THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS

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

The Committee on Investment of Employee Benefit Assets (CIEBA) appreciates the opportunity to comment of the Department of Labor's proposed regulation on *Default Investment Alternatives Under Participant Directed Individual Account Plans.* CIEBA is the voice of the Association for Financial Professionals (AFP) on employee benefit plan asset management and investment issues. CIEBA represents 120 of the country's largest corporate retirement funds. Its members manage more than $1.4 trillion -- $852 in pension plan assets and $511 defined contribution plan assets. CIEBA member defined contribution plans cover 5.5 million participants.

CIEBA commends the Department of Labor for its timely release of proposed guidance to facilitate the Pension Protection Act provisions on automatic enrollment in defined contribution plans. Effective automatic enrollment programs have the potential to increase retirement security for millions of Americans. Providing guidance to and relief for fiduciaries with respect to default options is necessary for the widespread adoption of automatic enrollment in defined contribution plans.

CIEBA generally agrees with the proposed rules that a "qualified default investment alternative" (QDIA) should be diversified and managed to reflect the level of risk appropriate to the participant's demographic characteristics. Such a blend of asset classes, including both capital appreciation and capital preservation vehicles, are most likely to increase retirement savings for "defaulted" participants. We are also pleased that the proposed rules are not limited to automatic enrollment, but provide protection to fiduciaries of plans with other types of participant defaults.

Association for
Financial Professionals

7315 Wisconsin Avenue • Suite 600 West • Bethesda • Maryland 20814
Phone: 301.907.2862 • Fax: 301.907.2864
www.AFPonline.org

While CIEBA agrees with the general direction of the proposed regulation, there are several specific proposals which need clarification or improvement. The three areas of most concern are: the narrow definition of who can manage a QDIA, the notice requirement and transition 'relief'.

Definition of QDIA Manager and Related Issues

CIEBA is concerned about the requirement that a QDIA be managed by an investment manager, as defined in section 3(38) of the Act, be an investment company registered under the Investment Company or be managed on an individual basis through managed accounts. This requirement may greatly limit the ability of plan sponsors to offer cost effective, well-diversified investment alternatives tailored to their particular plan. Many plan sponsors have found that their participants are best served when the plan sponsor constructs the model asset allocation, such as target-date or target-risk funds, using the existing investment options within the plan (the "core funds") approach.

The core funds approach benefits plan participants by allowing plan sponsors to:

1. *Provide more economical (lower fee) target date or target risk funds to their participants.* Many large plan sponsors use collective trusts and/or separate accounts as their core funds. These collective trusts and separate accounts, because of economies of scale, tend to have expenses that are much lower than those of retail or even institutionally-priced mutual funds. In one study, a large plan sponsor found that it could save between 25-45% on fees by blending the core funds within its plan rather than using a typical set of target-date mutual funds.

2. *Tailor the asset allocations of the target-date or target-risk funds to the characteristics of their participant population.* Despite having the same objective, the underlying asset allocations of these funds can differ substantially, depending upon an investment firm's investment philosophy or market outlook. Further, these asset allocations do not take into account whether plan participants also have access to a defined benefit plan. Allowing plan sponsors to develop their own asset allocations ameliorates this issue by allowing the plan sponsor to keep the asset allocation tailored to the plan and its participants.

3. *Provide the "best-in-class" options within the asset allocation portfolios and optimum diversification.* Target-date or target-risk mutual funds usually limit the underlying funds within the asset allocation to the mutual funds offered by a given mutual fund family. Different mutual funds managed by the same fund family can vary significantly in terms of quality. A target-date or target-risk fund may include both excellent and mediocre funds in order to meet their diversification needs. Further, in some cases, these related mutual funds have overlapping style. This can result in target-date or target-risk mutual funds that have reduced diversification benefits. Allowing plan sponsors to select the best-in-class funds should result in lower costs and better investment funds for participants.

As worded, the proposed regulation may significantly limit the ability of plan sponsors to use a core funds approach. Under the proposal, the manager of the core funds approach would be required to: A) have the power to manage, acquire, or dispose of any asset of a plan; B) be registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the state, or be a bank or insurance company; and C) acknowledge in writing as to being a fiduciary with respect to the plan. The above requirement would exclude plan sponsors who are not registered investment advisors. Limiting the ability of plan sponsors to independently create target-date and target-risk funds is an undesirable outcome. The result of any such limitation may diminish the quality of offerings to participants, while significantly increasing their costs.

Finally there are several proposals related to QDIA that require assumption of fiduciary responsibility by outside parties. Since the plan sponsor already assumes fiduciary responsibility for core funds, these requirements provide little additional protection for participants and would result in higher costs which are not in the best interests of plan participants and beneficiaries. For example, if a plan sponsor uses an outside investment consultant to help build model asset allocation funds, and the outside consultant is required to assume fiduciary responsibility for the asset allocation, the cost of such services could increase measurably.

Notice Requirement

The proposed regulation calls for a notice to a participant 30 days prior to the first default investment. If adopted as part of the final regulation, this requirement will make it impossible for plans to provide immediate participation for new employees. Making plans impose a waiting period of 30 or more days in order to satisfy the notice requirement will reduce both participation and individual savings and negate the benefits of automatic enrollment.

The 30-day notice requirement also presents difficulties for participants who have separated from employment. They may be defaulted because of a change in investment options or other circumstances. A good faith effort by the plan sponsor to notify these participants should be recognized as satisfying the notice requirement in the final regulation.

Finally, the annual notice requirement in the proposed regulation needs clarification. As drafted, the annual notice requirement is open-ended. However, if a participant has taken an affirmative action with respect to their account, an annual notice about their participation in the default investment could be confusing. We urge the Department to clarify that the annual notice is not required after a participant has made any transaction affecting the account, such as changing contribution levels or any funds transfer.

Transition Issues

Guidance is needed on how fiduciaries are to move from existing plan default options to the new regime in order to qualify for the fiduciary relief provided by these regulations. The guidance is needed both for plans where the current default would meet the QDIA requirement and those whose default options would not qualify.

Transition for plans that have a QDIA should be relatively straightforward. All participants in the QDIA should be notified that they have the option to change investment options, but if they do nothing, they will remain in the default option. Plan fiduciaries would be covered by the fiduciary relief provided by the regulation following issuance of the notice.

Transition for plans that do not have a QDIA is more problematic. These plans should not be required to transfer participants in their current default to a new QDIA over the short term. It would be very costly for plan sponsors to identify which participants are in the default option by choice and which are not. Therefore, moving all of these participants quickly with only limited notice will create confusion for participants and generate ill will.

One possible response is for the Department to “grandfather” existing prudent default options (money market funds, stable value funds, etc.) and amounts contributed to them through December 31, 2007. Plan sponsors would then have sufficient time to create a new QDIA for contributions and transfers going forward.

Conclusion

Again, CIEBA commends the Department of Labor for its expeditious release of the proposed regulation on *Default Investment Alternatives Under Participant Directed Individual Account Plans* and appreciates the opportunity to share our views. If you have any questions regarding this letter, please feel free to contact me at (301) 961-8682 or jschub@afponline.org.

Sincerely,

Judy Schub

Judy Schub
Managing Director
CIEBA