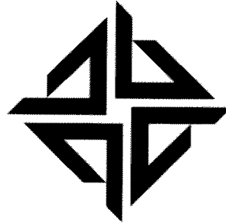

DIVERSIFIED INVESTMENT ADVISORS

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submitted electronically to e-ORI@dol.gov
Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Attn: Investment Advice Class Regulation and Investment Advice Class Exemption

Ladies and Gentlemen:

Diversified Investment Advisors, Inc. ("Diversified") appreciates this opportunity to comment on the regulation and class exemption recently proposed by the U.S. Department of Labor's Employee Benefits Security Administration (the "Department") relating to the provision of investment advice by a fiduciary adviser to participants and beneficiaries of participant-directed 401(k) and other individual account plans and individual retirement accounts ("IRAs"). The proposed regulation (the "Proposed Regulation")[1] would implement the statutory exemption set forth in ERISA sections 408(b)(14) and 408(g) (the "Statutory Exemption"), which exempts from ERISA's prohibited transaction provisions a fiduciary adviser's provision of investment advice, investment transactions entered into pursuant to that advice, and the receipt of compensation by the fiduciary adviser or an affiliate in connection with the provision of advice or investment transactions pursuant to the advice. The proposed class exemption (the "Proposed Class Exemption")[2] would provide relief for investment advice transactions similar to those covered by the Statutory Exemption and Proposed Regulation, subject to different conditions.

Diversified is a national investment advisory firm specializing in retirement plans. The company services over $66 billion in retirement plan assets, helping more than 1.4 million participants save and invest for retirement. Its expertise covers the spectrum of defined benefit and defined contribution plans, including participant-directed 401(k) and similar plans.

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[1] Investment Advice — Participants and Beneficiaries, 73 Fed. Reg. 49896 (Aug. 22, 2008) (proposed rule).
[2] Proposed Class Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Self-Directed Individual Account Plans and IRAs, 73 Fed. Reg. 49924 (Aug. 22, 2008) (notice of proposed class exemption).

Diversified commends the Department on the Proposed Regulation and the Proposed Class Exemption and strongly supports adoption of these proposals. We agree with the Department that these proposals will, by removing barriers to providing affordable, quality investment advice to retirement plan participants and IRAs, improve their investment results and provide a net financial benefit to those plan participants and beneficiaries and IRA beneficiaries who elect to receive this advice. We also believe that the Proposed Class Exemption would complement the Statutory Exemption and Proposed Regulation by furthering the availability of individualized investment advice to both plan participants and beneficiaries and IRA beneficiaries under more flexible conditions that protect participant interests by providing transparency, procedural rigor and limit the possible impact of conflicts of interest.

While we overall support these proposals, we respectfully request certain clarifications that would enhance the workability of the Proposed Regulation and Proposed Class Exemption.

1. Clarify that investment transactions resulting from an automatic rebalancing direction are covered by the Proposed Regulation and Proposed Class Exemption.

Paragraph (h)(2) of the Proposed Regulation and section III(k) of the Proposed Class Exemption would require (consistent with conditions under the Statutory Exemption) that the sale, acquisition or holding of a security or other property must occur solely at the direction of the recipient of investment advice. Diversified requests that the Department confirm that this condition will be satisfied with respect to transactions occurring pursuant to a participant's standing automatic rebalancing instruction.

Investment advice programs often allow the participant to authorize in advance that the fiduciary adviser perform automatic rebalancing of the participant's portfolio at regular intervals (*e.g.*, quarterly or annually) pursuant to a non-discretionary formula, without further specific direction by the participant. This non-discretionary automatic rebalancing is a ministerial, non-fiduciary transaction that occurs solely as a result of the participant's automatic rebalancing direction and should satisfy requirements under paragraph (h)(2) of the Proposed Regulation and section III(k) of the Proposed Class Exemption. We request that the Department confirm that an investment advice arrangement that permits participants to direct rebalancing of their accounts at regular intervals pursuant to a non-discretionary formula does not violate conditions under the Proposed Regulation or the Proposed Class Exemption.

2. Clarify that a fiduciary adviser need not take into account in providing advice every factor listed under paragraph (c)(1)(ii) of the Proposed Regulation and section III(c) of the Proposed Class Exemption

Paragraph (c)(1)(ii) of the Proposed Regulation and section III(c) of the Proposed Class Exemption would require that the investment advice "take[] into account information furnished

by a participant or beneficiary relating to age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences." Diversified requests that the Department clarify that a fiduciary adviser *may* take these or other factors into account, consistent with the condition that any investment advice must be based on generally accepted investment theories, and so long as the fiduciary adviser discloses to the plan fiduciary or IRA beneficiary responsible to authorize the program which types of information it utilizes in formulating its investment recommendations.

Some highly customized (and, therefore, more expensive) programs do take into account all of factors enumerated by the Proposed Regulation and Proposed Class Exemption. However, many advice programs for good reasons do not take into account every one of these factors. Some factors may overlap or may be inferred from others (*e.g.*, age versus life expectancy, retirement age versus risk tolerance). Some factors are not relevant for recommendations relating to certain types of programs (*e.g.*, computer programs based solely on age and expected retirement date are not designed to take into account preferences for certain investments). Further, it may be difficult and more expensive to obtain all of the enumerated items, such as information regarding other assets or sources of income.

In this regard, we request that the Department clarify its statement that "the principles [that an advice program take into account information furnished by a participant relating to age, life expectancy, etc.] are so fundamental to the provisions of informed, individualized investment advice that a failure on the part of a plan fiduciary to insist on such conditions in the selection of an investment adviser for plan participants would, in the Department's view, raise serious questions as to the fiduciary's exercise of prudence."[3] This statement may cause plan sponsors to disqualify from consideration prudent, appropriate advice programs that may not take all of the enumerated factors into account and thereby, limit their selection to more highly individualized and more costly programs.

In comparison to the proposed requirement under paragraph (c)(1)(ii) of the Proposed Regulation and section III(c) of the Proposed Class Exemption, the Statutory Exemption does not include specifically enumerated factors that *must* be taken into account in providing advice. Although the Statutory Exemption conditions for advice based on a computer model (at ERISA section 408(g)(3)(B)(ii)) identifies the same enumerated factors, it only provides that the model "may" include these factors. The Department also has adopted a more flexible approach in the case of advice provided to IRAs based on educational materials (section III(e)(2)(C) of the Proposed Class Exemption), which makes clear that such factors are *examples* of the types of information that asset allocation information must take into account.

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[3] 73 Fed. Reg. at 49897.

Accordingly, we request that paragraph (c)(1)(ii) of the Regulation and section III(c) of the Proposed Class Exemption be clarified to provide that the fiduciary adviser must take into account relevant participant information based on generally accepted investment theories, which "may" include the enumerated factors. In addition, we suggest that information provided to the plan fiduciary or IRA beneficiary responsible for authorizing the arrangement include a discussion of the types of information that the fiduciary adviser will use in providing the advice and the reasons why that information provides an appropriate basis for providing prudent, individual investment recommendations under the arrangement.

3. Clarify that a fiduciary adviser is not prohibited from taking fees into account in selecting an "eligible investment expert" to certify a computer model.

Paragraph (d)(2) of the Proposed Regulation requires that, prior to utilization of a computer model in connection with an eligible advice arrangement, a fiduciary adviser must obtain a written certification that the computer model meets certain requirements from an "eligible investment expert" within the meaning of section (d)(3) of the Proposed Regulation. Paragraph (d)(5) of the Proposed Regulation provides that selecting an eligible expert to review the advice model is a "fiduciary act" governed by the requirements under ERISA section 404(a)(1). The Department explains that section 404 requires that the fiduciary adviser "act reasonably and prudently in its selection."[4]

Diversified anticipates that, in most situations, the fiduciary adviser who is responsible for selecting the eligible expert will also pay the expert's fees.[5] However, if the selection of the eligible expert is a "fiduciary act" in accordance with paragraph (d)(5) of the Proposed Regulation, a question is raised with respect to whether a fiduciary adviser may have a potential conflict of interest in selecting among eligible experts that may charge different fees (and thereby affect the costs of the program borne by the fiduciary adviser). We believe that, so long as the fiduciary adviser acts reasonably and prudently in making the selection, a fiduciary adviser is not

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[4] 73 Fed. Reg. at 49899. We note that the Proposed Class Exemption would incorporate these conditions by reference, by requiring that, where investment advice is based on a "proprietary" computer model, the model must meet conditions under the Statutory Exemption (ERISA sections 408(g)(3)(B) and (C)). See section III (e)(i)(A) of the Proposed Exemption.

[5] This would be consistent with the arrangements under Advisory Opinion 2001-09A, the SunAmerica Advisory Opinion, which also involved a fiduciary's use of an independent expert in connection with a program to provide participant advice services. Also, conditions under the Proposed Regulation suggest that the Department anticipates that a fiduciary adviser could be responsible for compensating the eligible expert. Specifically, a fiduciary adviser may not (as here relevant) be in a "material contractual relationship" with the fiduciary adviser (see paragraph (d)(3) of the Proposed Regulation). For this purpose, persons have a material contractual relationship if payments made by one person to the other person ... exceed 10 percent of the gross revenue, on an annual basis, of such other person (see paragraph (j)(7)).

per se prohibited from taking the eligible expert's fees into account in the selection process, even if the selection may affect the fiduciary adviser's costs in offering an advice program. See 29 C.F.R. § 2550.408b-2(e)(2) (no prohibited transaction where fiduciary does not cause the plan to pay additional fees). We urge the Department to confirm this view.

4. Clarify that a financial adviser may provide advice to employees who participate in a fiduciary adviser's in-house ERISA covered plan.

Under both the Proposed Regulation and the Proposed Class Exemption, the arrangement under which investment advice is provided to participants and beneficiaries must be expressly authorized in advance by a plan fiduciary (or IRA beneficiary) who is not the person offering the advice arrangement, a person providing designated investment options under the plan, or any affiliate of either (paragraph (e) of the Proposed Regulation; section III(a) of the Proposed Class Exemption). In the case of an IRA, an IRA beneficiary would not be treated as an "affiliate" of a person offering an advice arrangement or providing designated investment options solely by reason of being an employee of such person, which enables employees who are IRA beneficiaries to take advantage of investment advice arrangements offered by their employer.[6]

Diversified urges the Department to also exclude from "affiliate" status participants and beneficiaries of ERISA-governed plans maintained by a person offering an advice arrangement or providing designated investment options under a plan. The Department has already recognized in granting previous class exemptions that, subject to ERISA's general fiduciary protections, it is appropriate to allow a financial institution to use its own products and services for its in-house plans. *See, e.g.,* PTE 77-3 (allowing the use of affiliated mutual funds); PTE 79-41 (expanding the application of section 408(b)(5), which allows in-house plans to invest in insurance contracts issued by an employer or its affiliate); PTE 79-60 (allows sales of insurance or annuity contracts to plans maintained by an insurance agent or broker). Similarly, employees of a financial institution should not be precluded from accessing the same services that are afforded to clients of the institution. This additional relief could be subject to a requirement that the advice provider also provides the same investment advice program to participants of unaffiliated plans in the ordinary course of its business.

5. Clarify that an employer offering an employer securities investment option under a plan is not disqualified from authorizing an investment advice arrangement by virtue of being a person "providing designated investment options under the plan."

As noted, paragraph (e) of the Proposed Regulation (and section III(a) of the Proposed Class Exemption) both provide that an investment advice arrangement must be authorized by a plan fiduciary other than (as here relevant) "any person providing designated investment options

[6] See 73 Fed. Reg. at 49900 and 49925.

under the plan." The definition of "designated options" under paragraph (j)(1) of the Proposed Regulation and section IV(i) of the Proposed Class Exemption would exclude a "brokerage window" but would not exclude employer securities from the definition of "designated investment option." As a result, the Proposed Regulation and Proposed Class Exemption may inadvertently disqualify an employer (or affiliate) from approving an investment advice arrangement whenever a plan includes employer securities as a plan investment option.

The usefulness of the Statutory Exemption and Proposed Class Exemption would be substantially limited if employers (and their affiliates) are not eligible to approve an investment advice arrangements in connection with any plan that includes employer securities as a designated investment option. Accordingly, Diversified urges the Department to clarify that an employer offering an employer securities investment option under a plan will not be deemed to be a "person providing designated options under the plan" for purposes of paragraph (e) of the Proposed Regulation and section III(a) of the Proposed Class Exemption.

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We appreciate the opportunity to comment and hope that these comments will be helpful to the Department as it finalizes the Proposed Regulation and Proposed Class Exemption. We welcome any questions that you may have about these comments.

Sincerely,

Robert F. Colby, General Counsel