SIFMA
Securities Industry and
Financial Markets Association

January 31, 2007

The Honorable Bradford Campbell
Acting Assistant Secretary
Employee Benefits Security Administration
Suite S-2524
U.S Department of Labor
200 Constitution Ave. N.W.
Washington, D.C. 20210

Re: Response to Request for Information Regarding Computer Models for the Provision of Investment Advice to 401(k) Plans

Dear Acting Assistant Secretary Campbell:

On behalf of the Securities Industry and Financial Markets Association ("SIFMA")[1], I am writing to respond to the Department's Request for Information (RFI) in connection with computer models for the provision of investment advice to 401(k) plans. We believe that SIFMA is in a unique position to provide information to the Department because its member firms provide advice directly, or through their affiliated investment advisors, or in connection with their registered mutual funds, recordkeepers or banks and trust companies. Thus, the major providers of investment education and advice are either members of SIFMA or affiliated with members of SIFMA. That fact permits SIFMA to draw upon the broadest base of experience and knowledge relating to advice and investment education of any other single institution. We appreciate the opportunity to respond to this RFI and look forward to continuing to work with the Department as it completes its required review of computer models for investment advice under the Pension Protection Act of 2006.

Computer Model Certification

1. What procedures and information would be necessary and adequate to determine whether a computer model used in connection with an investment advice program satisfies the criteria described in ERISA section 408(g)(3)(B)? For example, would it be necessary to examine underlying computer programs/algorithms, computer software/hardware, or input data including investment-specific information; would it be possible to make a determination based on the results of applying the investment advice program to a sample set of the input data? (Commenters are requested to explain by

[1] SIFMA is the product of a recent merger of the Securities Industry Association ("SIA") and the Bond Market Association. SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

reference to each of the five computer model characteristics described in section 408(g) (3) (B), summarized above.)

In our members' view, one can determine whether a computer model used in connection with an investment advice program satisfies the criteria described in ERISA section 408(g)(3)(B) by looking at the results of applying the program to a sample set of the input data. Models are based on mean variance optimization, and the program uses expected volatility and expected return, based on historical performance, to provide asset allocation and investment product results. Testing the model using a series of inputs designed to ensure that the model is not inappropriately weighted or slanted toward investments offered by the fiduciary advisor is the most straightforward method of making the determination required by each of the subsections set forth below. Any review of computer models should have enough flexibility to permit different types of models and a different range of goals.

(i) Applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time.

(ii) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments,

(iii) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan,

(iv) operates in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser, and

(v) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

2. What types (e.g., technological, financial, other) and levels (e.g., educational, professional experience, professional certification) of expertise would be required to determine whether a computer model used in connection with an investment advice program satisfies the criteria described in ERISA section 408(g)(3)(B)? (Commenters are requested to explain by reference to each of the five computer model characteristics described in section 408(g) (3)(B), summarized above.)

SIFMA members believe that any investment professional consulting firm with experience in assessing models and with familiarity with computer systems (or people within a financial institution with similar backgrounds) should be able to determine whether a computer model used in connection with an investment advice program satisfies the criteria described in section 408(g)(3)(B). One would expect such individuals to have advanced math or engineering backgrounds and employment experience in the financial industry.

SIFMA would note that the statutory language relating to "expert" does not use the term fiduciary. This was an intentional move by Congress to ensure that there would be numerous entities able to offer their services as certifiers and auditors of computer models. Currently, there are only a handful of firms who will create a model that meets the requirements of the Sun America Advisory Opinion because of the potential fiduciary liability. A computer-based model exemption that required the certifier to accept liability would drastically reduce the number of firms willing to certify models. This would lead to very little competition in the marketplace and higher costs for the plans and the participants.

3. With respect to currently-available computer models or programs for providing investment advice to plan participants or beneficiaries in the form of asset allocation portfolios comprised of plan investment options:

a. What is the process for designing, developing and implementing the computer model/program? What parties are involved, and what are their roles? What hardware and software technologies are used to construct computer model investment advice programs? What direct economic costs are associated with the process for designing, developing and implementing the computer model/program?

As noted above, an investment professional consulting firm with experience in assessing models and with familiarity with computer systems (or employees of the financial institution with equivalent experience and expertise) is generally responsible for developing the model. The process used for designing the model is quite straightforward. The model is loaded with risk and return characteristics for each asset class represented in the plan, based on publicly available historical information. Then the optimizer is programmed to constrain the results to accommodate the available options under the plan. The economic costs relate to the cost of the system and its capacity to run variations, and the cost of the data inputs from a third party source.

b. What types of modifications are made to the computer model/program after use has begun? Why and how often are the modifications made (e.g., changes in methodology, technology, economy, marketplace, or plan), and how do the modifications affect the investment advice provided? What parties are involved in the modification process, and what are their roles? What direct economic costs may be associated with the modifications?

Generally on an annual basis, new and updated investment data is programmed into the model, as well as changes in options under a particular plan. Changes in methodology or technology would be made far more rarely. Investment consultants are generally the individuals involved in keeping the models current and working properly.

c. What economic costs and benefits are associated with the use of the computer model/program for providing investment advice, including changes in investment performance and in retirement wealth due to the provision of such advice? What are the indirect costs and benefits, such as impact on markets for financial services, including investment advice services, and impact on financial markets, including demand for and pricing of securities?

Computer models are an additional method of approaching participants and helping them devise an investment strategy. Where models are the exclusive delivery system, they allow participants, without time constraints or investment consultant availability constraints, to vary the inputs into the model to find a comfortable investment strategy. Where models are used in conjunction with investment professionals, they help to standardize and guide the results. It would not appear that models would have any effect on the demand for and pricing of securities.

4. Would the responses to 3.a., 3.b., or 3.c. differ in the case of a computer model/investment advice program intended to satisfy the requirements of ERISA section 408(g)(3)(B)?

Other than the cost of certification, which would likely increase the cost of the advice to the participants, we think that the responses to 3 a., b. and c. would be largely the same. The more onerous the certification conditions, the greater the cost of providing advice and the less available the advice would be. In this connection, we think the Department should pay special attention to the material affiliation requirement in the statute because of the consolidation in the industry and the possibility that certification could be provided by discrete units of a financial institution, where the rest of the institution does business with other providers of advice. In our view, an entity should not be deemed to be affiliated with another if ownership between them is 20% or less, and if the certifying entity receives less than 20% of its revenue from the institution sponsoring the model.

5. With respect to the Department's development of regulatory guidance, what special considerations, if any, should be made for small businesses or other small entities? Are there unique costs and benefits for small businesses or other small entities?

The cost of certifying the models may well exclude small businesses from offering advice using computer models, other than "off the shelf" models. The Department should permit off the shelf models to be exempt from certification, and should deem a model to be "off the shelf" if it has been licensed or sold to at least three fiduciary advisors. Changes to the model to accommodate plan options should not require certification.

Model Form for Disclosure of Fees and Other Compensation

1. In general, what types of information relating to fees received by fiduciary advisers and their affiliates would be helpful to participants and beneficiaries in making their investment decisions?

SIFMA believes that a participant is entitled to fully understand the advisory fee charged to his or her account, the asset management fees on any mutual fund or collective trust, any revenue sharing from nonproprietary mutual funds or collective trusts, and the commissions charged, if any, on the purchase of any individual security (and not the commissions charged by the collective trust or other pooled fund). The material should be factual and straightforward so that a participant can readily understand it without being overwhelmed with detail.

2. What types of fees and compensation (including those provided by third parties) would be encompassed by ERISA section 408(g) (6 (A (iii)? In relevant part, this provision refers to ``all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property."

We think this language would include the asset management fees of a mutual fund, the fees charged by other pooled funds, revenue sharing, 12b-1 fees and other service fees paid by unaffiliated mutual funds, commissions, and placement fees but would not include things like float, soft dollars, or other fees or compensation that would be difficult to quantify or isolate for a particular account. To the extent that there is separate advice for the fees, or for the use, or repeated use of a computer model, that information should be provided as well.

3. What challenges might be encountered in assembling and/or presenting the information on fees and compensation described in section 408(g) (6) (A) (iii) in a manner that is clear and understandable by the average plan participant? Are there any suggestions as to how these challenges can be addressed by the Department?

The Department has done a good deal of work providing sample disclosure and questionnaires to help plan sponsors understand service provider fees. In addition, the SEC has worked very hard to devise a chart under the Investment Company Act that clearly identifies the fees charged by a mutual fund. In our view, either of those models of disclosure would be helpful, adding in other categories such as affiliated brokerage, or a chart which provides categories which could either be filled in or marked inapplicable. The challenge faced by the industry is that there are other investment options available – collective trusts, separate accounts, and increasingly, other alternative pooled vehicles. However, we do not believe that these issues are impossible to work through. The industry would welcome the opportunity to work on a chart with the Department that would be helpful to plan participants.

4. Is there a form or format for presenting information on fees and compensation described in section 408(g)(6)(A)(iii) (e.g., narrative, chart, combination of both) that might be particularly suitable in giving participants a clear and understandable description of the fees and compensation received by a fiduciary adviser or its affiliates? Is there an optimal time frame, relative to when the advice is provided, for providing this information to participants and beneficiaries? What impact, if any, will the receipt of a model form have on investment decisions made by participants and beneficiaries?

In our view, a chart may be the most graphic and most effective way of presenting the information in a clear and concise fashion. The legislation requires that this material be provided at the inception of the relationship. We do not believe that the model form should be required, however.

5. Persons that may qualify as ``fiduciary advisers" are invited to provide forms that they currently use, or might use, to provide the kinds of fee and compensation

information described above. As described in ERISA section 408(g)(11)(A), "fiduciary advisers" may include investment advisers registered under the Investment Advisers Act of 1940, certain banks and similar financial institutions, insurance companies qualified to do business under the laws of a State, and brokers or dealers registered under the Securities Exchange Act of 1934. Commenters are reminded that submissions are made solely for the purpose of assisting the Department. Accordingly, no inferences should be drawn as to whether the forms submitted meet the standards for presentation described in ERISA section 408(g)(8)(A).

SIFMA and its members are gathering forms that might be helpful to the Department and will forward them as soon as possible.

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Again, we appreciate the opportunity to comment on this effort and look forward to working with you and your staff.

Sincerely,

Liz Varley

Liz Varley
Vice President and Director, Retirement Policy
Securities Industry and Financial Markets Association

cc: Robert J. Doyle, Director, Office of Regulations and Interpretations
Employee Benefits Security Administration

Ivan L. Strasfeld, Director, Office of Exemption Determinations
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