently interested in pursuing.

- While Morgan Stanley is a leading provider of indices used as the basis for most of the current computer models used on the market, even Morgan Stanley believes that certain asset public data does not currently exist which would enable a model to provide the kind of information which a beneficiary would need to appropriately consider each investment - that is, we are not currently aware of indices that are readily available to consistently classify and analyze all potential investments that may be offered to an IRA holder.

- As described above, we are concerned that the fundamental parameters of Mean Variance Optimization and the "efficient frontier" - which are designed for entire portfolios - do not readily translate themselves to non-mutual fund/non-pooled investment vehicles that mimic entire asset classes, and that IRA clients, relying upon such models, receive a false sense of security as to the trade-off of risk and reward.

3. If there are any currently available computer model investment advice programs meeting the criteria described in Question 1 that may be utilized for providing investment advice to IRA beneficiaries, please provide a complete description of such programs and the extent to which they are available to IRA beneficiaries.

      Response: Please see the response for Question 1, which represents the majority of models that may be used by IRA clients of which we are aware. As noted above, we do not believe that any of the models currently available satisfy all of the criteria specified.

4. With respect to any programs described in response to Question 3, do any of such programs permit the IRA beneficiary to invest IRA assets in virtually any investment? If not, what are the difficulties, if any, in creating such a model?

      Response: While IRA clients may directly invest in any of the products offered through Morgan Stanley unless precluded by applicable law (e., life insurance), as stated above in Questions 1 and 2 we know of no models that cover all such investments, and we believe there are significant impediments to the development of such models for the retail IRA marketplace.

5. If computer model investment advice programs are not currently available to IRA beneficiaries that permit the investment of IRA assets in virtually any investment, are there computer model investment advice programs currently available to IRA beneficiaries that, by design or operation, limit the investments modeled by the computer program to a subset of the investment universe? If so, who is responsible for the development of such investment limitations and how are the limitations developed? Is there any flexibility on the part of an IRA beneficiary to modify the computer model to take into account his or her preferences? Are such computer model investment advice

programs available to the beneficiaries of IRAs that are not maintained by the persons offering such programs?

Response: In Morgan Stanley's experience, all computer models (whether or not developed by the particular financial institution) limit, to some degree, the portfolio and investment allocations modeled by the program - usually, to a model composed of various indices that do not track any specific, non-mutual fund investment option. These limitations result from a number of factors, including (a) the proposed marketplace for the models (e. ., retail vs. institutional use, or whether or not the model is intended to serve as a tool for a specific advisory program with a limited universe of investment options), (b) the cost of creating and updating the models, (c) the availability of public information regarding the particular investment, and (d) with respect to securities, whether or not such securities may be offered by the particular broker (M, is there a valid registration statement for a "publicly traded security," or does the particular broker have a selling agreement with the mutual fund adviser). In our experience, the primary "flexibility" an IRA client has in modifying the model's output is through the questionnaire, which allows the client to exclude certain types of investments from consideration (e.g., investments that only have a short history, or the ability of the client to choose not to include "proprietary" or mutual funds or managers affiliated with the financial institution), but in our experience many IRA clients simply disregard model outputs if they do not, for example, include particular types of investment classes or if they are not capable of evaluating a particular bond, fund or pooled investment.

6. If you offer a computer model investment advice program based on nonproprietary investment products, do you make the program available to investment accounts maintained by you on behalf of IRA beneficiaries?

Response: Morgan Stanley offers various computer-based models (g.& the Morningstar/Ibbotson-based AdvisorOne process reference in Question 1) that are used in connection with particular advisory programs offered by Morgan Stanley or its affiliates that are either (a) designed to offer only non-proprietary mutual funds (**M,** Morgan Stanley Fund Solution) or (b) can be adapted to exclude any proprietary product offerings (managers, mutual funds or the like) such as Morgan Stanley's Personal Portfolio Account. These models would be available within these programs, but are, however, subject to the limitations on product and methodology described in more detail in Questions 1 and 2.

7. What are the investment options considered by computer investment advice programs? What information on such options is needed? How is the information obtained and made part of the programs? Is the information publicly available or available to IRA beneficiaries?

Response: As described above in Questions 1 and 2, certain computer investment advice programs utilized at Morgan Stanley classify investments by particular asset classes (e.& Asset Scan or Account Evaluator), but do not currently classify all

investment options available to IRA brokerage customers. Computer models that attempt to provide portfolio-level asset allocation guidelines do not attempt to provide specific recommendations on investment options across the investment spectrum available to brokerage clients. Within Morgan Stanley's advisory programs, where the investment options may be more limited due to minimum investment requirements or quantitative due diligence requirements (such as our mutual fund-only advisory programs, or mutual fund/SMA/ETF programs), lists of available options within each portfolio allocation sleeve are generally presented.   None of these programs present individual recommendations on particular corporate stocks, bonds, alternative investments or the enumerated list of products described in Question 1.

The information on historical performance and various benchmarks for particular classes (most often used in connection with mutual fund advisory relationships), as well as the performance of particular securities, may be found in public or published sources, some of which are free and others which charge an access fee. Specific performance of SMA managers, for example, may be available only through the manager, subject to applicable regulatory requirements by the US Securities and Exchange Commission and the National Association of Securities Dealers.

8. How should the Department or a third party evaluate a computer model investment advice program to determine whether a program satisfies the criteria described in Question 1 or any other similar criteria established to evaluate such programs?

Response: Generally, if the Department or a third party were to evaluate a compute model investment advice program, we believe that the following criteria would be important components of any such evaluation:

(a) Does the model have an appropriate number of asset classes that are generally recognized as separate asset classes (and for these purposes, the guidance that the Department has previously provided on ERISA section 404(c) may be useful to determining compliance with this requirement);

(b) Assuming the answer to (a) is satisfactory, for each asset class, is the reviewer comfortable that the data used to extrapolate potential performance and volatility of the asset classes is supportable by historical and statistical analysis; and

(c) Within each asset class, are there sufficient numbers of commingled investment options that duplicate the broad parameters of the asset classes to provide the investor with a reasonable correlation between the projected performance/volatility of the asset class, and the projected performance of the actual investment?

However, as described in our responses to Questions 1 and 2 above, we do not believe that the models themselves, given that they are constructed on a portfolio theory basis, will satisfy the criteria if non-pooled investments (e.g., individual stocks, bonds) or assets that do not easily fall into particular asset categories (e., alternative investments) are

included. We are concerned that such models may misstate both the asset class performance and volatility with any such investments. Thus, we believe that any such model will not take into account the universe of investment options available to IRA holders, or therefore allow the IRA owner sufficient information to evaluate these investments appropriately.
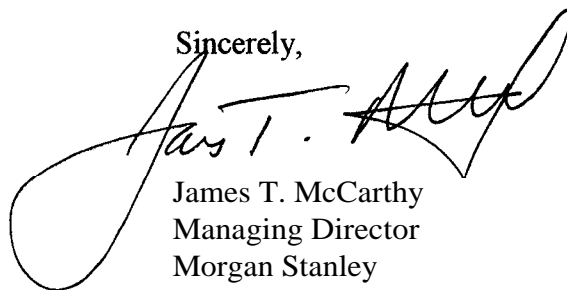
9. How do computer model investment advice programs present advice to IRA beneficiaries? How do such programs allow beneficiaries to refine, amend or override provided advice?

Response: Generally, asset allocation programs available to Morgan Stanley's IRA customers offer (a) pie chart asset allocation mixes by asset class and (b) some fulfillment options for each asset class - either (a) mutual fund or funds, (b) ETFs, and/or (c) separately managed account managers, depending upon whether or not the client is enrolled in a particular advisory program offering those options, or is otherwise eligible for such investments (M₃g_, many managers have minimum investment requirements below which they will not accept client allocations). The output, depending upon the particular program, usually describes these as examples of investment options to be considered. Amendments to such outputs primarily require the client to re-execute the modeling process **(M.** execute a new questionnaire/modify existing answers) to produce a new range of options.

Clients always have the ability to disregard any such output, and to make investment selections on their own in particular securities or managers, assuming that they satisfy the contractual and/or legal requirements to make such investments.

Again, we appreciate the opportunity to respond to this Request for Information from the Department. Please feel free to contact me if you wish us to respond to any additional questions.

Sincerely,

James T. McCarthy
Managing Director
Morgan Stanley

Cc: John Mack
        James Gorman
        Gary Lynch