

May 5, 2010

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Comments on Proposed Rule on Investment Advice, as published in 75 Fed. Reg. 9360
(March 2, 2010)

Dear Madam Assistant Secretary:

The Pension Rights Center submits the following comments on the Department's proposed rule on the exemption under ERISA § 408(g) of certain categories of investment advice from the prohibited transaction rules.

The Pension Rights Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families. The Center understands that participants and beneficiaries need professional, competent advice on how to allocate assets among various investment options in self-directed individual account plans. But the Center believes that that advice must be unbiased and free of conflicts of interest.

When Congress passed the Pension Protection Act of 2006, it tried to expand the availability of investment advice through regulation rather than through prohibition of conflicted investment advisers. To do this, it provided that a conflicted investment adviser must either use an objective, independently verified computer model or be subject to fee leveling.

While the Center has remained skeptical of the value of investment advice provided by conflicted advisers, it commends the Department for regulations that attempt to implement Congressional intent, which intended a strong bulwark against potential conflicts infecting investment advice by requiring either fee leveling or the use of an objective computer model. The Center also commends the Department for withdrawing the 2009 class exemption, which undermined the legislative judgments of Congress on the type of safeguards needed to minimize bias on the part of conflicted investment advisers.

Although we applaud the Department's proposed regulations as a significant improvement over the 2009 rules, we believe that the regulations can be improved. We provide a number of observations and suggestions for improvement below.

Moreover, we continue to believe that the addition of Section 408(g) to ERISA was an error and urge the Department to advocate for stronger legislative protections for participants.

Finally, we suggest that the Department also consider collecting into a single regulation its generally thoughtful prior guidance on investment advice by non-conflicted advisers and on the difference between investment education and investment advice.

Observations and Suggestions on Proposed Regulations

1. *Fee-leveling should apply to affiliates of investment advisors.* In a positive departure from the 2009 regulations, the proposed regulations expressly provide that an affiliate of a fiduciary adviser providing advice under a “fee-leveling” arrangement may not offer the adviser direct or indirect payments that is based on investments selected by participants or beneficiaries.

We are concerned that the forms in which benefits might be provided to an investment advisor will not always be transparent and that it will sometimes be difficult to identify forms of improper payment.

Moreover, bonuses paid by an affiliate to investment advisers that depend on overall affiliate performance may influence investment adviser’s recommendations. For these and other reasons, we recommend that the regulation apply fee-leveling requirements not only to individual fiduciary advisers, but also to their affiliates.

2. *Independent investment experts should be subject to limited-purpose fiduciary status.* Section 408(g) requires that an independent investment expert must certify that a computer model investment arrangement satisfies the statutory criteria for such model. The statute vests in the Secretary of Labor the authority to establish requirements for an independent expert.

We believe it essential to the integrity of the certification process that the independent investment expert be a fiduciary for the limited purpose of determining a computer model’s compliance with the statute. Thus, we would urge that the regulations require that an independent investment expert accept limited fiduciary status before certifying a computer model.

3. *A computer model should consider all investment options under a plan.* Section 408(g) provides that a computer model is valid only if it takes into account all investment options offered under the plan. The proposed regulations, however, permit a computer model to omit from consideration employer stock, deferred annuity products, and target date and similar funds.

We understand that incorporating the omitted items into a suggested computer-generated asset allocation raises a number of practical and theoretical issues, but we do not think it appropriate to ignore investment options open to participants. (It may be that a narrative description of how a participant should evaluate the appropriateness of target date funds or

annuities as an investment is the most sensible way for a computer model to consider such options.) In any event, this is an issue to which the Department should devote further thought.

4. *Historic returns on asset classes should be determined net of investment fees.* The proposed regulations, for both fee-leveling and computer-model investment advice arrangements, require that advice be based at least in significant part on historic risk and returns of various asset classes. The regulation should clarify that “return” refers to returns net of investment fees associated with investments in particular classes of assets.
5. *Electronic Communication.* The proposed regulations permit that the disclosures to participants required by Section 408(g) can be provided in electronic form, in accordance with Department rules. The Department’s rules for electronic communication—and particularly the Department’s guidance that Title I requirements are met by electronic communication that conforms to the IRS’s generally less protective electronic communication standards—are particularly inapt to communications involving fiduciary and investment considerations applicable to all employees, regardless of the employee’s level of sophistication.

We strongly urge the Department to permit electronic communication of notice of conflicted investment advice only to those employees who provide advance written consent to electronic communication.

6. *Model Notice.* We also have concerns about the regulations’ model notice, which we believe could be improved through the use of focus groups of participants of different background and educational levels. In particular, we believe that some information included in the model form is more pertinent than other information and that such information should be given greater prominence.
7. *Use of historical data in determining future expectations for investment options.* We applaud the Department for inviting comments on computer models using past performance as a basis for evaluating competing investment options within an asset class. Clearly, one way to increase a conflicted advisor’s fees is to weight the model toward actively managed funds by placing undue emphasis on past performance and by manipulating the time period over which such performance is measured. The department should address appropriate limitations on these potential abuses.

Problems with Statute

The Pension Rights Center continues to believe that the 2006 legislation authorizing conflicted investment advice was an error. The legislation was based, in part, on the dubious assumption that conflicted investment advice (provided by the vendors of investment products to plan participants) is either free or at least far less expensive than independent investment advice. Under this view, it was more likely that participants would have access to investment advice than if it had to come from independent parties.

The idea that conflicted investment advice is free, or at least inexpensive compared to independent investment advice, is questionable. Investment companies that provide conflicted investment advice are hardly eleemosynary institutions and are not providing the advice on a charitable basis.

Although the charges for the advice may not be transparent, participants will nevertheless pay them, either through higher administrative fees or through the selection of higher-cost investment products. Moreover, plan experience with independent investment advisors under Departmental guidance, such as the Sun America opinion, provides strong evidence that plans and participants will use independent investment advisors.

It can, however, be expected that some plan participants will be reluctant to pay independent investment advisers fees for services that conflicted parties provide nominally—but not in fact—for free. The statute thus may have the perverse effect of making it harder for independent advisors to compete. If this is the effect, participants will be the losers.

If you have any questions, please contact Norman Stein, Senior Policy Advisor, at 202-296-3776.

Respectfully submitted,

Pension Rights Center