Congress of the United States
Washington, DC 20515

December 5, 2006

The Honorable Bradford P. Campbell
Acting Assistant Secretary
Employee Benefits Security Administration
US Department of Labor
200 Constitution Avenue, NW, S-2524
Washington, D.C. 20210

Re: Default Investment Regulation, RIN 1210 AB10

Dear Acting Assistant Secretary Campbell:

We are submitting the following comments in response to the Department's proposed rule on Default Investment Alternatives under Participant Directed Individual Account Plans (published in the Federal Register on September 27, 2006).

Although we welcome opportunities to discuss strengthening defined benefit plans with the Department, our comments today are limited to defined contribution plans—specifically, the conditions under which a pension fiduciary's selection and monitoring of default investments for individuals may limit fiduciary liability under the Employee Retirement Income Security Act (ERISA).

The U.S. private pension system is in the midst of fundamental and far-reaching changes and we strongly believe that the guidance the Department provides will influence whether millions of individuals will live out their retirement years in comfort or poverty. While the primary type of defined contribution plan, the 401(k) plan, has existed for approximately 25 years, its emergence as the dominant retirement plan is recent. Almost 50 million workers are now covered by 401(k) plans. These plans were never intended to serve as the primary retirement vehicle, but rather as supplemental savings plans. Their limitations have become apparent as most experts estimate that individuals require $1-1.5 million to enjoy a comfortable retirement, yet median account balances hover under $30,000—barely a year's worth of retirement income.

There is a growing consensus that in order for 401(k) plans to deliver adequate retirement income they should:

1) automatically enroll all workers at adequate contribution levels;
2) automatically invest all workers in prudent low fee investments; and
3) automatically roll over account balances until retirement.

The Department's guidance is critical to ensuring that employers, plans, advisors, and participants can achieve retirement security. Retirement experts estimate that 9 out of every 10 workers either are not financially knowledgeable or do not want responsibility for their retirement investment decisions. Default investments could become the major form of investment if proven successful. For these reasons, the Department's regulations in this area are of critical importance. The rules set out by the Department will become the standard for the industry for years to come. The Department should carefully consider how plan sponsors and investment advisors will interpret the Department's rule.

First and foremost, it is imperative that the Department be stringent in its protections for participants and beneficiaries. The Department's rule is not simply an interpretation of the fiduciary rules. It is potentially a safe harbor from liability under part 4 of ERISA. In order to obtain such relief, a fiduciary must abide by the highest standard of care not just in selecting a default investment option, but also in monitoring it. The Department's final rule must remain clear that while an employer acting as a fiduciary may not be liable when in compliance, the investment manager or other individual, who also may be a fiduciary, remains fully liable for failure to comply with ERISA.

We also submit the following specific comments on the Department's proposed rule on qualified default investments:

Rate of return – The Pension Protection Act directed the Department "to issue regulations to provide guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation." The rule preamble refers to the "rate of return" in its discussion of capital preservation and appreciation, but never discusses inflation. The primary way by which investments can preserve or increase capital is by earning returns that equal or exceed the rate of inflation. The preamble of the final rule should explicitly recognize this generally understood basis for capital preservation. Similarly, the Department repeatedly focuses on the need for retirement savings to "generate adequate retirement savings." We are concerned that this implies a duty to "beat the market" through aggressive investing. Obviously, the key to adequate retirement savings is to put aside sufficient earnings each year, not to rely on unrealistic returns. We urge the Department to clarify this point in the final rule.

Notice to participants – The Department proposes that plans may satisfy the default investment safe harbor by either providing notice to participants in the plan's "summary plan description, summary of material modification or other notice." This proposal is inadequate to meaningfully notify participants of their default investment rights. Summary plan descriptions can be over 100 pages in length and are often not provided to participants in a timely or regular manner. Participants are unlikely to look for or read an explanation buried in a long document.

Typically, 401(k) plans provide one or two page investment election forms. The Department should require that such forms and all similar notices regarding investment elections include an explanation that failure to select an option will result in a default election. Further, the periodic benefit statements and similar materials provided to participants invested in default investments should include an explanation that their investments have been selected for them in the absence of their affirmative selection and how they can exercise their right to select an investment option. The Department should issue a model notice to reduce the burden on employers and ensure that understandable information is provided to participants.

In addition to providing specific information on how and when a participant can make an affirmative investment election, notices should also inform participants of their right to obtain all default investment related information upon request.

Fees and Expenses – We applaud the Department for clearly restating its longstanding position that fiduciaries must consider fees and expenses when selecting among default investments. We further support the Department's requirement that all such fees and expenses be disclosed to participants as required by plans complying with the Department's 404(c) regulations. However, we are concerned that many plans are not complying with the existing requirement, or at least are not doing so in a clear or understandable manner. We urge the Department to carefully monitor this requirement and provide more detailed guidance under this rule and 404(c) on how to meaningfully compare, understand and document all fees and expenses affecting participant accounts to participants and beneficiaries.

Conflicts of interest – The proposed rule is silent on financial incentives that may affect a fiduciary's selection decision or the prudence of the selection of a particular investment option as a default option. Of course, fiduciaries must comply with the prohibited transaction rules, but there are widespread problems related to conflicts of interest being investigated by the Department, Securities and Exchange Commission and State Attorneys General. Abusive practices jeopardize workers' retirement savings. The Department should therefore underscore that fiduciaries must affirmatively seek to identify any and all conflicts. At a minimum, fiduciaries should be required to follow the joint guidance issued by the Department and the SEC

(Selecting and Monitoring Pension Consultants: Tips for Plan Fiduciaries). More significantly, the Department should clearly state that the employer, plan administrator and fiduciary may not receive additional financial incentives related to the selection of a default investment option, other than reasonable service fees explicitly permitted by the conflict of interest rules.

Lifecycle Funds, Balanced Funds, and Managed Accounts – The Department takes a huge step in highlighting the potential role in the default investment market of lifecycle funds, balanced funds, and managed accounts. While we understand the Department's support for this growing market, we urge you to restate and clarify that a fiduciary's duty is to select a prudent investment—regardless of whether it is a lifecycle, balanced fund, or any other vehicle. In recent months there have been a variety of pension industry reports expressing concerns about lifecycle funds that charge excessively high fees, have an inappropriate composition of "fund of fund" lifecycle funds, or instances where brokers have dumped unsellable stocks into lifecycle funds. We urge the Department to provide greater guidance to fiduciaries on ***how*** to practically carry out their fiduciary responsibilities rather than appearing to endorse certain types of investment options. By clarifying this point, the final rule would avoid enabling unknowledgeable or unconscientious fiduciaries to think selection of **any** type of lifecycle fund, balanced fund or managed account satisfies the safe harbor.

Materials Provided to Participants – The proposed rule states that "under the terms of the plan any material provided to the plan…will be provided to the participant or beneficiary." We agree that it is imperative that the appropriate fiduciary provide all default investment information to participants and beneficiaries. It is not clear why this is the only requirement in the proposed rule that needs to be included in the terms of the plan. More importantly, this requirement does not always appear to be current practice and the Department will need to monitor compliance to ensure that participants know of this right (for example through the notice requirement). Coordination amongst fiduciaries and plan administrative staff may be needed to ensure compliance with this requirement.

Documentation of Selection Process – The Department should require the fiduciary to document the default investment selection process and explain why a particular investment was selected given its risk, return and fees. The document should be retained with other plan documents and be available to participants on request. This is the surest, and possibly only, way for the Department and participants to know if fiduciaries have acted prudently.

Thank you in advance for your consideration of these comments. We urge the Department to issue final rules that adequately protect the retirement benefits of workers and retirees.

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Sincerely,

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