

May 5, 2010

Via Electronic Filing

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

Attn: 2010 Investment Advice Proposed Rule

Ladies and Gentlemen:

The Investment Adviser Association¹ appreciates the opportunity to provide comments concerning the Department of Labor's proposed rule relating to the provision of investment advice to participants and beneficiaries in participant-directed individual account plans.² The proposed rule – and the provisions of the Pension Protection Act of 2006 (“Pension Protection Act”) that the rule seeks to implement – are intended to expand the availability of investment advice to participants in defined contribution plans. We strongly support this goal. We write only with respect to aspects of the Department's proposal and request for comments regarding the conditions applicable to computer models that may have broader implications for the provision of investment advice generally.

As the Department notes, with the rise in the number of employees participating in defined contribution plans, millions of plan participants are responsible for making investment decisions to assure their own retirement security. Policymakers are increasingly recognizing that professional investment advice assists participants in making better investment decisions and avoiding errors, such as inappropriate trading strategies or inadequate diversification. The availability of professional investment advice has been limited by prohibited transaction restrictions under ERISA that prevent a fiduciary from providing advice about investment options with respect to which it is affiliated or that otherwise result in an additional fee to the fiduciary.³ In enacting the Pension Protection Act,

¹ The Investment Adviser Association is a not-for-profit association that represents the interests of SEC-registered investment advisers. Founded in 1937, the Association's membership today consists of more than 475 firms that collectively manage in excess of \$9 trillion for a wide variety of individual and institutional clients. For more information, please visit our website: www.investmentadviser.org.

² Investment Advice – Participants and Beneficiaries, 75 Fed. Reg. 9360 (2010) (“Proposal”).

³ ERISA section 406.

Congress sought to increase the availability of professional advice to participants and beneficiaries in participant-directed individual account plans by providing an exemption from these restrictions accompanied by strong safeguards and conditions to address the conflicts of interest presented by these arrangements.⁴

This statutory exemption permits the provision of advice that would otherwise be subject to the prohibited transaction restrictions either through an adviser that is compensated on a “level fee” basis or through use of a computer model that is certified as unbiased by an independent expert. Although not supported by the provisions specified in the statute, the proposed implementing rule would mandate that any computer model be designed to avoid investment recommendations that inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot be expected to persist in the future. In discussing this requirement, the preamble states that “differences in historical performance are less likely to persist in the future and therefore are less likely to constitute appropriate criteria for asset allocation.” This statement appears to call into question investment advisers’ consideration of historical performance in analyzing potential investments.

In addition, the Department specifically requests comment on a series of issues related to generally accepted investment theories and appropriate criteria and factors for allocating assets in computer models, including whether the Department should designate particular theories or criteria in the final rule. For example, the preamble poses questions regarding, among other things, the role of historical data in computer models; whether a fund’s past performance relative to the average for the asset class is an appropriate criterion for allocating assets to the fund and whether a fund with superior performance may be recommended over a fund with average performance but lower fees; on what, if any, basis a fund’s superior past performance can be proven to derive from factors likely to persist in the future; and how, if at all, a model should take into account investment management style (*e.g.*, should a model ascribe different levels of risk to passively and actively managed investment options).

We are concerned about the implications of the Department’s comments on these issues beyond investment advice programs that take advantage of the computer model approach under the exemption. Read broadly, the views the Department may express in the final rule regarding generally accepted investment theories and considerations for investment recommendations could also affect existing computer model arrangements and all other investment decisions for plans and plan participants, such as which investment options are selected for a 401k plan menu and the conditions under which investment managers are permitted to manage defined benefit plan assets. For example, the Department’s discussion regarding the relative risks of active and passive management and its focus on costs could lead plan sponsors to overweight passively managed funds in 401k plan menus. The Department’s potential foray into the investment decision-making process is not appropriate for a number of reasons.

⁴ ERISA sections 408(b)(14) and 408(g).

First, the Department’s discussion goes beyond the scope of the statute and the implementing rule, which are intended to address conflicts of interest implicated by certain advice arrangements. As fiduciaries under ERISA, investment professionals owe both a duty of loyalty and a duty of care to the plan participants to whom they provide investment advice. The prohibited transaction provisions of ERISA are designed to ensure that fiduciaries do not breach their duty of loyalty by providing biased or conflicted advice to participants. Exemptions from these provisions – including the Pension Protection Act exemption this proposed rule is intended to implement – are carefully crafted to provide safeguards against conflicts of interest.

Analytically distinct from the duty of loyalty, a fiduciary’s duty of care under ERISA involves acting with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in similar circumstances (a “prudent person standard”).⁵ The Department consistently has interpreted this duty over the years under ERISA as focused on the procedures followed during the decision-making process rather than the results of that process.⁶ This standard is not a one-size-fits-all standard, but rather permits innovation and differing views on investment theories. We respectfully submit that consistent with the statutory exemption provided in the Pension Protection Act, the Department should focus its rulemaking on the duty of loyalty and conflicts of interest. A rulemaking that fundamentally alters the standard of care by mandating certain investment theories, styles, or decisions is not appropriate or called for by the legislation.

Second, investment professionals are in the best position to evaluate generally accepted investment theories and the factors to consider in making investment decisions. The proposed rule seeks to enumerate the specific factors that fiduciaries are permitted to consider in developing computer models.⁷ The final rule instead should require fiduciaries to use unbiased or objective factors generally. The independent expert would then be required to analyze and certify that the model is indeed constructed in an unbiased fashion. Restricting a fiduciary’s investment decision-making in a substantive manner (*i.e.* other than assuring that the process is untainted by conflicts) inappropriately interferes with an investment adviser’s professional skill and judgment. As discussed above, the adviser’s exercise of this professional judgment is subject to the prudent person standard under ERISA, which provides substantial protection for plan participants.

In the same vein, the Department’s request for comments focuses on whether it should specify “generally accepted investment theories” and “require their application” or designate some and not other criteria as appropriate and objective for computer models to consider. Again, we do not think the Department should specify generally accepted investment theories. The criteria for investment decisions should be determined by investment professionals, who are best positioned to evaluate and can respond to new information and changes in the

⁵ ERISA section 404(a)(1)(B).

⁶ *E.g.*, 29 CFR§ 2550.404a-1.

⁷ *E.g.*, Proposal at section (b)(4)(i)(E)(3).

marketplace when providing advice. Criteria codified in regulations are not flexible or readily modified based on changing circumstances. It is not prudent for the Department to set investment theories or criteria in stone, potentially hindering a fiduciary's ability to make decisions in the best interests of plans or plan participants.

Third, the historical performance of an investment is an important consideration in the evaluation of both the investment itself and the investment within the overall mix of investments. Clients routinely request information about past performance in RFP processes and periodic reporting. Clients' review of whether to renew investment advisory agreements or continue to offer certain investment options in their plans typically incorporates performance data. Indeed, the Pension Protection Act and the proposed implementing disclosure *requires* fiduciaries to provide plan participants with information about past performance and historical rates of return of the designated investment options available under the plan.⁸ Similarly, while the SEC requires mutual funds to caution that past performance is not necessarily an indication of how the fund will perform in the future, the SEC specifically requires that such funds disclose their past performance data to investors in the funds' prospectus. Although historical performance may not always be likely to persist in the future, investment managers should not be precluded from taking it into account in their overall analysis. Historical performance traditionally has been considered in the investment decision-making process and is certainly a "generally accepted" criterion in investment selection.

The Department's discussion of the relative merits of superior past performance and lower fees is particularly troubling. *We respectfully submit that the least expensive option is not necessarily the best option for each investor.* An investment professional might wish to consider a number of relevant criteria regarding each investment option, including expenses, historical data, benchmarks, investment objectives, portfolio holdings, turnover, relative risk, and risk-adjusted performance. As the Department itself recognizes in its proposed model disclosure, while fees and expenses are important factors, "it is also important to consider additional information such as performance, investment strategies, and risks."⁹

Fourth, the Department's questions regarding fees and investment management style may implicitly favor passive investing over active investing. The selection of management style should be left to the judgment of investment professionals based on all relevant criteria and circumstances related to both the investor and the potential investments. Active management is unquestionably a generally accepted investment strategy and can be an appropriate part of a plan participant's mix of investments. Indeed, most investment managers employ active management styles. The final rule should not be interpreted to require that computer models or other asset allocation advice prioritize investments based principally on fees or style. Such investments may not result in better overall performance over time and could lead investors to miss opportunities for better risk-adjusted returns or more appropriate diversification. Plan sponsors and investment professionals are in a better position than regulators to make these substantive investment decisions.

⁸ Proposal at section (b)(7)(i)(B).

⁹ Proposal at 9370.

For all of these reasons, we urge the Department to avoid regulating specific investment decision-making criteria that are otherwise untainted by conflicts of interest. We would be pleased to work with the Department to further the goal of expanding the availability of professional investment advice for participants in defined contribution plans while providing appropriate safeguards for plan participants.

We appreciate the opportunity to provide our views on these issues. Please do not hesitate to contact the undersigned if you need additional information.

Respectfully submitted,

A handwritten signature in cursive script that reads "Karen L. Barr".

Karen L. Barr
General Counsel