Prudential Financial

Scott G. Sleyster
Executive Vice President
Prudential Retirement

The Prudential Insurance Company of America
280 Trumbull Street, H17A, Hartford CT 06103-2795
Tel 860 534-8888 Fax 860-534-2614
scott.sleyster@prudential.com

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

Re: Comments on Proposed Regulations on Default Investment Alternatives
Under Participant Directed Individual Account Plans
[RIN 1210-AB10]

Ladies and Gentlemen:

Prudential Financial ("Prudential") is a leading provider of retirement services for public, private, and non-profit organizations. With over 80 years of retirement experience, Prudential meets the needs of over two million defined contribution plan participants and more than one million defined benefit plan participants and annuitants. We value this opportunity to comment on the proposed regulations on qualified default investment alternatives ("QDIAs") released by the Department of Labor (the "Department") on September 27, 2006, 71 Fed. Reg. 56806 (the "Regulation" or "Regulations").

We share the Department's view that providing workable rules for obtaining fiduciary relief in connection with selecting default investments will create a more positive environment for employers to adopt and utilize automatic enrollment features and will result in increased savings and retirement security for workers and their families. We believe that the Department's proposed rules represent a good first step toward achieving these objectives. However, we believe there are several important areas – which we have set forth below – where the Department should expand, clarify or revise the rules so that the final Regulations may enable plan sponsors and participants to achieve the above-stated objectives.
Finally, having had the opportunity to review the comments being submitted to the Department by various trade associations, we want to state our endorsement of the letters of the American Council of Life Insurers, the American Benefits Council, the Stable Value Investment Association and the Committee of Annuity Insurers.

DEFINITION OF QUALIFIED DEFAULT INVESTMENT ALTERNATIVES ("QDIAs") SHOULD INCLUDE CAPITAL PRESERVATION FUNDS

Section 624(a) of the Pension Protection Act of 2006 (the "PPA") states that default investments should "include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both". We are disappointed that the proposed Regulation fails to include as a QDIA any investment that is dedicated to the preservation or protection of principal or guarantee of capital. We believe that expanding the Regulation to include these investment alternatives is appropriate and fully consistent with the goals of the legislation. Clearly, if Congress meant to exclude stable value funds from a list of QDIAs, it would not have included them in its statutory language listing of appropriate default investments.

CONTINUED USE OF STABLE VALUE FUNDS, WIDELY USED BY PLAN SPONSORS, SHOULD BE ENCOURAGED.

As the Department has acknowledged, plan sponsors have shown a widespread preference for stable value as a default investment. According to a survey of 1,900 defined contribution plan sponsors undertaken by Vanguard Center for Retirement Research, more than 81 percent of those plans that offered default investment options selected a principal protected vehicle for default investments. While some plan sponsors may have been influenced in this selection by fiduciary liability concerns, we think many plan sponsors have made this choice based upon stable value funds' unique characteristics of providing a guaranteed rate of return coupled with protection of principal, liquidity and typically low expense ratios.

There are numerous default investment situations where principal protected funds are best situated to play a significant and prominent role. For example, employers with groupings of older participants who may be approaching retirement should have the opportunity to use either a stable value or guaranteed target maturity/asset allocation fund alternative as a QDIA. As well, plan sponsors who employ younger workers in more mobile industries should be permitted to designate principal protected funds as default investments.

With the shift of investment risk to participants who are increasingly more dependent on their defined contribution plan as their primary retirement income vehicle, the determination of whether to offer principal protected default investments should be based upon an evaluation of the importance of removing the cyclical market and investment risk and volatility impacts that could arise at a participant's retirement or distribution date while also offering guaranteed returns commensurate with the objective of maximizing accumulations for retirement. In any case, employers and plan sponsors are in the best position to judge the extent to which principal protected and capital guaranteed products would benefit their participants and the Regulations should offer them the opportunity to make that judgment.

FAILURE TO INCLUDE STABLE VALUE FUNDS SENDS AN INAPPROPRIATE MESSAGE TO PLAN SPONSORS.

We are concerned that despite the positive attributes and features of stable value funds, the Department's failure to include them as a QDIA will send the strong - and wrong -message to plan sponsors that a stable value investment is an imprudent choice, both as a default investment and as an investment option for participants making affirmative investment elections. And, we do not think this message will be

overcome by language in the Regulation's preamble that selection of a QDIA is not the exclusive means by which a fiduciary may satisfy his or her responsibilities under ERISA.
Additionally, we urge the Department to consider the potential for market disruption caused by an implication that a stable value investment is an imprudent choice. Plan fiduciaries might feel compelled to redirect amounts currently invested in - as well as future contributions to - stable value funds. This, in turn, could create cash flow and liquidity interruptions and cause interest crediting rates to drop. This would arguably result in lower returns on stable value funds, dissuading participants who have affirmatively chosen such funds from continuing their use.

THE DEPARTMENT'S FAILURE TO INCLUDE STABLE VALUE FUNDS AS A QDIA IS INCONSISTENT WITH ITS PRIOR POSITIONS AND RESEARCH.

The Department's failure to include principal protected funds as a QDIA is puzzling in light of the Department's prior recognition that fiduciaries who select such funds for other purposes will satisfy their fiduciary obligations under ERISA. Specifically, the Department's automatic rollover safe harbor deems that a plan fiduciary will satisfy his or her fiduciary obligations in connection with automatic rollovers of certain mandatory distributions if the distribution is rolled over into an individual retirement account which is invested in a product designed to "preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity." Similarly, the Department reiterated its favorable position on the use of capital preservation investment vehicles for the distribution and investment of account balances of missing participants in connection with certain defined contribution plan terminations. See DOL Field Assistance Bulletin 2004-02 (Sept. 30, 2004); 29 C.F.R. § 2550.404a-3 (Safe Harbor for Distributions from Terminated Individual Account Plans).

We urge the Department to consider whether its decision to exclude principal protected investments is based on assumptions on both returns and retiree time horizons that are inconsistent with the Department's own research and peer review process. We understand that the Department commissioned three peer reviews of its assumptions. Among the significant results of the peer reviews is that none of them support the high equity risk premium that the Department apparently relied upon as a key factor in excluding principal protected investments.

THE REGULATION WOULD HAVE A CHILLING EFFECT ON THE DEVELOPMENT OF NEW PRODUCTS.

We ask the Department to be mindful of the chilling affect that its proposed restrictions on QDIAs may have on the development of new equity based products that carry insurance company guarantees. These products provide a level of guaranteed income for life with the potential for upside participation based upon market performance. Variations of these new products may relate equity and fixed income/stable value exposures to a participant's age. Many plan sponsors have expressed a strong interest in offering such products as default investments for their participants. As currently drafted, the Regulation appears to exclude as a QDIA an investment that incorporates a guarantee from an insurer's general account, which is used in some cases. We fail to see any basis for such an exclusion and ask the Department to correct this matter in the final Regulation.

PRODUCTS WITH INVESTMENT GOALS SIMILAR TO THOSE OF ELIGIBLE QDIAS, SUCH AS MODEL ASSET ALLOCATION PORTFOLIOS, SHOULD BE INCLUDED

The Department's Regulation inappropriately excludes investment products and services with investment goals appropriate for default investments merely because they are not, in and of themselves, registered investment companies (mutual funds) or managed by an investment manager as defined in Section 3(38) of ERISA. Many stable value investment alternatives are offered under contracts guaranteed by insurance company general accounts; they are not separately managed by an investment manager. Other prudent investment alternatives include model asset allocation portfolios (described in Department of Labor Interpretative Bulletin 96-1) and managed accounts (i.e. the "Discretionary Asset Allocation Service" described in the Department's Advisory Opinion 2001-09A) that may include mutual funds but are not themselves registered investment companies or managed by an investment manager. <u>These investment alternatives in all material respects meet the descriptions contained in Section 29 CFR Section 2550.404c-5(e)(5) to qualify as a QDIA but for the absence of an investment manager or mutual fund structure.</u> Limiting QDIAs to registered investment companies, or to investments managed by an investment manager would have the impact of discouraging the use of prudent and appropriate investments which otherwise meet the design requirements specified in the Regulation**.**

COMPUTER DRIVEN MODEL ASSET ALLOCATION PROGRAMS SHOULD BE PERMITTED

We ask the Department to recognize that many plans offer managed account asset allocation models that are in substance QDIAs but fall outside the structural limits of the Regulation. It is common for these investments to be selected through the deployment of computer driven model asset allocation programs. The funds that are part of these fee-efficient model asset allocations consist solely of funds that are available under a plan that are selected by the plan's fiduciary as appropriate investment alternatives for plan participants. The model portfolio is derived by a computer program that is developed by an independent third-party investment expert who may or may not have a direct relationship with the plan (and certainly no contractual relationship with the plan).

The structural limits on QDIAs in the Regulations imply that a QDIA can only be constructed by a person who is both a fiduciary and an investment expert. That notion is inconsistent with the basic fabric of ERISA. While plan sponsors (or other fiduciaries) have responsibility for designating and monitoring the investment options that are available under a plan and may exercise active investment management over the underlying assets of the plan, nothing in ERISA requires the sponsor to be an investment expert. Similarly, there is no reason under ERISA that a plan fiduciary may not select a participant-level model portfolio/asset allocation program or managed account program, as the plan's designated default investment. Similarly, it is appropriate for a sponsor to choose an asset allocation program with a specific model portfolio that is most suitable for a given cohort of plan participants. For these reasons, Prudential urges that computer-driven model asset allocations and managed account programs be eligible as QDIAs if a plan fiduciary has approved the asset allocations and the allocations were developed with the input of an investment adviser.

NOTICE

The Pension Protection Act also added notice requirements under Section 404(c)(5)(B)(i) and (ii) of ERISA. The requirement to provide notice to participants at least 30 days before contributions are applied to default investments is incompatible with immediate participation plans. We suggest that the Regulations adopt a more flexible standard that would require advance notice to be provided within a reasonable period of time following the date that the participant or beneficiary becomes eligible. For purposes of determining “reasonable”, we suggest using the time period during which employees are given an opportunity to change and/or decline participation in an automatic contribution arrangement after contributions first commence.

We also ask the Department to confirm that the annual notice requirement may be satisfied through the use of other documents such as the summary plan description or quarterly benefits statement and need not be a stand alone notice. Specific investment and diversification information that PPA requires to be a part of quarterly benefit statements will serve as a much better personalized reminder to participants to explore the options available to them with regard to diversification and will serve to encourage active decision making by participants and beneficiaries. To require sponsors to send another notice to participants will cause unnecessary costs and administrative burdens to be incurred by plans.

TRANSITIONAL RELIEF

The Department should be mindful of the need for relief by plan sponsors who chose default investments for their participants prior to the passage of PPA. We suggest that any new requirements be applied prospectively only. In many instances, the identity of participants for whom default investments are being made is not available. Thus, it is essential that the final Regulations provide a workable method of obtaining fiduciary relief with respect to both existing participants and existing defaults investments that are not QDIAs.

Prudential would like to thank the Department for its interest and attention to these most important issues and concerns.

Sincerely,

Scott G. Sleyster