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VIA ELECTRONIC MAIL

October 6, 2008

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Investment Advice Regulations
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

RE: Proposed Participant Advice Regulation

Dear Sir or Madam:

Vanguard appreciates the opportunity to submit these comments on the Department's proposed regulation regarding the provision of investment advice to participants and beneficiaries under sections 408(b)(14) and 408(g) of ERISA.

Vanguard has offered a broad array of investment education and advice programs and services to our mutual fund investors for decades. These programs and services range from simple investor education questionnaires and allocation models to full-service discretionary advisory programs. We believe that our substantial experience in the retirement, investor education and advice areas positions us well to provide helpful comments to the Department on this very important issue.

1. Vanguard supports the Department's participant advice proposals.

Investment advice can be a valuable tool for improving the investment performance of participant-directed individual account plans. Many participants fail to take control of the investments in their plan accounts and they may consider themselves too inexperienced to make specific investment choices. Others fail to act upon or do not fully understand the educational programs available to them. The result can be poorly diversified investment portfolios that are too conservative at one extreme, or that are poorly diversified or excessively aggressive at the other extreme.

Research performed by the Vanguard Center for Retirement Research demonstrates that participant advice programs can improve expected returns (by over 300 basis points for some participants) and improve portfolio efficiency (the level of return achieved per unit of risk). Benefits inure both to lower-income participants with low levels of financial experience, as well as to more affluent participants prone to taking high levels of risk.[1] In this way, the Department's facilitation of responsible investment advice programs provides yet another avenue, in addition to the recently finalized qualified default investment alternative (QDIA) regulation, whereby public policy can improve the quality of portfolios in participant-directed plans.

For these reasons, Vanguard strongly supported inclusion within the Pension Protection Act of the prohibited transaction exemption allowing provision of participant investment advice pursuant to certain "eligible investment advice arrangements" (the "Statutory Exemption"). We also support the Department's proposed regulation and proposed class exemption relating to participant investment advice (the "Proposed Regulation" and the "Proposed PTCE," respectively).

In our view, the Department's proposals strike an appropriate balance between protecting participants and beneficiaries and allowing fiduciary advisers the necessary flexibility to establish and maintain broadly available and effective advice programs.

2. Vanguard supports the Department's interpretation that the fee-leveling requirement should not apply to affiliates of a fiduciary adviser.

The Proposed Regulation affirms the Department's interpretation taken in Field Assistance Bulletin 2007-01 that in order to satisfy the level-fee requirement of the Statutory Exemption, only the fees or other compensation of the fiduciary adviser are subject to the level-fee requirement. Vanguard agrees with the Department's interpretation, particularly in light of the fact that if fee-leveling across affiliates was required as a condition under the Statutory Exemption, there would be no need for the prohibited transaction exemption to exist.

We also support the Department's determination that the fees and compensation paid to any employee, agent or registered representative of the fiduciary adviser also should not vary based on the advice provided or the investment options chosen by participants or beneficiaries. This limitation on the variability of the individual's compensation serves to prevent inappropriate incentives for steering participants and beneficiaries to certain investment options.

3. Vanguard urges the Department to permit computer model advice with respect to investments selected by the IRA owner.

Vanguard supports the Department's conclusion in its Report to Congress that IRA computer model advice programs that meet all of the requirements of the Statutory Exemption exist today. The Department found that computer models need not address the

[1] Gary R. Mottola and Stephen P. Utkus, *Managed Accounts and Participant Portfolios*, 2006. Vanguard Center for Retirement Research. www.vanguard.com/retirementresearch.

entire universe of financial investments available for investment by an IRA owner. Rather, the computer model must take into account all of the generally recognized asset classes that are necessary for construction of a diversified portfolio.

Vanguard also supports the Department's clarification that, in the context of retirement plans, computer model advice programs may be based on a universe of investments that come only from a single family of affiliated investments. In such circumstances, the Department concluded in the preamble to the Proposed Regulation that "a computer model would not fail to meet this requirement merely because the only investment options offered under the plan are options offered by the fiduciary adviser or [its affiliates]."[2] Presumably, this rule is based on the recognition that the plan's fiduciaries (other than the fiduciary adviser) have determined that the affiliated investment options are prudent and that investment therein is consistent with the best interests of participants and beneficiaries.

Similarly, many of our IRA clients come to Vanguard as investors and advice clients because they approve of the fundamental investment and business principles that we adhere to:

- investing with a long-term perspective;
- offering investments that keep costs as low as possible;
- communicating candidly and openly about investment costs, risks and potential rewards; and
- operating with the highest standards of ethical behavior.

Thus, IRA clients come to us for investment advice with an expectation that our advice models will mirror our investment philosophy. As a result, clients expect that we will be advising them within the available universe of Vanguard investment options. In essence, like the fiduciaries in the plan context that may choose to offer plan investments in only one fund family, the IRA investor selects the menu of investment options to which the advice will apply.

Vanguard strongly believes that the final class exemption should permit computer model advice for IRAs based on a menu of investments selected by the IRA owner. The computer model exemption for IRAs should not be limited to situations in which the fiduciary adviser selects both the potential universe of funds and develops a computer program to recommend among those funds. It should be possible for an IRA owner to pre-approve the funds to which the computer model will apply in the same way that a plan fiduciary selects the menu of investment options to which the computer model is applied. In effect, it should be possible for an IRA owner to manage the scope of the advice that it is seeking by limiting the advice to a universe of funds to those that the owner pre-approves.

This approach is consistent with the statutory language in section 408(g)(3)(B)(v), which requires that the model take into account "all investment options under the plan." Just as a

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[2] 73 Fed. Reg. 49,898 (Aug. 22, 2008).

plan fiduciary (other than the fiduciary adviser) can select the investment menu to which the computer model applies, an IRA owner should be able to select the investment universe to which the computer model applies.

Our recommended approach would accommodate IRA owners who are looking for advice that is focused primarily on asset allocation and diversification, rather than fund selection. It would also allow IRA owners who believe in Vanguard's investment approach and philosophy to seek advice about asset allocation among the Vanguard family of funds. This is particularly appropriate given the intimate knowledge that Vanguard has of its own funds.

In practice, our existing computer models accommodate non-Vanguard investments by giving the client the ability to retain investments that our model determines are consistent with their long-term investment plan. Our advice model will provide "sell" or "hold" recommendations on the non-Vanguard investments, accommodating retention of investments that are consistent with our recommended investment plan. We will then provide "buy," "sell" or "hold" recommendations on Vanguard investment options. Obviously, these parameters are disclosed up front to clients so that they understand how the model will work and to provide clients with an opportunity to seek advice from other providers if the parameters are not what they prefer.

This approach has been favorably embraced by our clients and in our view this approach to advice is a prudent and appropriate approach to portfolio advice. As such, we request that the Department view this approach as one which would not present impermissible bias for purposes of the Statutory Exemption.

4. The Department should provide additional guidance as to the use and timing of the annual audit.

Vanguard believes the Proposed Regulation would be more practically effective if the Department provided clarification on how the findings of the annual audit must be used and when the annual audit must be completed. Under the Statutory Exemption and the Proposed Regulation, the fiduciary adviser is required to engage an independent auditor to conduct an audit of the advice arrangement for compliance with the applicable requirements, and distribute the report to plan fiduciaries and IRA beneficiaries. The Proposed Regulation adds the obligation that, in the event the auditor identifies noncompliance, the fiduciary adviser must send a copy of the report to the Department.

While the Statutory Exemption and the Proposed Regulation describe the audit as an "annual" audit, no guidance has been given as to when the audit should be performed. Especially given that fiduciary advisers and auditors are still today trying to determine the scope and details of such audits, we recommend that the Department provide flexibility in the timing of the annual audit. Assuming the Proposed Regulation is finalized late in 2008, it is requested that fiduciary advisers should have at least until the end of 2009 to complete the first annual audit. This will allow time for proper analysis of the final regulation, adjustments to advice programs (if necessary) and establishment of proper project scope for the audit.

5. The Department should create a self-correction program for non-substantial operational failures.

We strongly encourage the Department to consider a method to accommodate a self-correction approach for instances of non-compliance if the fiduciary adviser has made a good faith effort to comply with the requirements of the Statutory Exemption and the failures are not substantial.

The new rules impose numerous disclosure and other compliance responsibilities on fiduciary advisers. Moreover, these responsibilities will need to be satisfied in connection with a myriad of transactions potentially involving millions of participants and IRA owners. Given the nature of the compliance responsibilities and the sheer volume of transactions that will need to be compliant, it is very possible that minor errors will occur. It is vital that there be a method of correcting these errors to preserve the benefit of the Statutory Exemption.

A self-correction regime is simply good policy. If there is a system of self-correction in place, then fiduciary advisers will have a strong incentive to review and supervise advice programs to both ensure that errors are not made and to catch and correct errors as quickly as possible. If correction is not possible, then advisers will have little in the way of an incentive to catch errors since nothing can be done to fix them.

A self-correction regime would also improve the effectiveness of the required audits. Our experience with audits in various aspects of Vanguard's business is that audits are most effective if the auditor and the business unit being audited approach the audit with the goal of finding weaknesses and promptly and appropriately addressing them. We are concerned that the Proposed Regulation as currently structured does not contemplate that the auditor and the fiduciary adviser may work together to uncover and correct instances of noncompliance that may be discovered during the course of the audit. The automatic reporting to the Department of any violations may have an unintended chilling effect – potentially discouraging thoroughness in the audit process on the one hand and discouraging adoption of advice offerings on the other.

As such, we would encourage the Department to allow fiduciary advisers who have made a good faith effort to comply with the applicable requirements to correct any noncompliance identified by the audit within some reasonable correction period (for example 120 days) after the audit findings are provided by the auditor. More generally, we urge the Department to consider establishing a comprehensive program for correcting and enhancing compliance with the terms of the Statutory Exemption.

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Vanguard appreciates the opportunity to submit these comments and we would welcome the opportunity to continue working with the Department if we can be of additional assistance. If there are any aspects of our comments that you would like to explore in greater detail, please do not hesitate to contact the undersigned or Dennis Simmons of Vanguard's Legal Department at 610-669-4065.

Sincerely,

R. Gregory Barton