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

Attention: Default Investment Regulation

Ladies and Gentlemen:

John Hancock Financial Services, Inc. ("John Hancock") submits its comments on the regulations proposed by the Department of Labor (the "Department") regarding default investment alternatives under participant directed individual account plans, which were published on September 27, 2006 at 71 Fed. Reg. 56806 (the "Proposed Regulation").

Through its affiliated companies, John Hancock offers insurance, annuities, mutual funds and other financial products throughout the United States. In particular, John Hancock is a major provider of retirement planning services and products to 401(k) plans, including stable value funds and related products. At present, more than 35,000 tax-qualified 401(k) plans are invested in John Hancock retirement products. Of these, more than 7,800 are invested in a John Hancock stable value fund.

John Hancock is a member of both the American Council of Life Insurers and the Stable Value Investment Association. John Hancock endorses and supports the comment letters that each of these associations is submitting in response to the Proposed Regulation. However, because we feel that the Proposed Regulation could have far reaching consequences and is based in part on questionable assumptions, John Hancock feels compelled to add this letter of comment on its own behalf.

Although John Hancock offers a variety of retirement products in the 401(k) market place that would qualify under the Proposed Regulation as "qualified default investment alternatives" or "QDIAs," including "life cycle" or "target date" funds; we feel that the Department erred in omitting stable value funds from the list of QDIAs contained in subpart (e)(5) of the Proposed Regulation. We understand that this omission was intentional; however, we believe that this omission results from a misunderstanding on the part of the Department concerning the structure and characteristics of today's stable value funds.

We applaud the Department's efforts to foster increased participation in 401(k) plans by encouraging automatic enrollment. We also endorse the goal of encouraging retirement savings and investment generally. However, we believe that the Proposed Regulation reaches an unacceptable result based on incomplete or inaccurate information and suspect assumptions. The Proposed Regulation introduces risk disproportionate to the expected rewards; assumes that all plans have equivalent needs and demographics; and effectively eliminates many of the most popular current choices of plan fiduciaries. It is founded on inflated equity premiums, ignores volatility, pre-empts fiduciaries from considering the risk tolerance levels of their constituencies, and disadvantages participants who, for any reason, do not remain invested for the very long term.

For the reasons set forth above, and below, we urge the Department to amend subpart (e)(5) of the Proposed Regulation to include a fourth category of QDIA, which might be described as follows:

- (iv) An investment fund product designed to preserve principal and pay a reasonable rate of return supported by a contract with a credit worthy bank or insurance company that provides book value payouts for participant upon withdrawals from the fund.

In support of the foregoing change to the Proposed Regulation, we urge the Department to consider the following arguments and data.

Stable Value Funds Are Superior to Money Market Funds and Other Cash Equivalents

In the preamble to the Proposed Regulation, the Department clearly states that it considered "near risk-free fixed income instruments" including "money market funds, certain bank deposits, and stable value insurance products." The Department also makes clear that such products were rejected because, in its opinion, "including such instruments would be more likely to erode benefits than to increase them."

Stable value funds provide a unique combination of benefits including the investment returns of an intermediate investment-grade bond fund (superior to money market fund returns), the daily liquidity for plan participant withdrawals (equivalent to that of a money market fund), and stability of principal without price volatility (equivalent to money market funds).

Over the last 24 years, stable value funds have earned a consistently positive return, higher than money market funds and 90-day Treasuries. Historically, since January 1, 1983, stable value funds have delivered average annual returns of 7.28%, more than 200 basis points per annum over T-Bills,¹ with less volatility than T-Bills. Over the same time period, stable value funds have beaten inflation by 411 basis points on an

¹ Average annualized monthly return of the Hueler Companies' FirstSource Separate Account Stable Value Index vs. 3-mos T-Bills for the period January 1983 – September 2006.

annualized basis,² and outperformed T-Bills in 282 out of 285 months (99% of the time).³ By September 2006, an individual who invested in stable value funds in 1983 rather than 90 day T-Bills would have received an additional 58% cumulative return.⁴ The track record of stable value funds does not support the Department's conclusion that they erode rather than increase participant benefits.

Stable Value Funds are Superior to Balanced Funds

On the other hand, the Department wrote that it elected to include balanced funds that provide "a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole." The Department admitted that while the risk level of a balanced fund "may be appropriate for all affected participants it is unlikely to be optimal for all." Nevertheless, the Department felt confident that such a model has enough advantages to merit inclusion as a QDIA. Among other things, the Department wrote that such products "may be simpler, less expensive and easier to explain and understand" and that inclusion "might help heighten competition in the market place and thereby enhance product quality and affordability" The same could be said of stable value funds.

Stable value funds have relatively low costs compared to balanced funds, particularly those that use a "fund of funds" structure. According to a 2004 study by IOMA, Inc., annual fees for stable value funds average 42 basis points, compared to 78 basis points for balanced funds.⁵ In addition, as already stated, stable value funds have a proven track record over the last 23 years -- consistently providing a positive return which exceeds the rate of inflation.⁶ What could be simpler, less expensive and easier to explain and understand than an account that provides a guaranteed positive rate of return and guarantees the individual participant's right to withdraw his/her account balance?

Furthermore, the history of stable value funds compares favorably with balanced funds, especially when one considers the risk-reward characteristics or volatility of each. Since January 1, 1983, a 70% equity/30% fixed income balanced portfolio would have had negative returns 92 out of 285 months (32% of the time)⁷, while a stable value fund would have had none.

2 Hueler Companies' FirstSource Separate Account Stable Value Index vs. CPIU annualized for the period from January 1, 1983 through September 30, 2006.

3 See footnote 1.

4 Ibid.

5 Plans in Transition: IOMA's Annual Defined Contribution Survey (2004). Similarly, a more recent study focused on life cycle funds found the total average expense ratio on such funds (including the costs of the underlying funds) to be 71 basis points. Turnstone Advisory Group LLC, Popping the Hood: An Analysis of Major Life Cycle Fund Firms, Appendix B (2006).

6 See footnotes 1 and 2 above.

7 Returns for a hypothetical 70/30% balanced fund are based on the weighted average of the S&P 500 Index and the Lehman Brothers Aggregate Bond Index for this time period.

The proposed Regulation Overstates Equity Returns and Understates Volatility

We agree with the Department that over the very long term of 78 years cited by the Department,⁸ the historical average return on equity investments has been superior to the return on most other investment classes, including stable value funds, balanced funds and money market funds. However, there have been many changes to the markets during this period, stable value funds have not existed for that entire time period, and few if any investors remain invested that long.

First, we note that a 78 year investment horizon may overstate results, and a significantly shorter investment horizon is probably more appropriate. Indeed, strong arguments can be made that the past 15-20 years is more representative of current market conditions, and therefore a more appropriate basis for the Department's assumptions. The Department's peer reviewers also commented on this when they criticized the assumed equity premium as excessive. Professor Laibson comments that the assumed 6.5% premium is not expected by most economists in the near future, and recommends a smaller premium.⁹ Ms. Liang suggests an equity premium of around 2.00%, and states "the equity premium that has been realized since 1926 is higher than can be justified by reasonable levels of investor risk aversion or risk under many asset pricing models."¹⁰

Second, we believe that volatility can and should be an important consideration for plan participants, and therefore also for fiduciaries when considering a default investment option. Sudden and sharp declines in retirement plan investments can, depending on the timing, place retirement income at risk. For example, from January 1983 (the first date that the Hueler Companies stable value index is available) through September 2006, the S&P 500 recorded negative returns in 100 months out of 285 months, or 35% of the time. In fact, over some extended time periods, stable value funds have out-performed equities. For the period January 1998 through September 2006, stable value fund returns (as measured by the Hueler Companies stable value index) exceeded the returns of the S&P 500 by 5.47% to 5.35%.

Protection from downside risk is important, particularly for those participants who may be close to retirement age, for lower income workers with few other financial assets and the need to access savings, or for participants who may be withdrawing their plan benefits soon for other reasons.¹¹ For these people, stable value funds may, depending

⁸ We acknowledge that the estimated return on the types of funds covered in the Proposed Regulation is based on returns over a 78-year period, from 1926 to 2004 from the Ibbotson Associates Stocks, Bonds, Bills and Inflation 2005 Yearbook.

⁹ Peer Review for Default Investment Safe Harbor Regulation Department of Labor by Prof. David Laibson, Harvard University, June 5, 2006.

¹⁰ Peer Review for Default Investment Safe Harbor Regulation Department of Labor by Nellie Liang, Federal Reserve, June 2006.

¹¹ According to one of the peer reviewers of the economic model used to assess the effects of the proposed regulation, "For lower income workers with few other financial assets, the additional volatility in pension balances [from using higher-risk investments] might be especially costly." Peer Review for Default Investment Safe Harbor Regulation Department of Labor by Nellie Liang, Board of Governors of the Federal Reserve System, at 2 (June 2006).

on circumstances and market conditions, be better able to preserve future retirement income and prevent the erosion of benefits than the types of funds currently covered under the QDIA definition. Stable value funds have significantly less volatility than investments with equity components:¹²

Annualized Standard Deviation (as of 9/30/06)					
	5-Years	Jan 98-Sept 06	10-Years	15-Years	Jan 83-Sept 06
S&P 500	12.74	15.39	15.52	13.81	14.73
70/30 S&P 500/LB Agg	8.62	10.60	10.83	9.82	10.67
Hueler SVF Pooled Index	0.16	0.24	0.24	0.25	0.57

Principal preservation and liquidity are especially important features for default investment options. No one should assume that individuals who are default participants will ever track or understand their 401(k) default investments or make a future affirmative investment election. To the extent that the class of default participants includes people with limited retirement savings and no other retirement plan, it is inappropriate for the Department to encourage plan fiduciaries to gamble on the stock market with the monies which may constitute a participant’s sole supplement to social security.

On the other hand, the likelihood that significant numbers of these participants will transfer out is significant. Many default investors are inexperienced and, for various reasons, do drop out or minimize contributions. Dallas L. Salisbury, president and chief executive of the nonprofit Employee Benefit Research Institute, was quoted in the Boston Globe on October 1, 2006 as “concerned that employees who cash out of their retirement account in the short term will be subject to wild swings in the market and could end up losing money.”¹³ According to Washington Post columnist Michelle Singletary, “Salisbury said the options should allow plan sponsors to default to the more conservative money market and stable value funds . . . given that many employees with relatively small amounts of money in their 401(k)s do cash out when they change jobs.”¹⁴ Other evidence shows that nearly 30% of participants who are initially 100% invested in their plan’s default option transfer out of that default investment option within 3 years.¹⁵ Thus, one unintended consequence of the Proposed Regulation is that it exposes nearly 30% of default participants to short-term market risk. Stable value funds minimize this risk, while providing reasonable rates of return.

¹² MPI Stylus, as of September 30, 2006.

¹³ “A forced 401(k)? Not a bad idea at all” by Michelle Singletary, Boston Globe (October 1, 2006).

¹⁴ Ibid.

¹⁵ See Building Futures Volume VII, published (2006) by Fidelity Investments, at page 137, reporting on the experience of the Fidelity data base.

The Proposed Regulation Assumes that One Size Fits All and Eliminates A Fiduciary's Ability to Choose QDIAs that Meet the Needs of Its Constituency

Stable value investment options are included in more than two-thirds of employee-directed 401(k) plans,¹⁶ and represent over 33 percent of the assets of those plans. In fact, as a percent of total plan assets, stable value funds have modestly increased over the past few years. This is the result of several causes: the aging (and increasingly risk averse attitude) of baby boomers; an extended bear stock market since early 2000, which illustrates the volatility of equity assets and has caused a decrease in equity assets in most defined contribution plans; and a decline in interest rates, which has made money market funds less appealing. Each of these factors illustrates a reason why plan fiduciaries should be permitted a QDIA choice that emphasizes capital preservation while providing reasonable opportunity for capital appreciation. The population invested in stable value includes both default and non-default participants. There is no basis for concluding that the risk tolerance and demographics of default participants is significantly different from this class of participants as a whole.

In its regulations on automatic rollovers (published at 69 Fed. Reg. 58018) and termination of abandoned individual account plans (published at 71 Fed. Reg. 20820), the Department provided relief from ERISA's fiduciary responsibility rules for the use of principal-protected funds, such as stable value funds. The final regulations at 29 C.F.R. 2550.404a-2 provide that a roll over IRA must be invested in products designed to "preserve principal and provide a reasonable rate of return . . . consistent with liquidity." We believe that participants who would be defaulted participants and thus affected by the Proposed Regulation are comparable to those individuals covered aforementioned IRA regulations, and are just as concerned with safety, volatility and liquidity. The Proposed Regulation represents a disturbing departure from prior guidance in related areas, and a surprising willingness to expose the unwary to market volatility.

Plan fiduciaries should be allowed broader latitude to consider the unique characteristics of their default population when selecting a default option. The Department's regulations permit the plan fiduciaries to consider the demographics of individual participants in selecting an appropriate default option (for example, in selecting an appropriate lifestyle fund for a particular participant and through a managed account). Similarly, plan fiduciaries are permitted to consider the demographics of the plan's population as a whole in the context of selecting an appropriate balanced fund QDIA. However, the Proposed Regulation does not permit a fiduciary to consider the characteristics of those participants who are least likely to provide instructions where those participants, as a group, may differ significantly from the plan's population as a whole. Final regulations should allow fiduciaries to consider the unique characteristics of this participant group in identifying an appropriate default investment option. For many plans, we believe that those participants least likely to provide investment instructions are young participants, far from retirement, who may change jobs frequently. For these participants, an investment option that cannot decline in value, is both liquid and insulated from short-term market volatility, may well be the best choice.

¹⁶ See Deloitte Consulting LLP & Pensions & Investments, 2004 Annual 401(k) Benchmarking Survey, at page 19 (77% of plans offer stable value as a "core" investment option).

The Department's emphasis should be on encouraging automatic enrollment programs. The Department should permit plan fiduciaries greater latitude to make reasonable choices for default investment options, that (in the judgment of the relevant fiduciary) are designed to encourage greater participation generally and discourage opt outs. If contribution rates are even slightly affected by periods of portfolio losses (which do occur with equity options and balanced options) then the benefits expected by the Department are suspect. Evidence shows that increased contribution rates, not asset allocation, is the primary driver for generating increased retirement savings.¹⁷ Thus, if limited default investment choices discourage plans from implementing automatic enrollment, or if default participants later react negatively to volatile equity performance by opting out when investment losses occur, the Proposed Regulation may ultimately decrease retirement savings and the potential gains expected from funds with higher historical long-term performance records will not materialize.

Other Potential Adverse Consequences of the Proposed Regulation

We whole heartedly agree with the Department' that the Proposed Regulation "is both intended and expected to tilt plan sponsors' default investment preferences away from [other] instruments and toward the three types it embraces." We too expect that the Proposed Regulation will encourage plan fiduciaries to adopt new default investment options and to move monies out of existing default investment options, notwithstanding language in the preamble to the Proposed Regulation that some plans might continue to use existing default options after adoption of the Proposed Regulation.

This is a particular problem for stable value funds, and therefore, a potential problem for a significant percentage of current default participants.¹⁸ We are concerned about the potential market disruption that could occur if the Department's regulations do not permit a full range of fixed income-type investment vehicles as appropriate default investments. In this regard, we anticipate that plan sponsors who currently use stable value or other default options not included as QDIAs under the Proposed Regulation, would seek to move those investments into a QDIA shortly after the Department publishes its final regulations. This would mean that billions of dollars in 401(k) plan assets would be moved over a relatively short time to investment products that qualify for QDIA treatment. Such a massive shift of assets could exert inflationary pressure on those "equity-based" products. Plans will also incur significant expenses in the form of required notifications, administrative and transaction costs and processing fees, all of which will reduce participant account balances and investment returns.

¹⁷ See Defined Contributions Plans – Missing the Forest for the Trees by Putnam Investments August 2006, which shows that, over a period of 16 years a 1% change in contributions has twice the effect on accumulations as moving from a conservative portfolio to a growth portfolio.

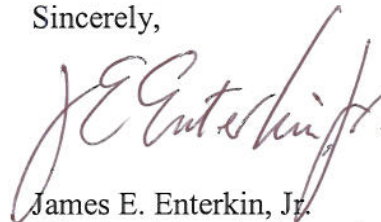
¹⁸ Fidelity reports that, in its data base, plans with a stable value default investment option represent 27% of all participants in the data base, and plans with a money market default investment option represent 24% of all participants in the data base. See Building Futures Volume VII, published (2006) by Fidelity Investments, at pages 124 and 125. Fidelity also estimates that among plans with a stable value default investment option, 62% of all participants who have a single investment option are invested in that default option, and of those participants 45% were defaulted in (whereas 17% elected in). The comparable figures for money market fund default investment options are 52%, with 41% defaulted in (and 11% electing in). See Building Futures Volume VII, published (2006) by Fidelity Investments, at page 135.

There may be additional unanticipated consequences of a decision by fiduciaries to move default monies currently invested in stable value funds. Stable value funds generally guarantee the value available for withdrawals by plan participants; however, most funds impose a “market value adjustment” in the event that a plan or plan sponsor initiates a withdrawal from the fund, if the portfolio value of the assets be less than book value. If so, then the amount that can be withdrawn may be limited to the market value of the underlying fund investments, and/or subject to delays of up to 12 months. If the Proposed Regulation remains unchanged, and if (as expected) it encourages plan sponsors to shift existing default investments out of stable value funds, those transfers would not constitute qualified participant withdrawals (which are guaranteed for prompt payment at book value). Assuming that a stable value fund’s book value exceeds the market value of its portfolio at that time, it would be imprudent and inequitable for the fund to waive its Market value adjustment provisions. Such provisions are designed to protect the remaining participants in the stable value fund from dilution of their investment. Any large payout in excess of market value means that disproportionately fewer assets remain to support the fund’s continuing book value obligations, which in turn will depress future crediting rates for those continuing investors. Given the large number of plans now using stable value funds as their default investment option, and the large number of participants invested in stable value funds (both by choice and by default), if the final regulation fails to include stable value funds within the definition of QDIAs, significant numbers of existing plan participants may be adversely affected.

Conclusion

For all of the foregoing reasons, and the reasons described by the ACLI and the SVIA in their comment letters, we urge the Department to amend subpart (e)(5) of the Proposed Regulation to include stable value funds as a fourth category of QDIA.

Sincerely,

A handwritten signature in dark ink, appearing to read "J. E. Enterkin, Jr.", written in a cursive style.

James E. Enterkin, Jr.
Vice President & Counsel