COMMENTS ON THE PROPOSED RULE ON DEFAULT INVESTMENT ALTERNATIVES UNDER PARTICIPANT DIRECTED INDIVIDUAL ACCOUNT PLANS

PROFIT SHARING / 401K COUNCIL OF AMERICA

UNITED STATED CHAMBER OF COMMERCE

NATIONAL ASSOCIATION OF MANUFACTURERS

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The Profit Sharing / 401k Council of America (PSCA)[1], the United States Chamber of Commerce (the Chamber)[2], and the National Association of Manufacturers (NAM)[3] are pleased to file comments on the Proposed Rule on Default Investment Alternatives under Participant Directed Individual Account Plans. The proposed rule achieves two major goals for default investments. It provides limited fiduciary liability relief that mirrors the relief provided for participant-directed investments under section 404(c)(1) for plan sponsors utilizing Qualified Default Investment Arrangements (QDIA). The proposed rule also encourages plan sponsors to provide default investments that are comprised of a mixed asset classes designed to create long term capital appreciation. The proposed rule is greatly enhanced by providing relief to plans that do not wish to conform to the requirements of section 404(c)(1). While the changes included in the proposed rule reflect provisions of the Pension Protection Act of 2006, we are aware that the Department was prepared to act in a similar manner under its regulatory authority, regardless of Congressional action. We applaud the Department's initiative in this area.

The purpose of a safe harbor is to encourage certain behavior but not to deny the validity of other choices. In the end, it is the employer's fiduciary decision that determines how retirement plan funds should be invested. If an employer believes that the use of a default fund invested solely in risk-free investments is the most prudent option for their employees' specific circumstances, then that employer should not be penalized. We are pleased that the regulations recognize the validity of that choice in the preamble of the proposed rule. To make it clear that the employer will not be penalized for making any prudent determination, we suggest that the Department make this statement within the regulation itself.

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[1] PSCA, established in 1947, is a national non-profit association of 1,200 companies and their 6 million employees that advocates increased retirement security through profit sharing, 401(k), and related defined contribution programs to federal policymakers and provides practical assistance on profit sharing and 401(k) plan design, administration, investment, compliance, and communication to its members. PSCA's services are tailored to meet the needs of both large and small companies, with members ranging in size from Fortune 100 firms to small entrepreneurial businesses.

[2] The United States Chamber of Commerce is the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region, with substantial membership in all 50 states. The Chamber of Commerce is committed to strengthening the retirement security of all Americans and believes that the employer-provided retirement system is a vital factor in retirement security. As such, the Chamber and its members strive to improve participation in and accessibility to the employer-provided retirement system.

[3] The National Association of Manufacturers (NAM) is the nation's largest industrial trade association, representing small and large manufacturers in every sector and all 50 states. The NAM is a strong supporter of the nation's private and voluntary pension system and our mission is to enhance the competitiveness of manufacturers and to improve American living standards by shaping a legislative and regulatory environment conducive to U.S. economic growth. Visit the NAM website at www.nam.org for more information about manufacturing and the economy.

We strongly agree that the proposed rule, in conjunction with other provisions of the Pension Protection Act of 2006, will encourage the adoption of automatic enrollment arrangements. While the Department estimates that annual contributions to 401(k) plans will increase by between $1.9 billion and $3.8 billion in 2005 dollars, our analysis indicates an even higher amount. A study on behalf of PSCA conducted by Aon Consulting of 130,000 401(k)-eligible employees in 2003 found that those not taking full advantage of the employer match forfeited $89 million in company contributions. When the results of this study are projected to include all 401(k)-eligible employees, $30 billion in employer matching contributions was left unclaimed by employees in 2003. Because the employee contribution necessary to obtain the employer matching contribution typically is twice the company contribution, the total additional retirement savings in 401(k) plans would have been $90 billion with 100% participation at a employee saving rate sufficient to obtain the full employer matching contribution. We believe that a broader adoption of automatic enrollment will capture a significant percentage of these forgone savings.

Again, we are pleased to see the Department's initiative in this area. We offer the following comments on the proposed rule in hopes of creating a final rule that will significantly increase retirement savings.

CONDITIONS:

The 30-Day Notice Requirement Should be Modified to Accommodate Plans that Provide Immediate Enrollment – Under the proposal, the required notice must be furnished within a reasonable period of time at least 30 days in advance of the first investment in a QDIA and within a reasonable period of time at least 30 days in advance of each subsequent plan year. While we find this to be a reasonable requirement for most situations, the requirement conflicts with a "best of class" approach to automatic enrollment in which automatic enrollment occurs immediately upon hire and the elective deferral is deducted from the first paycheck (except in the rare situation in which a paycheck is delayed beyond thirty days of initial employment). Under immediate automatic enrollment, the employee never experiences a reduction in take-home pay as the result of being automatically enrolled. This generally makes automatic enrollment "painless" for the new employee and results in a higher enrollment rate. We support the requirements that prior notice and an opportunity to direct an investment be provided in all situations, but the final rule should provide a shorter time period for the advance notice for plans that desire to immediately automatically enroll newly-hired employees. In that situation, the minimum advance notice period should be five business days or when participants are normally provided with enrollment materials.

We understand the concern of providing protection mechanisms for participants, but we do not believe that a shortened notice period will adversely affect participants. Section 902 of The Pension Protection Act of 2006 permits a plan to provide a permissible withdrawal feature that provides for the return of contributions to an automatic enrollment arrangement if requested by a participant within 90 days of the initial contribution. This feature provides relief to automatically enrolled newly hired employees with the shorter advance notice period by allowing them to "undo" the transaction. In addition, employees are always able to opt-out of the automatic enrollment or change their investment from the QDIA at any time.

Clarification Needed on Information to be Provided to the Participant – We recommend that Advisory Opinion 2003-11A, relating to the use of a mutual fund Profile to satisfy certain requirements under the 404(c) regulations, should apply to the requirement to provide material relating to the investment in a QDIA by a participant or beneficiary. Additionally, we request that further guidance be provided regarding the phrase "under the terms of the plan" in this proposed provision.

Redemption Fees Should Not Be Considered a Penalty– Under the proposed rule, participants and beneficiaries must be permitted to transfer assets from a QDIA without financial penalty. The final rule should specify that a mutual fund and pooled fund redemption fee, as well as other fees routinely applied to an investment when offered as normal, non-default investment, will not constitute a financial penalty under this requirement. Without this relief, plan sponsors could face the dilemma of conflicting requirements.

Equity Wash Rules Should Not Be Considered a Penalty or Restriction – In these comments we discuss several expanded roles for stable value funds in addition to the roles they have in the proposed rule. These funds typically require that transfers between stable value funds and certain other types of funds be "washed" in an equity fund as a condition of the transfer. The final rule should specify that this requirement is not considered a financial penalty or other restriction on the ability of a participant or beneficiary to transfer from a QDIA to another investment alternative.

QUALIFIED DEFAULT INVESTMENT ALTERNATIVES

The Proposed Rule Unfairly Limits Investment Managers – The proposed rule limits a QDIA to an investment that is managed by either an investment manager as defined in ERISA section 3(38) or an investment company registered under the Investment Company Act of 1940. We believe that this requirement is overly restrictive and burdensome and should not be included in the final rule. First, this requirement eliminates the ability of a plan sponsor to directly manage a QDIA. Second, it prohibits the ability of plan sponsors to choose a guaranteed benefit contract directly from an insurance company if they believe it is in the best interest of the plan. Third, it would require plan sponsors to hire an intermediary, thus increasing plan costs.

The final rule should not prevent a plan sponsor from directly managing a QDIA. The preamble states:

> "The Department believes that when plan fiduciaries are relieved of liability for underlying investment management/asset allocation decisions, those responsible for the investment management/asset allocation decisions must be investment professionals who acknowledge their fiduciary responsibilities and liability under ERISA. For this reason, the proposed regulation requires that, except in the case of registered investment companies, those responsible for the management of a qualified default investment alternative be "investment managers" within the meaning of section 3(38) of ERISA."

Hopefully the Department is not implying that plan sponsors managing plan investments are somehow less qualified or less aware of their fiduciary role and its accompanying responsibilities than investment managers and other fiduciaries and will not foreclose the ability of plans to use attractive default investments managed by other qualified persons when appropriate. Plan sponsors who manage their own pool funds are fiduciaries with respect to the choices they make. They should have the same ability to run the pool as another fiduciary, such as an investment advisor.

As the Department mentions elsewhere in the proposed regulation, nothing in the proposal relieves the plan sponsor of the responsibility to prudently select and monitor those involved with the management of funds in connection with a default investment. The proposed rule would impose accountability on the plan sponsor without corresponding control. This is a significant deviation of the processes laid out in ERISA. The proposed rule should not undermine the employer's fiduciary oversight of the qualified plan investment process. Plan sponsors should have the ability to determine the investment allocation and manage the funds in the QDIA.

The proposed limitation that requires a QDIA to be managed by an investment manager as defined in ERISA section 3(38) eliminates many products that carry a guarantee from an insurance carrier. While insurance companies can be, and often are, investment managers, they cannot assume this role for guaranteed benefit contracts, as these guarantees are backed by the general account of the insurance company. With the increasing desire to provide guarantees, especially income guarantees, to individuals approaching retirement and in retirement, it seems short sighted to eliminate the primary source of such guarantees. It seems clear that the default investments for people in or near retirement will also be in demand at some point in time.

Finally, the requirement that an intermediary be hired to manage the assets in the default fund will also impose significant costs on plan participants. For example, large companies frequently provide their defined contribution participants with a range of separately managed account funds, with varying levels of participation by a section 3(38) investment manager. The cost of investment management to participants using these funds is as low as one basis point. Some of these companies also pay all administrative costs. They could easily structure a QDIA using existing separately managed account funds without hiring a section 3(38) investment manager at no additional cost to plan participants. (Some companies have expressed an interest in doing exactly this). The absolute minimum fee to pay an intermediary investment manager as required by the proposed rule is ten basis points. If a company has to hire an investment manager to manage the default fund, some plan participants could experience a 1000 percent increase in their plan fees.

We support a level playing field among retirement service providers to insure that market forces will minimize plan costs that impact retirement savings. A process that favors some fiduciaries over others will reduce competition, increase costs, and produce unintended consequences. We recommend that proposed section 2550-404(c)(5)(e)(3) be entirely eliminated in the final rule.

A QDIA Should Be Permitted to Hold Employer Securities in a Separately Managed Account – Some plan sponsor-managed investment alternatives delegate one or more section 3(38) investment managers to manage plan assets in accordance with parameters set by the plan sponsor. In some cases the professional manager will invest some plan assets in employer securities. Assuming that this situation does not meet the section 3(38) requirement for a QDIA, we suggest that this situation is analogous to the proposed exception that permits a QDIA to hold employer securities held or acquired by an investment company registered under the Investment Company Act of 1940 or a similar regulated pooled investment vehicle because the plan sponsor has no discretion regarding the decision by the investment manager, acting as a fiduciary, to acquire or hold employer securities. The final rule should permit a QDIA to hold employer securities in this situation.

In addition, the preamble to the final rule and the final rule itself should clarify that an employee contribution to a QDIA can be matched with employer securities.

Post-retirement issues – Some participants will remain in a QDIA after retirement. For this reason, a QDIA should consider age or life expectancy beyond a target retirement date. The preamble to the proposed rule raises this issue when discussing the "balanced fund" QDIA, noting that a plan may "conclude that a new or additional investment fund product or model portfolio is required to take into account significant changes in the demographics (e.g., age) of the plan's participant population."

The other QDIAs, the "targeted-retirement-date" and "managed account" products, have the capability to accommodate retired participants. However, the proposed rule only requires these two products to manage assets based on age, target retirement date, or life expectancy. One interpretation is that these products could manage assets based solely on the target retirement date, thereby disregarding the age or life expectancy of the retired participant. The final rule should specify that a QDIA must be prudently managed for participants who remain in the QDIA beyond a target retirement date.

PRIOR AND SUBSEQUENT DEFAULT INVESTMENTS

Relief Provided Under the Final Rule Should Apply to Transfers from Existing Default Arrangements - The final rule should clarify that the relief provided in this proposed rule applies when a plan with an existing default investment designates a new QDIA and transfers individual account assets to the QDIA pursuant to the requirements of this rule. This relief should apply for default investments in existence prior to and after the effective date of the final regulation, regardless of the prior default investment's status as a QDIA or if the former default investment is retained as a plan investment.

We have discovered that a significant number of plans cannot determine which participants in a default investment affirmatively elected to be in the default fund. This situation is almost universal if the plan has changed record keepers at any time. The final regulation should provide that in this situation a plan may, pursuant to the notice and other requirements of the proposed rule, transfer all participants in the existing default investment into a QDIA. Without this relief, plans may be reluctant to move employees from an existing default investment into a QDIA that may be a more appropriate default investment for the participants.

NONDIVERSIFIED FIXED INCOME PRODUCTS

The Final Regulations Should Maintain Flexibility for the Use of Nondiversified Fixed Income Products - We have long recognized that too many employers have concluded that the current regulatory environment and ERISA itself put such a great emphasis on the preservation of assets that it would be imprudent to select a default investment that included risk to principal. As a result, many default investments are invested solely in fixed income investments or products. We played a leading role in securing legislation and regulatory relief so that employers will increasingly choose diversified default investments. We also agree with comments in the preamble that fixed income products are expected to be included in the three QDIA investments. However, the QDIA provisions of the proposed rule should permit employers the flexibility to determine the role of fixed investments in the QDIA, including situations in which the QDIA is composed entirely of this type of product. Following are two examples to support this recommendation. These examples are merely illustrative and should not be interpreted as the only instances where the use of nondiversified fixed income products would be prudent.

In one case an employer might determine that it is in the best interest of retired participants of advanced age who remain in a QDIA that all of their assets be in a fixed investment or product. This would include products that guarantee an income as well as a fixed rate of return. Another employer whose workforce turnover is very high during the first two years of employment might choose to have the funds accumulated during an employee's first two years with the company invested solely in a risk free investment or product. Such a decision could be based on a determination that the possible loss of capital appreciation on such small amounts over such a short period is more than offset by the benefit of being

able to distribute the full value of an employee's savings if they terminate. This design enhances employee relations and limits "bad publicity" about automatic enrollment. It also could translate into fewer employees electing out of an automatic enrollment arrangement.

ERISA PREEMPTION

The Department Should not Issue Additional Preemption Standards under ERISA Section 514(e) - Section 902 of the Pension Protection Act of 2006 includes a provision creating a new section 514(e) that provides that ERISA preempts "any law of a State which would directly or indirectly prohibit or restrict the inclusion in any plan of an automatic contribution arrangement." The provision is effective upon enactment (August 17, 2006).

We were strong advocates for legislation to clarify or reinforce that ERISA preempts a state law, usually a wage garnishment law, which would interfere with an automatic enrollment arrangement. At the same time, we were convinced that the existing preemption in section 514(a) applied to automatic enrollment arrangements. Unfortunately, Congress may have hampered rather than helped the situation. It is unclear whether any relief is still available under section 514(a) or if section 514(e) is the exclusive remedy available to plan sponsors. The new provision conditions the preemption on meeting the investment and notice requirements that are the subject of this proposed rule. Until the final rule is effective, it's not clear that either preemption section applies to automatic enrollment arrangements. Furthermore, the attachment of conditions for obtaining ERISA preemption under the new provision is troubling. For the first time, raising ERISA preemption may require establishing that other requirements (the investment and notice requirements) have been satisfied. This is akin to asserting ERISA preemption under section 514(a) and being required to establish that a plan met its duties regarding investment selection under section 404(a) and the notice requirements under section 101.

We do not believe that the Department should exercise its option under section 514(e) to prescribe additional regulations that would establish minimum standards in order to obtain relief under the section. We do, however, urge regulations confirming that section 514(a) continues to apply to an automatic enrollment arrangement, despite the enactment of section 514(e). The regulations should also provide that investment and notice requirements under section 514(e) can be met by good faith compliance until this final rule is effective. The Department should also consider acting on a pending advisory opinion request addressing the preemption of state wage garnishment laws for automatic enrollment arrangements that was filed prior to the enactment of section 514(e).

INNOVATION

Vigilance is required to minimize any negative effect that this rule will have on the innovation of new investment products. The elite status afforded the three QDIA products could hamper the introduction and adoption of new default investments. For example, neither target-date funds nor managed accounts had any measurable standing as plan investments as little as five years ago. Would the existence of this rule five years ago have stymied their adoption by plan sponsors? We are aware that the Department is sensitive to this concern. We suggest a statement in the preamble to the final regulation indicating that the Department recognizes the beneficial dynamic nature of retirement investment products and intends that this rule will allow consideration of new QDIA products.

GUIDANCE UNDER SECTION 404(a)

As the proposed rule clearly states, it provides no relief under ERISA's requirement to prudently select and monitor any QDIA - such relief would have to be provided under section 404(a). Despite this disclaimer, there is the possibility the proposed rule will be interpreted to provide guidance under section 404(a) regarding the selection of a default investment. It could also be used as guidance for discretionary plans in which investment decisions are made by the plan sponsor or another fiduciary. We also anticipate that this rule would be cited by defendants, and even judges, in cases alleging fiduciary breaches under section 404(a). In addition, we expect that some plan sponsors who are concerned about fiduciary liability in selecting a diversified default investment will find solace under the proposed rule.

Consequently, it makes eminent sense for the Department to issue guidance under section 404(a), in the form of an Interpretive Bulletin, which eliminates the peculiar situation described above. The guidance would merely formalize the indirect but clear message contained in the proposed rule – that when considering a default plan investment or when investing plan investments in a discretionary environment, it may very well be prudent to consider a portfolio that is composed of mixed classes of assets designed to achieve long term appreciation and long term capital preservation of retirement assets.

Thank you for considering these comments. Please do not hesitate to contact us if you have any questions or if we can be of any assistance.

David L. Wray
President
Profit Sharing / 401k Council of America

Aliya Wong
Director of Pension Policy
United States Chamber of Commerce

Jay Timmons
Senior Vice President for Policy and Government Relations
National Association of Manufacturers