EMPLOYERS COUNCIL
ON FLEXIBLE COMPENSATION
927 15th Street, NW • Suite 1000 • Washington, DC 20005 • (202) 659-4300

November 9, 2006

Submitted Electronically to e-ORI@dol.gov andVia Regular Mail

Office of Regulations and Interpretations
Employee Benefits Security Administration (EBSA)
Room N-5669
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Attn: Default Investment Regulation

Ladies and Gentlemen:

The Employer's Council on Flexible Compensation ("ECFC") appreciates this opportunity to provide comments on the Department's proposed regulations implementing the default investment provisions of the Pension Protection Act of 2006, Public Law 109-280 ("PPA"). ECFC applauds the Department for its efforts to facilitate the adoption of automatic enrollment features in 401(k) plans. The ECFC agrees that the regulations will go a long way toward increasing the number of participants in privately-sponsored 401(k) plans and the assets available to them at retirement.

ECFC is a non-profit membership association committed to the study and promotion of 401(k) plans, cafeteria plans, and other elective compensation and flexible benefit plans. The more than 2800 members of ECFC include Fortune 100 companies that are plan sponsors, corporations, governments, unions, universities, hospitals, and clinics as well as leading actuarial, insurance and accounting firms that design and administer flexible benefit plans. Founded in 1981, the Council has great experience in designing and administering compensation and benefit programs that offer flexibility for employers and employees.

While we believe the regulations as proposed give plan sponsors much needed certainty, in our view several conditions could be clarified or expanded. In drafting our comments we have tried to suggest changes that would increase the number of sponsors willing to adopt auto-enrollment programs without eroding participant protections. In addition, our comments highlight some of the administrative difficulties plan sponsors would face under the proposed regulatory scheme.

A. Clarify the Treatment of Redemption and Market-Timing Restrictions

In response to recently publicized late trading and market timing abuses, many mutual funds now impose redemption fees in connection with sales of shares. In addition, many mutual funds and other pooled vehicles impose limits on frequent trading (such as "round trip" restrictions) that limit a seller from re-investing in the fund within a certain period of time. It is possible that some mutual funds available through a single plan may impose these types of restrictions while others do not, and the fees and restrictions themselves could vary significantly from fund to fund. We expect that more mutual funds will begin to impose redemption fees in response to the SEC's recent final redemption fee rules. SEC Rel. No. IC-267782, 70 Fed. Reg. 13328 (Mar. 18, 2006). In addition, many plan sponsors have amended their plans to impose these types of fees and restrictions at the plan level. These fees and limits protect fund investors, including benefit plans, from losses resulting from market timing.

Under the proposed regulation, participants and beneficiaries must be able to "consistent with the terms of the plan … transfer, in whole or in part, [defaulted] assets to any other investment alternative available under the plan without financial penalty." See proposed 29 C.F.R. § 2550.404c-5(c)(5). In addition, a plan's default option will not qualify as a qualified default investment alternative ("QDIA") unless it does not impose financial penalties or restrict the ability of a participant to transfer to any other plan option. See proposed 29 C.F.R. § 2550.404c-5(e)(2). We know of no reason why the QDIA investments proposed by the Department would not impose these types of restrictions like any other pooled vehicle. To the extent they do, we ask the Department to clarify in final regulations that redemption fees and market timing restrictions imposed at either the fund or plan level in connection with the plan's default option would not constitute "penalties" or "restrictions" within the meaning of conditions (c)(5) and (e)(2) of the regulation, and would not cause relief under ERISA 404(c)(5) in connection with default investments to be unavailable.

B. Relax the Disclosure Condition

1. Limit the Nature of Disclosures that Must be Provided

The proposed disclosure condition is problematic for plan sponsors in two respects. The regulation currently requires that "[u]nder the terms of the plan, any material provided to the plan relating to a participant's or beneficiary's investment in a qualified default investment alternative (e.g., account statements, prospectuses, proxy voting material) will be provided to the participant or beneficiary." See proposed 29 C.F.R. § 2550.404c-5(c)(4).

On its face, this rule requires plan sponsors to provide more disclosure to defaulted participants and beneficiaries than is currently required with respect to affirmative participant instructions made in 404(c) plans. In particular, we note that many 401(k) and 404(c) plans do not pass voting rights in connection with mutual fund shares through to participants and beneficiaries. By its terms the current regulation would require proxy voting materials received by the plan to be passed on to defaulted participants even though the plan does not pass through voting rights. In addition, the plan may receive plan-level statements from the plan's custodian or recordkeeper showing the plan's mutual fund holdings. The plan may receive annual prospectuses even though a prospectus, or a summary document such as a profile, has already

been provided to participants. The plan may also receive semi-annual reports from mutual funds. It does not make sense, and will cause substantial expense, to require sponsors to pass these materials on to defaulted participants when it does not do so with respect to other participants.

That said, we agree that defaulted participants should be entitled to disclosure concerning their plan investments. We ask the Department to instead require that participants whose accounts have been invested by default be provided the same disclosures that are currently required with respect to affirmative investment instructions under current 404(c) regulations and interpretations.

A rule that requires no more disclosure in connection with default investments than is currently required under 404(c) regulations is far more efficient and would not result in substantially increased administrative costs. To satisfy the proposed disclosure rule, a plan administrator would have to (1) analyze every document provided to the plan, (2) determine whether the document relates to a participant's investment in the default investment option, and (3) identify each participant who has invested in the default option by default instead of by affirmative election. By contrast, plan administrators are well aware of the disclosures required under 404(c) regulations and have developed processes for providing them. We see no reason that plan administrators should be faced with the burden and expense of developing new disclosure procedures in connection with default investments.

In addition, the Department's reference to "account statements" as one of the disclosures that must be passed through to participants should be eliminated because Congress has addressed this issue. Specifically, section 508 of the PPA amends ERISA to require that individual account plans provide quarterly benefit statements to participants and beneficiaries who have the right to direct the investment of their accounts. Because a participant whose assets who have been invested by default in compliance with DOL's proposed regulations must be able to provide directions, he or she would be entitled to these statements. Section 508 of the PPA is generally effective for plan years beginning in 2007. Calendar year single employer plans will be subject to these requirements before the Department's default regulations are expected to be effective.

2. Eliminate the Requirement of a Plan Amendment

The proposed disclosure condition appears to require the plan document itself to describe the disclosure rights of participants whose assets are invested by default. This will require all plans that utilize a default investment to be amended to describe the disclosure obligation. We note that current 404(c) regulations do not require the *plan terms* to describe the disclosures to which participants are entitled – they simply require that specific disclosures *be provided* in the manner described. In our experience with 404(c) plans, rarely if ever does the plan document describe particular disclosures to which participants are entitled; however, disclosure rights may be described in an SPD or other materials that describe the plan's investment options.

We believe the intent of the disclosure rule is to ensure that defaulted participants are provided relevant information regarding investments made on their behalf, not to dictate the content of the plan's legal instrument. We see no reason that the plan document itself must describe the disclosure rights of defaulted participants when there is no corresponding requirement for participants who direct their accounts under a 404(c) plan. Defaulted

participants in particular are unlikely to take the steps necessary to obtain a plan document to review their disclosure rights. And it is unnecessary to require a plan to incur the legal and administrative costs of securing a plan amendment. Accordingly, we ask the Department to eliminate the requirement that the plan describe disclosure rights in connection with default investments.

C. Immediate Relief for "Immediate Participation" Plans

Many plan sponsors offer eligibility for plan participation on the first day of employment. In addition, most plans are required, under IRS rules, to provide for immediate participation in reemployment situations. These eligibility rules are fully consistent with the Department's stated goal of encouraging employers to adopt plan features that increase the number of participants and the amount of assets set aside for retirement.

The proposed regulation requires the plan to provide a notice to a participant "within a reasonable period of time of at least 30 days in advance of the first [defaulted] investment." See proposed 29 C.F.R. § 2550.404c-5(c)(3). If a plan can provide the notice no earlier than the first day of employment/reemployment, we assume that fiduciary relief in connection with default investments would not be available until 30 days later, at the earliest. The Department should not discourage these arrangements by denying plan sponsors fiduciary relief in connection with default investments until the 30-day notice requirement can be satisfied.

We ask the Department to waive the 30-day notice requirement for plans that offer, or are required to provide, immediate participation. For these plans, fiduciary relief in connection with default investments should be available concurrently with the provision of the notice describing the plan's default option and rules.

Unless relief for defaulted investments is available, many sponsors will stop offering immediate eligibility, opting instead to impose a 30-day or more waiting period on all participants. Alternatively, sponsors could choose to offer immediate participation to those participants who provide investment instructions and impose a waiting period against those who do not, an approach that would be difficult if not impossible to administer. Both of these solutions involve delaying participation for at least some plan participants and should not be encouraged by the Department. The Department could, in fact, spur the adoption of more immediate eligibility plans by permitting plan fiduciaries to qualify for relief concurrently with the provision of the notice, which would significantly benefit plan participants.

D. Capital Preservation Products Should Qualify as QDIAs

The Department stated in its preamble that although capital preservation products such as money market or stable value investment products may play a useful role in a diversified portfolio, such vehicles are not appropriate default options because they are unlikely to generate sufficient returns. 71 Fed. Reg. at 56807. Nonetheless, the Department acknowledged that many plan sponsors, by some surveys as much as 58 or 81 percent of plan sponsors who currently offer automatic enrollment features, have designated capital preservation products as their default option. 71 Fed. Reg. at 56806 n.4.

We respectfully request that the Department include capital preservation products among the types of investments eligible for QDIA treatment. There are several reasons why plan sponsors should have the freedom to designate an investment product primarily aimed at preserving principal as the plan's default investment option. First, capital preservation products could be an appropriate choice for a plan, or portion of a plan, that covers a population close to retirement age, or during a blackout period or transition. Such a vehicle may also be an appropriate default option for an employer with a very young population, or a high rate of turnover, where many of the plan's participants will terminate in short order and roll their account balances out of the plan. Under these circumstances, and many more, an investment option that is unlikely to decline in value could well be the most appropriate choice.

We are also troubled by the Department's proposal to categorically exclude capital preservation products from its list of QDIA investment products because both the PPA and the legislative history contemplate that DOL's regulations would address the "appropriateness" of designating "a mix of asset classes consistent with capital preservation or long-term capital appreciation" as default investment options. ERISA § 404(c)(5); Technical Explanation of H.R. 4, the Pension Protection Act, JCX-38-06 at 148 (Aug. 3, 2006). However, under the proposed regulation, relief under ERISA section 404(c)(5) is conditioned on the use of one of the prescribed QDIA products. By eliminating capital preservation products from QDIA treatment, the Department has effectively "passed" on particular investment styles that will, and will not, satisfy ERISA's fiduciary standards. In effect, the Department has substituted its judgment on appropriate investment strategies for the judgment of plan fiduciaries (or their service providers) with intimate knowledge of the unique circumstances of their plans and participants. We recognize that the statute permits the DOL to address the "appropriateness" of various investment strategies in its regulation, but we are disappointed that the DOL would absolutely deny relief in connection with capital preservation products when they may be an appropriate choice for a fiduciary under specific facts and circumstances. Accordingly, we ask the Department to give plan fiduciaries the freedom to choose capital preservation products by designating them as a permissible QDIA.

E. Application of Default Investment Principles to HSAs

The Department stated in its proposal that its default investment regulations were initially intended to provide relief under section 404(a) of ERISA rather than section 404(c). See 71 Fed. Reg. at 56814. The regulations specifically apply to "individual account plans," a term that is limited to pension plans. ERISA § 3(34). Many ECFC members have adopted health savings accounts ("HSAs") that involve individual participant accounts that may be invested at the account holder's direction. Although the Department has provided guidance on the circumstances under which HSAs would not be covered by ERISA, it is possible that a plan sponsor may choose to treat an HSA as subject to ERISA. In addition, it is possible that an HSA may become subject to ERISA, either because participation is not completely voluntary, or because the employer has not maintained neutrality with respect to the program. See DOL Field Assistance Bulletin 2004-01 (Apr. 7, 2004); DOL Field Assistance Bulletin 2006-02 (Oct. 27, 2006).

Like their 401(k) counterparts, many HSA account holders never provide investment instructions. In this regard, plan sponsors or service providers that invest ERISA-covered HSA assets without participant directions face the same fiduciary liabilities as sponsors of 401(k) plans that invest participant accounts without affirmative investment instructions under current law.

Although we recognize that DOL's default investment regulations have no direct application to HSAs, it would be helpful to our members if DOL provided guidance to the effect that sponsors would be deemed to satisfy their fiduciary obligations under ERISA section 404(a) if ERISA-covered HSA assets are invested in a QDIA meeting the conditions of final default regulations. In our view this would be consistent with DOL's approach to expand the relief provided by the regulation to a broader range of plans than only those that qualify for 404(c) protection. In particular, we ask that DOL articulate that a fiduciary would be deemed to satisfy his obligations under 404(a) with respect to the selection of the default investment and the diversification of account assets if undirected funds are invested in a QDIA.[1]

F. Transition Issues

As the Department is aware, many plan sponsors have already selected default investment options in connection with automatic enrollment features, or for other undirected amounts. Many of these plan sponsors are currently investing undirected account balances in qualifying default investments, such as lifestyle funds. Others are investing undirected contributions in currently non-qualifying defaults, such as money market or stable value products. Once final rules are effective, these sponsors want to qualify for fiduciary relief in connection with previously defaulted contributions as soon as possible in the most cost-effective manner.

A problem faced by many plan sponsors is that the records relating to the plan's holdings in any one investment option, such as a mutual fund or other pooled investment vehicle, do not identify those participants who have invested in the fund because they failed to provide investment instructions. In other words, many plans cannot distinguish, based on the plan's records, those investors who have invested in the fund by default from those who affirmatively chose the fund.[2] In other instances, a participant may have been initially defaulted into the current default option and subsequently affirmatively decided to continue the investment without memorializing that election. These sponsors are particularly concerned about how to achieve

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[1] In this regard, we expect that the scope of fiduciary relief in connection with investing HSA assets in a QDIA could be comparable to that provided in connection with the selection of investments under DOL's safe harbor regulation for automatic rollovers. See 29 C.F.R. § 2550.404a-2.

[2] Some plans may be able to reconstruct investment records to identify those participants whose assets were invested in the default option by default at substantial cost to the plan. In any event, developing the recordkeeping necessary to distinguish defaulted participants from non-defaulted participants in any investment option on a going forward basis will involve significant expense for these plans.

fiduciary relief in connection with defaulted investments once final regulations are effective. They are also concerned about complying with their fiduciary duty to keep administrative and transaction costs associated with transitioning defaulted investments to a QDIA to a reasonable level. It is important that the DOL clearly address how the conditions of the regulation apply in transitions involving previously defaulted amounts in both QDIA and non-QDIA defaults.

1. Transition Issues for Plans Currently Utilizing QDIAs

Consider a plan that currently invests undirected account balances in a qualifying lifestyle fund appropriate for the participant's age and expected retirement date. Because the participant's account has already been invested by default in a QDIA for some amount of time, the requirement to provide notice 30 days "in advance of the first investment" should not apply. Accordingly, we ask the Department to clarify that fiduciary relief is available in connection with these default investments as soon as a notice is provided in compliance with the regulations.

Moreover, because many plans are unable to distinguish those participants who have been defaulted into the fund from those who affirmatively elected the fund, those plan sponsors will be required to send the notice to all investors in the default fund. The notice would generally describe the fact that the investor is currently invested in the plan's default option and will remain so invested unless a contrary direction is provided. This notice may be confusing for those participants who have affirmatively chosen the default fund. We ask the Department to confirm that plan sponsors retain relief under ERISA 404(c)(1) with respect to a participant's prior affirmative selection of the default fund notwithstanding the provision of the default notice.

2. Transition Issues for Plans Currently Using Non-QDIAs

Many plans currently invest undirected account balances in a non-qualifying default option under the proposal such as a money market fund. Assume that the plan's records do not allow the plan to distinguish those plan investors who affirmatively selected the money market fund from those whose accounts were defaulted. Again, the plan could provide a notice to all investors in the fund advising them, among other things, that their balance will be transferred to a QDIA unless other instructions are provided within 30 or more days. Under these circumstances, account balances of some participants who had affirmatively chosen the money market fund could be transferred to a QDIA if the participant fails to respond.

Sponsors are understandably very concerned about their liability under these circumstances, particularly because the Department's current equity-based QDIA options could involve increasing the volatility to which participant accounts are subject. And they fear that relief under 404(c)(5) may not be available for these transfers because the participant had previously selected the money market fund.[3]

[3] In this regard, the proposed regulations require that the participant had the opportunity to direct the investment of their account but did not do so. See proposed 29 C.F.R. § 2550.404c-5(c)(2).

For these transfers from non-QDIAs to QDIAs following final regulations, we ask the Department to clarify that, assuming all notice requirements are met, plan sponsors remain eligible for relief under ERISA section 404(c)(1) with respect to those investors who previously affirmatively elected the non-QDIA option regardless of whether their account balances are ultimately moved to a QDIA. In addition, we ask the Department to confirm that fiduciary relief is available under ERISA section 404(c)(5) when those participant accounts are reinvested in a QDIA notwithstanding the fact that the participant may have affirmatively chosen the non-QDIA option at an earlier time.

Alternatively, we ask the Department to permit fiduciaries to obtain relief through a negative consent process for investments previously defaulted into a currently non-qualifying albeit prudent default option. In this regard, instead of providing that the participant would be moved to a QDIA unless other instructions are provided, the notice could provide that a participant in a non-QDIA would remain in the non-QDIA unless the participant directs otherwise. The notice would clearly describe the effect of a participant's failure to respond, i.e., that a non-response would be treated as the participant's affirmative consent to the use of the non-QDIA for previously defaulted amounts, and would give the participant an appropriate amount of time to respond. For example, such a notice could be provided as many as 60 to 90 days prior to the transition, and reminder notices could be sent.

It would be helpful if the Department would address whether such a negative consent process could be used in a transition situation to obtain relief under 404(c)(1) in connection with participant accounts previously defaulted into non-QDIA options. Such a procedure would ease some the administrative and legal concerns of plan sponsors who are reluctant to move previously defaulted participants (who were previously notified of the plan's prior default rules) into an equity-based QDIA option.

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We appreciate the opportunity to provide these comments on the Department's proposed default regulations. We welcome the opportunity to answer any questions you may have regarding our comments.

Sincerely,

Lewis Freeman
President
Employers Council on Flexible Compensation