DCIIA Defined Contribution Institutional Investment Association

DCIIA Public Policy
Investment Advice Comment Letter

May 4, 2010

Submitted Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5665
U.S. Department of Labor
200 Constitution Avenue, NW.
Washington, DC 20210

Attention: 2010 Investment Advice Proposed Rule

RE: Investment Advice Proposed Rule

The Defined Contribution Institutional Investment Association (DCIIA) appreciates the opportunity to comment on the proposed regulation to increase workers' access to high quality investment advice that the Employee Benefits Security Administration ("EBSA") published on March 2, 2010.

Who We Are. The Defined Contribution Institutional Investment Association (DCIIA) is a recently formed non-profit trade association dedicated to enhancing the retirement security of American workers. DCIIA members include investment managers, consultants, record keepers, insurance companies, plan sponsors and others committed to improving retirement outcomes for American workers by advocating for better defined contribution plan design and institutional investment management approaches.

DCIIA Supports the Need for Unbiased Investment Advice. DCIIA strongly supports EBSA's conclusion that plan participants who receive and follow quality unbiased[1] investment advice can reduce costly investment errors. In fact, a recent report confirms that offering investment help improves investment outcomes for participants.[2] The main finding of this report is that 401(k) participants of all ages using employer-provided, professional investment help – defined as target-date funds, managed accounts, or online advice – are better off across a variety of market cycles than those who do not use professional help. On average, the median annual return for participants receiving investment help was almost 2% (186 basis points) higher than for participants not using professional investment advice, *net of fees*. In addition, participants receiving professional investment advice had portfolios with risk levels that were both more appropriate for their retirement horizons and more efficiently allocated among their plan's investment options. *Of particular concern, given their limited time to recover from costly investment mistakes, was that the greatest variability in observed portfolio risk levels was found among retirees and near-retirees not using professional investment advice*. The report covers the period between January 1, 2006 and December 31, 2008, and is based on a dataset of seven large plans representing more than 400,000 individual participants and over $20 billion in assets.

Again, DCIIA commends EBSA for its recognition of and support for unbiased investment advice for plan participants and for the opportunity to comment on the regulation and on the additional questions posed in the regulation. Our comments are intended to address EBSA's Request for Comment and the questions posed in the regulation.

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[1] DCIIA believes quality unbiased advice can be provided by independent or affiliated advisors, through investment advice arrangements that rely on the statutory exemption and those that do not need to rely upon the statutory exemption that EBSA has permitted. See "Existing DOL Guidance Should Not be Impacted," below.

[2] *Help in Defined Contribution Plans; Is It Working and for Whom?* Financial Engines and Hewitt Associates joint research, January 2010, available at: http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/2010/DCHelpReport_Jan2010.pdf.

Comments Related to the Statutory Computer Model Investment Theory, Asset Allocation Models and Criteria. In response to questions raised by EBSA in the preamble to the proposed regulations, DCIIA believes it is very important that EBSA not seek to define or mandate minimum requirements or parameters or any model for "generally accepted investment theories."

It is true that many asset allocation products, such as balanced funds or target date funds, rely on Modern Portfolio Theory (MPT), Monte Carlo simulations, optimization models or a combination of all three. However, asset allocation models and theory have changed and will change over time. An example is the development of "Post-Modern Portfolio Theory," also referred to as mean-variance, nearly 30 years after Harry Markowitz introduced MPT. Today, mean-variance analysis is widely used in asset allocation models. Because investment models and theories are refined and evolve over time, in our view, it would be counter-productive to narrowly define the way in which models are created or to mandate the use of specific models. Mandating a certain type of model or model inputs will lead to less innovative, sub-optimal models. In turn, sub-optimal models will lead to sub-optimal outcomes for participants.

For similar reasons, DCIIA would recommend that the regulation not designate specific criteria as being (or not being) an appropriate and objective basis for asset allocation. In our experience, model criteria and inputs vary across the industry and change over time. As well, there is no one person or group that could appropriately determine which asset classes to include, what return and risk assumptions to use and how frequently to re-visit the appropriate model criteria and inputs. This is best done with the specific facts and circumstances at hand. Further, the regulation should not regulate the number and types of investment options included within a model or how investments should be classified. To provide an example, the same investment could serve multiple purposes within a model portfolio. Some might prudently include Treasury Inflation-Protected Securities (TIPS) within the "real asset" asset class, while others might prudently include TIPS as a fixed income alternative. There is no universal rule, or single answer, with regard to these variables.

Also, the risk in expressly designating criteria to be used is that important criteria may be omitted. If the regulation only suggests a partial list of criteria, the risk is that such a partial list would rapidly become the complete list, as designers of the computer models could become reluctant to add criteria that are not set out by explicit mention in the regulation. One strength of the “prudent man” rule is that the rule leaves open the question of what criteria to consider in making a prudent decision, requiring the decision maker to give appropriate consideration to the factors entering into such decision.

Computer Models and Historical Performance. DCIIA is also concerned with the language in Section 2550.408g-1(b)(4)(i)(E)(3) of the proposed regulations relating to computer models. Specifically this provision states that a computer model should avoid investment recommendations that would “[i]nappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future”. Similarly, EBSA asked for comments on when a fund’s past performance relative to the average for the asset class is an appropriate criterion for allocating assets to the fund. The concern is that this provision and EBSA’s question appear to seek to strictly limit the consideration of a fund's historical performance in evaluating that fund allocation in the model.

Historical performance relative to other investment alternatives has long been a factor that plan fiduciaries consider when evaluating a plan’s investment menu. The Department of Labor has recognized the importance of historical performance information by requiring that it be made available upon request in 29 CFR 2550.404c-1(b)(2)(i)(B)(2)(iv) for plan sponsors seeking relief under ERISA Section 404(c). In addition, providing historical performance information is mandated for plans seeking fiduciary relief in qualified default investment alternatives through reference in 29 CFR 2550.404c-5 (c)(4).

If the regulation is interpreted as limiting the consideration of historical performance, this would have the result of making investment fees the key factor for evaluating funds within an asset class. Our concern is that this would create a bias towards passively managed funds over actively managed funds. DCIIA is also concerned that this requirement may also be interpreted to apply outside of the context of this regulation -- to the detriment of plan participants and their future retirement security. DCIIA believes that plan sponsors and other plan fiduciaries should be able to select passively *or* actively managed funds based on what is believed to be in participant's best interests and without any bias favoring passively managed funds.

Furthermore, with the possible exception of the expected cash flows associated with US Treasury or other government investments (i.e., the risk-free rate), almost every other input into an investment model carries some degree of uncertainty and might be interpreted to fall within "cannot confidently be expected to persist in the future." For example, one input in deciding an appropriate mix between stocks and bonds is often the expected volatility of stocks relative to that of bonds. However, equities might have 25% or more annualized volatility in some market conditions, and 10% or less annualized volatility in others. If it were known with certainty that stocks carried a 10% annualized volatility, one might allocate a great deal to stocks in the portfolio, but much less at 25% annualized volatility. For that reason, one might choose, as an example, a 17% expected volatility for modeling purposes, recognizing that future realized volatility likely would differ. The reality is that uncertain inputs are necessary inputs and the likelihood of persisting in the future is not the only criteria to judge confidence or prudence.

From a practical perspective, it is important to note that today the vast majority of plan sponsors select both active and passive strategies for their DC plans. Computer models established under the regulation should support these allocations if the regulation is to provide assistance to these plans. What's more, it is helpful to understand that defined benefit plan sponsors with institutional investment options available to them also select both active and passive investment management and the majority of defined benefit plan assets are invested actively. Plan fiduciaries, including investment advisors and plan sponsors, should be encouraged to take into account a broad range of considerations, including fees, risk and historical investment performance as they prudently select an appropriate investment line up.

Accordingly, there should not be a bias in the regulation against including "a factor that cannot confidently be expected to persist in the future." These inputs should be allowed when prudent. However, if EBSA continues to be concerned with the level of future uncertainty of different inputs, then a preferred approach would be to require disclosure of the risk of relying on one or other assumptions, or the sensitivity of the recommendation to variations in any assumption.

<u>Existing DOL Guidance Should Not be Impacted</u>. DCIIA believes EBSA has the opportunity with the regulation to increase participant access to investment advice, including by setting appropriate standards so that advice – whether provided by independent or affiliated advisors – will be unbiased. Investment advice is available today to a significant number of plan participants through investment advice arrangements that do not need to rely upon the statutory exemption. For example, investment advice is provided by independent fiduciaries who engage in acts not described in ERISA section 406(b)(1), including arrangements that the DOL has permitted because the advisor does not cause the plan to pay additional fees for the service furnished nor to pay a fee to any affiliate of the advisor.[3] Investment advice is also provided in accordance with the model described in the SunAmerica advisory opinion.

It is therefore imperative that the existing permissible investment advice arrangements, under which millions of plan participants receive unbiased investment advice, remain available. For this reason, DCIIA commends and supports EBSA for maintaining in the regulation a provision stating that none of the regulation, ERISA section 408(g)(1) or Code section 4975(f)(8) invalidate or otherwise affect prior regulations, exemptions, interpretive or other guidance issued pertaining to the provision of investment advice and circumstances under which such advice may or may not constitute a prohibited transaction under section 406 of ERISA or section 4975 of the Code.

Participant access to quality investment advice (whether discretionary or non-discretionary) will increase once plan sponsors and industry participants feel that there is clarity around the requirements to provide investment advice. As a result, to support increased access to unbiased investment advice, and to provide additional encouragement for plan sponsors to provide investment advice to their plan participants, and due to the concerns expressed above, we respectfully suggest that EBSA add additional clarification to the regulation that no inference should be made to the provision of investment advice or fiduciary investment decisions not addressed by the regulation, including discretionary investment management. Industry participants and plan sponsors should understand that the requirements of the regulation apply only to advice provided in reliance on the statutory exemption and that no inference should be made to the provision of investment advice or fiduciary investment decisions not addressed by the regulation, including discretionary investment management. Otherwise, DCIIA believes that

[3] See for example Department of Labor ERISA Advisory Opinion 97-15A (May 22, 1997).

the goal of supporting increased access to unbiased investment advice (whether discretionary or non-discretionary) could be significantly diminished.

Target Date Fund Recommendation Should be Permissible. As we review the primary methods for delivery of investment advice to participants, DCIIA believes that target date funds will increasingly be a significant portal for participant access to investment advice. Research indicates that the majority of defined contribution plan participants are uncomfortable making investment decisions for their plan accounts.[4] In addition, once participants make an asset allocation decision (or a decision is made for them in the case of a default investment) they tend not to rebalance their account investments or make other changes. It is likely that this sort of inertia will also be seen in participants who receive investment advice, which could adversely affect participants' investment outcomes. For example, as a result of the advice she receives from a fiduciary adviser, a participant's account may initially be appropriately invested but in time, because of varying performance of her account investments and the fact that she is closer to her retirement date, her asset allocation may become less than optimal. Because target-date funds automatically rebalance and become more conservative with time, they can help address this issue.

Given the potential value of target-date funds for participants who are not actively engaged in the management of their plan accounts, we believe it would be entirely appropriate and prudent for fiduciary advisers to recommend them. Therefore, we respectfully request EBSA to make it clear—in the preamble to the final rule or the text of the rule itself—that the advice given to a participant under either the fee-leveling or computer model approaches may be a recommendation to invest his or her entire plan account in a target-date fund.

Request for Clarification to the Fee Leveling Provision of Proposed Regulations. Paragraph (D) of Section 1.2550.408g-1(b)(3) of the regulation (Arrangements that use fee-leveling) currently provides that no fiduciary adviser may receive "any fee or other compensation . . .that is based in whole or in part on a participant's or beneficiary's selection of an investment option." To be consistent with the statutory fee-leveling exemption, we believe that this provision should be clarified to state that no fiduciary adviser may receive "any fee or other compensation . . .that varies based in whole or in part on a participant's or beneficiary's selection of an investment option." This would be consistent with the language of the statutory exemption in Section 408(g)(2)(A)(i) of ERISA that provides that "any fees . . . received by the fiduciary adviser for investment advice . . . do not vary depending on the basis of any investment option selected." The intent of this provision does not appear to prevent the receipt of "any" compensation, just "variable" compensation based upon the investment selected. This is an important distinction for fiduciaries that rely upon fee leveling to provide unbiased investment advice.

DCIIA's Core Beliefs. DCIIA members believe the current defined contribution retirement system, with the adoption of institutional design approaches available today, can and will provide for the retirement security of working Americans. The important advances contained in the Pension Protection Act, particularly the safe harbor protections for plan automation features and appropriate default investment selection, provide plans with important guidance and fiduciary safe guards which can result in higher participation and savings rates, more appropriate investment allocations and improved long-term investment performance.

By incorporating techniques of professional pension management found in traditional defined benefit pension plans, defined contribution sponsors can improve retirement savings outcomes, affording their employees a better quality of life in retirement while managing their own fiduciary liabilities in plan governance. Some of the most prominent best practices include:

1. Open Architecture in Assembling Best-in-Class Plan Design

Open architecture provides plan sponsors and their consultants with the ability to select the best combination of partners to meet plan needs, including investment manager, record keeper, custodian, managed account, advice and other service providers.

[4] For example, in survey results published in "Inside the Minds of Plan Participants" in the Fall of 2009, AllianceBernstein reported that 62% of participants don't enjoy investing, invest inconsistently, don't pay attention to their investments and lack confidence in their ability to make good investment decisions.

2. Full Support for All Investment Vehicles and Product Solution Formats

The continued development of standard industry trading systems and information sharing protocols provides plan sponsors with a very wide range of DC-appropriate investment and pricing options which, depending on plan preferences, may be best delivered through mutual fund, insurance contract, collective trust or individual and institutional separate account formats.

3. Improved Default Programs as Most Effective Path to Realizing Successful Outcomes

Auto-enrollment and sufficient auto-escalation of contribution rates – coupled with a well-constructed qualified default investment and an effective employee communications and education program – can generate sufficient balances for workers to fund an adequate income replacement rate at retirement. Spending needs and longevity risk can be addressed by existing as well as new post-retirement investment and income management solutions being introduced to the market.

4. Full Lifetime Approach to Providing Retirement Income Adequacy

The likelihood of a successful retirement income outcome may be improved by careful attention during both the working (accumulation) and retirement (distribution) phases, and by including a combination of employer-sponsored and individual retirement accounts, to initially grow and ultimately preserve savings necessary to meet spending needs over an individual's total life expectancy.

5. Full Expense Transparency from All Service Providers

Plan participants benefit from plan sponsors providing fiduciary oversight of plan economics, and being knowledgeable about the breakdown of all plan costs and sources of revenue, including but not limited to investment management, record keeping and other administrative expenses.

Thank you again for the opportunity to provide comment on the regulation. We look forward to continuing to work with EBSA to better the retirement security of American workers.

Sincerely,

Lew Minsky
Executive Director
Defined Contribution Institutional Investment Association

cc: DCIIA Public Policy Committee.