



November 13, 2006

SUBMITTED ELECTRONICALLY

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

Subject: Proposed Regulation, Default Investment Alternatives Under Participant Directed Individual Account Plans

Dear Sir/Madam:

Watson Wyatt Worldwide is a global consulting firm focused on human capital and financial management. This letter provides comments on your proposed regulation concerning default investment alternatives under participant directed individual account plans. The comments are based in part on a survey that Watson Wyatt conducted after the proposed regulations were released.

I. Watson Wyatt Survey

In the third week of October 2006, Watson Wyatt Worldwide conducted a web-based survey on default investments and the proposed DOL regulations. The target group for this survey was all subscribers of Watson Wyatt Worldwide's *Insider*, which is a monthly newsletter that addresses current issues in retirement and health benefits.

Survey respondents, who are benefits directors and managers at private sector employers, represent about 1.5 million full-time employees. The average number of full-time people employed at the respondent firms is about 16,000. The largest number of full-time employees is 200,000 and the smallest is 50.

The total number of participants represented by the survey is 900,000 and the average number of participants is about 10,000. The average percentage of eligible workers who participate in the DC plan is 75%.

The total amount of assets in the primary defined contribution (DC) plans is \$96 billion. The average value of plan assets is \$1 billion. The maximum value is \$25 billion. The minimum value is \$90,000.

II. Watson Wyatt Survey Results and Comments

A. Prevalence of Default Investment Funds

According to the survey results, 94% of the DC plans have a default investment fund. Of the respondents, 47% expect to leave the assets that are currently invested in the default investment fund in the same fund, 27% expect to use DOL guidance to decide what to do with these assets if guidance is provided on this question, 13% don't know what they will do with such assets and 3% expect to transfer the assets into new funds.

Comment:

Please provide clear guidance on how employers can obtain fiduciary protection concerning assets already in default investment funds, including situations where there is no record of which dollars in the default fund are the result of a default and which are the result of a participant election.

B. Reasons for Existing Default Investment Funds

Currently, the main reasons for having default investment funds are for employee non-selections (72%), auto enrollment (35%), rollovers (17%), elimination of investment option (9%) and change in recordkeeper (7%).

Comment:

Please clarify (beyond footnote 5 of the proposed regulation) that the regulation will apply to more than auto enrollment, e.g., to employee non-selections.

C. Principal Types of Existing Default Investment Funds vs. Types Allowed Under Proposed Regulation

The four top funds used as the default fund by respondents are the life-cycle or target retirement date (TRD) fund, the stable value fund, the money market fund and the balanced fund. Specifically, 38% of respondents who said they have a default fund use a life-cycle or TRD fund, 27% use a stable value fund, 18% use a money market fund and 8% use a balanced fund. None use a professionally managed account for this purpose.¹

There are three fund types that are specified in the proposed DOL regulations. They are the life cycle or TRD fund, the balanced fund and the professionally managed account fund. Currently, if the published regulations were implemented as proposed, 48% of the respondents would have to change their default investment fund.

¹ Firms that use default investments for auto enrollment are more likely to use one of the equity-based funds, which are the life-cycle or TRD fund and balanced fund, than those who use default investments for other purposes. The percentage of firms using the life-cycle or balanced funds when the firm uses a default fund for auto enrollment is 70%, whereas the percentage of firms using these equity-based funds when the firm uses a default fund for employee non-selection is 47%.

Comment:

Significant numbers of plans currently use stable value or money market funds as their default investment funds, which would not be allowed under the proposed regulations. Given the changes that would be required if the regulations were finalized as proposed (including searching for and vetting replacement funds) and the finite number of service providers available to assist in those changes, please consider extending the effective date beyond 60 days after finalization of the regulations and also providing generous transition rules.

D. Respondents' Preferences Concerning Type of Default Investment Fund in Wake of Proposed Regulation

When asked about the three fund types specified in the proposed regulations, 94% of the respondents thought that the life-cycle or TRD fund was either somewhat positive or very positive in appropriateness as a default investment fund, versus 60% for the balanced fund and 39% for the professionally managed account. This was further reiterated when the respondents were asked to rank the attractiveness of the three funds as a default fund. Most respondents chose the life-cycle or TRD fund, then the balanced fund and then the professionally managed fund.

When asked whether other suggested funds are also appropriate as a default investment fund, 35% of respondents said they were moderately interested or very interested in a stable value fund and 18% in the money market fund. When looking at respondents who said they currently use a stable value fund as a default investment fund, 64% said they were moderately or very interested in keeping it if they could. Similarly, when looking only at respondents who said they currently have a money market fund as a default investment fund, 53% of the respondents said they were moderately or very interested in a money market fund as a default investment fund.

Comment:

Listing the specific types of acceptable default funds could effectively freeze the types considered by plans and hamper innovation. Please consider a process to add to the acceptable types without having to amend the regulation.

E. Overall Effect of Proposed Regulations

In the Watson Wyatt survey, respondents said that the proposed changes overall will have a positive effect on their workforce. Most, that is, 58% and 54% of respondents, think the effect will be somewhat positive or very positive on lower paid-employees and moderately-paid employees, respectively. Only 27% feel that the proposed DOL regulations will have a somewhat positive or very positive effect on highly-paid employees.

F. Some Additional Specific Respondent Comments

- “Please clarify the requirement that the participant have been given the opportunity to make an investment election before using a default option and how that would work with automatic enrollment, particularly where all investment elections in the plan are handled directly between the participant and the service provider by internet or phone.”
- “The proposed rules go too far in requiring annual notification. If you provide a quarterly benefit statement, the participants should already have the knowledge that they have the ability to change the allocation of funds.”
- “The requirement of an investment manager/RIA to manage the default fund is costly and potentially subject to conflicts of interest. Extension of relief to investment committees for asset allocation decisions, with documented advice from investment consultants (as SEC-registered under Form ADV), while requiring investment managers/RIA's to make buy-sell decisions should be acceptable.”
- “We feel very strongly that stable value and money market funds should be included as Qualified Default Investment Alternatives.”

Thank you for this opportunity to comment on the proposed regulation. If you have any questions concerning our comments or would like to discuss them further, please contact me at 703-258-8142.

Sincerely,

A handwritten signature in cursive script that reads "Robyn R. Credico".

Robyn R. Credico
National Director Defined Contribution Consulting