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VIA E-MAIL

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

RE: Proposed Default Investment Regulation

I understand that the Department of Labor will soon be finalizing regulations regarding appropriate qualified default investment alternatives (QDIA). I have previously commented to the department in this regard, but wanted to add a few additional thoughts on why stable value funds should not be included in the list of QDIAs. I'll keep my comments brief. I am a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries with 35 years experience in defined benefit and defined contribution plan markets. Among other positions, I have headed the Portfolio Strategy Group and the Stable Value Products Group for two major insurance companies.

I understand that supporters of stable value funds have argued that stable value should be allowed as a QDIA in situations where plan participants are either close to retirement or are perceived as likely to withdraw their balances from the plan in the near future due to job changes. For reasons that I will explain below, using stable value as a QDIA in these situations may gravely and adversely affect other plan participants who use stable value with a longer investment horizon. If preservation of capital is deemed to be of critical importance, the better option would be a money market fund.

For the most part, stable value funds invest in short-to-intermediate term fixed income instruments with an average portfolio duration of 2.5 to 4.5 years. The stable value fund provider maintains two "sets of book." One set of books keeps track of the actual market value of the investment portfolio acquired by contributions made to the stable value fund. This set of books is (normally) not reported to plan participants at all, but may be reported to the plan sponsor. The second set of books keeps track of deposits to, less withdrawals from, plus interest credited to, the stable value fund. This second set of books is what is reported to plan participants. The credited interest rate is determined periodically, normally be formula, in a way so that any difference between the first set of books (actual market value of the underlying asset portfolio) and the second set of books will be eliminated over time.

If a stable value fund is offered as a QDIA to participants who are expected to be removing their assets from the plan in the very near future, the credited rate setting process described above will result in increased volatility in the credited rate. In a rising interest rate environment, this action would have a potentially very damaging effect on the credited rate paid to other plan participants using the stable value fund over a longer investment horizon. The damage is caused both by minimizing the amount of new investments acquired as interest rates rise as well as by generating capital losses (which will need to be recovered by reducing future credited interest rates) on amounts liquidated to pay benefits to the participants defaulted to the stable value fund because of their impending withdrawal from the plan.

If the Department does allow stable value funds to be offered as a QDIA, then I believe it should also require one of the two following conditions be satisfied: either (i) require complete disclosure to plan participants of the potential impact that impending withdrawals by the defaulted group may have on future credited rates, or (ii) require a separate (from the plan's "normal" stable value option) stable value fund be established for use only by the group defaulted into the stable value fund.

The disclosure required by (i) is problematic in that it may be difficult to present simply, effectively, and in a manner for plan participants to fully understand. The condition required by (ii) is more straight forward in protecting all plan participants' interests and, if implemented, would likely result in a much shorter duration underlying portfolio for the stable value fund used as a QDIA. In fact, the duration of the QDIA stable value fund is likely to be so short that its performance would not be expected to differ significantly from that a money market fund. Hence, using a money market fund as a QDIA is probably the most cost effective and equitable solution for those situations where withdrawal from the plan is anticipated in the near future.

In the interest of brevity, I'll stop my comments here.

WAMA greatly appreciates the opportunity to provide these comments. If the Department is interested in discussing any of the above in greater detail, or if WAMA can be of any further assistance, please either call me at (860) 306 – 9205 or e-mail me at jake.auger@wamallc.com.

Respectfully submitted,

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