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Fidelity INVESTMENTS

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SUBMITTED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
ATTN: 2010 Investment Advice Proposed Rule
Room N – 5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: 2010 Investment Advice Proposed Rule

The U.S. Department of Labor ("Department") published a proposed rule relating to the provision of investment advice ("Proposal") in the Federal Register on March 2, 2010 (71 FR 70429). This response to the Proposal is submitted on behalf of the group of financial service companies for which FMR LLC is the parent company and which is known as Fidelity Investments ("Fidelity").

Fidelity provides record keeping, investment management, and custodial services to more than 18 thousand Internal Revenue Code ("Code") Section 401(k), 403(b) and other individual accounts plans covering more than 12 million employees and their beneficiaries. Fidelity also services over 8.5 million individual retirement accounts under Code Section 408 and Roth individual retirement accounts under Code Section 408A (collectively, "IRAs"). Fidelity Management Trust Company serves as the trustee for most of the 401(k) and other individual account plans that are serviced by Fidelity, and serves as custodian for the IRA and 403(b) accounts.

Section 601 of the Pension Protection Act of 2006 ("PPA") added Sections 408(b)(14) and 408(g) to ERISA to provide an exemption for the provision of investment advice to participants and their beneficiaries under individual account plans and IRAs. Although the Department issued final rules under the PPA exemption on January 21, 2009, those rules were first deferred and then ultimately withdrawn on November 20, 2009. The Proposal preamble states that the new proposal generally retains the framework provided in the final rules withdrawn last year. However, the Proposal would introduce new conditions for computer models used to provide investment advice under the PPA exemption and specifically invites comments relating to the methodology for computer-based investment advice.

Comments on the investment methodology for computer-based advice are provided below in item (1) and several other issues raised by the Proposal are addressed in items (2) through (5).

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(1) Investment Methodology.

The Proposal would impose new restrictions on the computer-based methodology that may be used by a fiduciary adviser by defining what constitutes "generally accepted investment theories" under the PPA exemption. As discussed below in detail, we are concerned with the proposed expansion of the Department's normal regulatory role into an area that requires investment expertise. In addition, it is the view of our investment staffs that the proposed restriction would in fact be contrary to generally accepted investment theory and prohibit the use of a critical analytical tool.

Section 408(g)(3)(B)(i) of ERISA (as added by PPA) requires that a qualifying computer model "applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time". The Proposal repeats that principle, but it goes on to state that computer models should be designed and operated to avoid investment recommendations that "[i]nappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future…". The Proposal preamble states that for such purpose, fees and expenses and management style are likely to persist, **but that differences in historical performance within an asset class are not likely to persist and are therefore less likely to constitute appropriate criteria for asset allocation**.

As an initial matter, we question why the Department would consider taking a position in an area of investment methodology, something the Department has appropriately left to investment professionals in the past. In finalizing the regulations that define a "qualified default investment alternative", for example, the Department added language to each of the three categories of eligible investment options that requires that each apply generally accepted investment theories (72 FR 60479). However, there is neither discussion in the preamble nor language in the regulation itself that would attempt to dictate the parameters of generally accepted investment theory to the manager or adviser who is responsible for constructing the investment option portfolio.

In addition, the proposal to ignore historical performance seems inconsistent with the statutory requirement in the PPA exemption that participants be provided with historical performance information on available investment options before the provision of advice covered by the exemption. See ERISA Section 408(g)(6)(A)(ii). While the statute specifically mandates that historical returns of asset classes be taken into account, it **does not** prohibit the use of historical performance in evaluating specific plan investment options. An even greater concern, however, is that the Proposal would contradict generally accepted investment theories practiced by a broad segment of the investment community.

Risk Control

Our investment staffs view historical performance as a critical tool in assessing the suitability of investment options for inclusion in a diversified portfolio. Analysis of historical returns provides important insights into the behavior of investment options that are useful to the analysis and characterization of investment options and to the construction of appropriately diversified investment solutions. The analysis of historical performance plays a crucial role in understanding and modeling the risk of investment options. The relevant dimensions of the risk of investment options include:

- Variability of returns, e.g., total return volatility, tracking error (measuring deviation from the benchmark) vs. an appropriately specified benchmark.
- Behavior in combination with other investment options, e.g., correlation, covariance (measuring the relationship or co-movement between options).

These elements of investment return - guided wholly or in part by an analysis of historical returns - are critical to the construction of an investment solution designed to present a level of risk (measured as variability of total return) consistent with the needs and preferences of a given investor. Historical performance plays a key role in the development and application of modern portfolio theory, which relies heavily on historical performance to model not only the behavior of individual investment options but, more importantly, the diversifying impact of individual options in combination with other options – viewing risk and return in a portfolio context. The insights gained from historical performance are crucial to the estimation of the risk of the total investment portfolio.

It is important to note that the value of historical returns to the process of understanding and modeling risk is not exclusive to active management, or to the creation of actively managed investment solutions. Index fund management relies heavily on a variety of sampling and optimization techniques which, in turn, rely on historical security returns to inform estimates of risk and co-movement necessary to the construction of index-tracking portfolios.

Portfolio Characterization

A key tenet of generally accepted investment management theory is that asset allocation is the fundamental element of appropriate investment advice. In today's dynamic investing world, constructing well-diversified investment solutions that conform to an appropriate asset allocation requires an assessment of certain attributes (risk exposures) of the individual options used to effect exposure to a given asset class.

For example, even when the asset class characteristics are "known" - whether based on prospectus disclosure or on holdings-based analysis - an investor needs to be able to independently confirm that an option that is nominally in a specific asset class in fact

demonstrates investment characteristics consistent with that asset class. However, the characteristics of an option are often unknown, or as is the case for holdings-based analysis, may be obtained only after a meaningful reporting lag. Mutual fund companies are required by Securities and Exchange Commission ("SEC") guidance to maintain and publish policies for fund holdings disclosure, and fund groups generally impose a delay in portfolio holdings disclosure under their policies. Fortunately, a returns-based analysis, specifically the imputing of investment attributes to an option based on analysis of historical returns, provides the investor with an alternative means for evaluating those asset class characteristics

Based on the analysis of these characteristics, the investor can select and combine options with a greater degree of confidence that a solution will manifest the behavior of the desired asset mix. Evaluating historical behavior provides useful complementary insight for virtually any investor, and in many cases, provides the only available insight to determine the asset class, sub asset class, style, or sector exposure of an investment option. Risk models also use historical returns as part of the process of computing the identifiable characteristics of investment options influenced by macro factors such as sensitivity to inflation, the price of oil, or the Treasury yield curve. In satisfying the PPA exemption requirement that a computer model must generally take into account "all designated investment options" available under the plan, analysis of historical returns of investment options may be the only practical means of satisfying that requirement.

The following examples, involving two mutual funds that are both characterized as U.S equity large-cap growth funds, are intended to help illustrate this discussion:

Example 1: An analysis of historical returns could reveal that one is correctly categorized based on the fund's historical returns' correlation with returns of the Russell 1000 Growth index, but the other fund, due to its returns' higher correlation to those of the Russell 2000 Growth index, is more properly categorized as a US equity small-cap growth fund. Appropriate categorization is an integral feature of investment advice and can make a large difference in an investor's portfolio allocation.

Example 2: An analysis of historical returns could reveal that both are correctly categorized based on the funds' historical returns' correlation with returns of the Russell 1000 Growth index. Nevertheless, the same analysis might reveal that, while the two funds are in the same category, one fund's returns vary much more from month to month compared to the other. That is, the first fund is much riskier than the second. This conclusion, based on historical returns, might properly have a large impact on the decision whether and how much to include each fund in the investor's portfolio.

It should also be noted that the consideration of historical performance is a matter of common – that is to say, generally accepted – practice beyond the world of computer advice models, be it for purposes of fund research (e.g., the calculation of risk-adjusted returns or

returns-based style analysis), fund/manager screening and selection, or the routine attribution analysis conducted by investment consultants and plan fiduciaries.

Discrimination Among Investment Options for Future Return Potential

In addition to their value for purposes of characterizing investment options and evaluating and controlling portfolio risk, historical returns also have the potential to serve as a useful discriminating metric in the identification of superior forward-looking return. This does not mean that historical performance would dictate whether one investment option will outperform another. However, it can be used to help determine which option, among like options, has a better likelihood of superior performance. It has the potential to serve as a useful signal in the identification of superior, forward looking, risk-adjusted returns (a measure of return per unit of risk).

Abundant and persuasive evidence, in the form of academic and professional studies currently exists on the topic of performance persistence. A brief bibliography in Appendix A offers a representative set of studies that make the case for performance persistence. A review of the wider body of academic and professional literature on this topic would simply confirm the variety of disparate views among investment professionals.

The Proposal preamble invites comments on a series of questions relating to the factors that may be taken into account by a qualifying computer model. Several of the final questions raise the issue of historical performance in another context:

> "On what if any bases can a fund's superior past performance be demonstrated to derive not from chance but from factors that are likely to persist and continue to affect performance in the future? Should the use of a fund's superior past performance as a criterion for allocating assets to the fund be conditioned on such demonstration? How, if at all, should a model take into account investment management style? For example, all else equal, should a model ascribe different levels of risk to passively and actively managed investment options?"

In describing the various benefits of a broad set of information inputs beyond asset class behavior and fees and expenses, we are making the case that generally accepted investment theory compels investment advisers to recognize the unique attributes of ***each investment option*** and ascribe different levels of risk (or, more generally, investment behavior) to every individual investment in the interest of constructing appropriately diversified investment solutions. The mere fact that an investment option is managed passively to mimic the performance of an index does not mean that generally accepted theory would always ascribe that option lower "risk". For example, technology stocks accounted for almost 30% of the market cap of the S&P 500 toward the end of 1999. The extent of that risk was demonstrated by a severe market fall soon thereafter

– experienced by both S&P-benchmarked index funds and active funds. Index funds managed against relatively volatile indices will manifest that relatively high volatility. What is important in the process of comparing across investment options is the attributes of each specific option and how it moves individually and in combination with the other investment options.

The foregoing discussion is not meant to suggest that fees and expenses are not important elements to be considered in the evaluation of investment options and the construction of investment solutions. Other things being equal, fees and expenses may be expected to serve as the primary discriminating factor. The contention of this letter, however, is that in many (if not most) cases, other things are in fact not equal.

In summary, we are suggesting simply that historical returns are a useful, in many cases essential, element in the process of evaluating and building investment solutions. Historical returns are a valuable element in the mosaic of information – empirical, fundamental, and qualitative – that can appropriately be brought to bear on the problem of designing appropriate advice investment solutions.

Finally, investment management, and generally accepted investment theory, is a dynamic and continually evolving combination of art and science. The practice of investment management is responsive to the introduction of new products and investment structures, to a continuously evolving body of practitioner and academic research, and to changing market dynamics and structures. Any attempt to either proscribe or exhaustively define appropriate criteria would have a chilling effect on investment management research and on the robustness of investment advice solutions.

(2) Mandated Requests for Information.

Several industry groups had objected to language in the original proposed rule that seemed to require that the fiduciary adviser – whether relying on the computer model rule or on the level compensation rule – request various pieces of information from a participant in addition to age. The Department retained this condition in the final rule withdrawn last year, stating in the preamble that they had done so because "these factors are so fundamental to meaningful investment advice" (74 FR 3825). The final rule made it clear, however, that the adviser could proceed under the exemption if the participant did not furnish such information.

The Proposal again retains the language that appears to require a request for various types of information in addition to age in the computer model rule, as well as comparable language in the fee-leveling rule. The Proposal again provides that the adviser could proceed under the exemption if the participant does not furnish such information. There is no commentary in the Proposal preamble to explain why no change has been made in the Proposal. We do not think that the language in the PPA exemption regarding what information a model <u>could</u> consider

means that such information must be solicited for either rule. We ask that the Department reconsider this aspect of the Proposal.

(3) IRA Brokerage Accounts.

The PPA exemption requires that the computer model must generally take into account all "designated investment options" available under the plan. In addition, performance information for designated investment options must be provided to participants in advance of the provision of advice under the exemption. The Proposal provides that self-directed brokerage accounts under a plan are excluded from the definition of designated investment options. We ask for confirmation that this exclusion applies equally to brokerage-based IRAs providing the same wide range of potential investments.

(4) Investment Manager Recommendations.

The preamble for last year's final rule stated that: "it is the view of the Department that the recommending of investment managers to participants and beneficiaries may constitute the provision of investment advice for purposes of both the statutory and class exemption contained in this final rule" (74 FR 3824). There is no such reference in the Proposal preamble.

The applicable regulations (29 CFR 2510.3-21(c)(1)(i)) appear to state that the provision of investment advice relates in part to recommendations concerning individual securities or other property, which (consistent with the omission in the Proposal of the language quoted above) suggests that the Department's position is that recommendations of investment managers do not constitute investment advice. If the Department position has changed on this point, however, then we respectfully ask the Department to confirm that the recommendation of an investment manager may also be entitled to relief under the PPA exemption.

(5) Disclosure by Electronic Means.

Section 408(g)(6)(A) of ERISA and the comparable provision in the Internal Revenue Code, both as added by PPA, require that a participant or beneficiary be furnished with various disclosures before the initial provision of investment advice covered by the PPA exemption. Although the statute refers to written notification, it also explicitly provides that the required disclosure "may consist of notification by means of electronic communication."

One of the disclosure items is past performance and historical rates of return "of the investment options available under the plan". This requirement may be intended to make certain investment information available to the participant or investor in the event that he or she wants to do some research before making a decision whether to hire the investment advisor or perhaps to help decide whether to implement the advisor's advice. We believe that the Congressional intent for such performance disclosure would be satisfied by the adviser ensuring that the participant

understands that he or she would, if so desired, have ready access to historical performance information.

Proposed Regulation Section 2550.408g-1(b)(7)(iii) states that the information required to be provided to participants may be provided electronically in a manner permitted by 29 CFR 2520.104b-1 (the "2002 Regulation"). Although the Department had acknowledged in the preamble to last year's final rule that they were reviewing the 2002 Regulation on electronic delivery, we have heard that such review is no longer a Department priority.

In Field Assistance Bulletin 2006-03 ("FAB") issued to provide transitional guidance for participant statements required under PPA, the Department concluded that effective access to a secure website would constitute delivery, subject in part to the condition that participants be provided with notice of such availability and of their right to request paper documentation instead. With regard to the use of electronic media to deliver such notice, the Department agreed that a plan may rely on either its guidance, at 29 C.F.R. § 2520.104b-1(c), or on the Department of the Treasury and Internal Revenue Service guidance, at 26 C.F.R. § 1.401(a)-21, relating to the use of electronic media to provide certain notices and documents required to be furnished to participants by retirement plans under the Internal Revenue Code.

We believe that the approach taken in the FAB should be followed under Section 408(g)(6)(A) of ERISA and the comparable Internal Revenue Code provision. That is, the Department should view the availability of performance information through a secure website as satisfying the requirement to furnish performance information, provided that before any advice is implemented, participants and beneficiaries have been furnished a notification that explains the availability of the performance information and how such information can be accessed by the participants and beneficiaries. In addition, the notification must apprise participants and beneficiaries of their right to request and obtain, free of charge, a paper version of performance information for any specific investment option that may be covered by the advice provided. Such notification should be written in a manner calculated to be understood by the average plan participant and furnished in any manner that satisfies the current rules for the provision of notices.

Other government agencies have responded to these advances in technology. In 2007, for example, the SEC established procedures that promote the use of the Internet as a reliable and cost-efficient means of making proxy materials available to shareholders. The notice and access proxy rules require all issuers and other soliciting persons to post their proxy materials on an Internet Web site and provide a Notice of Internet Availability of Proxy Materials ("Notice") to shareholders. Enhancements to those procedures took effect early this year.

Finally, Fidelity has shared information with the Department and the ERISA Advisory Council on several occasions in recent years with respect to how participants are using the Internet to monitor and manage their retirement accounts. We provided a chart with information

that compares Internet usage by age group over the past decade. Although the chart demonstrated a substantial increase in usage over all age groups, the increases are most striking among older participants. We would be pleased to provide the most recent information on Internet usage if that would be deemed useful.

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We would be pleased to provide additional information or to meet with Department staff to discuss this matter in more detail at your convenience.

Sincerely,

Douglas O. Kant

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APPENDIX A

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