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**VIA ELECTRONIC MAIL**

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February 9, 2007

Office of Exemption Determinations  
Employee Benefits Security Administration  
Room N-5700  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, D.C. 20210  
Attention: Mr. Ivan L. Strasfeld, Director

**Re: IRA Investment Advice Request for Information**

Dear Mr. Strasfeld:

As a top 50 trustee of Individual Retirement Accounts, Vanguard appreciates the opportunity to submit the following response to the Department of Labor's Request for Information on the use of computer models in the provision of investment advice to IRA holders (the "RFI").<sup>1</sup> Additionally, we believe our views are applicable for issues related to computer advice models for defined contribution plan participants.

Vanguard, the nation's largest provider of no-load mutual funds, serves as custodian on over 2.8 million IRA accounts, representing over \$220 billion in assets. We also provide administrative services for over 2500 defined contribution plans, representing almost 3 million participants with assets of almost \$215 billion.

Also, Vanguard has been offering 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 makes us well qualified to comment to the Department on the very important issues raised in the RFI.

**A. IRA computer advice models are feasible if the PPA condition is viewed as requiring a model to take into account all major investment asset classes.**

In the RFI, the Department asked for views on the requirement under the Pension Protection Act of 2006 (the "PPA") that a feasible IRA computer model advice program would have to, among other things, "[t]ake into account the full range of investments, including equities and bonds, in determining the investment portfolios of the beneficiary." In our view, this notion of a computer model accounting for the full range of investments should not be viewed as requiring advice models to consider the entire universe of possible IRA investments.

Rather, we believe that this condition should be viewed as requiring that a feasible IRA computer advice model take into account the full range of major *asset classes*, including equities and bonds. As explained below, our view is based on practical considerations and investment considerations.

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<sup>1</sup> 71 Fed. Reg. 70427 (Dec. 4, 2006).

From a practical standpoint, it is doubtful that any investment model can truly take every permissible IRA investment into consideration. Even assuming such a model could be built, however, we are certain that maintenance of such a model would ultimately result in significantly more costly advice programs for investors. Consequently, there must be some limitations on any computer model.

More importantly, our research has demonstrated that from a portfolio development perspective, the asset allocation decision (*i.e.*, the decision as to how to allocate a portfolio among major asset classes) – and not individual security or fund selection – is the most critical factor in determining long-term portfolio return.<sup>2</sup> Thus, we believe that a highly effective and reasonably priced IRA computer advice model can and should have limitations on the universe of investments which it will take into account, as long as the model takes into account the range of major asset classes sufficient to allow for a diversified investment portfolio. In our view that range of asset classes would have as the baseline stocks, bonds and cash.

**B. Advice models that accommodate non-proprietary investments should be treated as not biased in favor of the fiduciary adviser.**

In the RFI, the Department asked for views on the requirement under the PPA that for the computer model prohibited transaction exemption to apply, the model must operate in a manner that is not biased in favor of investments offered by the fiduciary adviser (or a person with a material affiliation or contractual relationship with the fiduciary adviser). This is obviously a very stringent standard. If read literally, it would effectively preclude the vast majority of existing computer advice models (and possibly even all existing models) from eligibility for the PPA exemption. For the reasons explained below, we would encourage the Department to read the PPA prescription more flexibly and conclude that a computer advice model that takes into account pre-existing, non-proprietary investments in making recommendations is a model that operates in a manner that is not biased in favor of the fiduciary adviser.

As an important threshold matter, many of our clients come to Vanguard as investors *and* advice clients because they accept 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, clients come to us for investment advice with an expectation that our advice models will mirror our investment philosophy and, therefore, clients expect that we will be advising them to move into Vanguard investment options.

At the same time, our approach accommodates non-Vanguard investments by giving the client the ability to retain investments that our model determines are consistent with their long-term investment plan. Obviously, these parameters are disclosed up front to clients so that they understand how the model will work and, presumably, will then seek advice from other providers if the parameters are not what they prefer.

Vanguard has for years offered advice programs that allow our clients to identify non-Vanguard investments as part of their portfolio and our advice model will provide “sell” or “hold” recommendations on the non-Vanguard investments, while providing “buy,” “sell” or “hold” recommendations on Vanguard investment options. This approach has been favorably embraced by our clients and our view is that this approach to advice on non-proprietary investments is an eminently prudent and appropriate approach to portfolio advice.

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<sup>2</sup> See, Vanguard Investment Counseling & Research Analysis, “The Asset Allocation Debate: Provocative Questions, Enduring Realities” (April 2005) attached as Exhibit A.

**C. The remaining criteria under the PPA computer model exemption will be satisfied as a matter of course with most advice models.**

In the RFI, the Department also asked for views on the following three other conditions associated with the IRA computer model exemption under the PPA: the model must (i) apply generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time, (ii) utilize relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments, and (iii) allow the beneficiary, in directing the investment, sufficient flexibility in obtaining advice to evaluate and select investment options.

In short, our view is that the Department should be comfortable that most computer model advice programs can satisfy these criteria quite easily through the advice model and accompanying disclosures (see immediately below for a discussion of our views on the appropriate disclosures that should be provided to advice recipients).

**D. The Department should provide standards for disclosure to users of an IRA advice model, particularly with respect to total fees that the user will pay.**

In addition to the disclosures required to be provided under the PPA, we suggest that the Department consider the following points in order to help develop consistent disclosure for IRA beneficiaries and plan participants.

1. **All advice and investment-related fees on underlying investments should be clearly disclosed.** In light of the significant impact that fees deducted from savings have on the ultimate success of an investment portfolio, the Department should require the clear and conspicuous disclosure of both: (1) fees charged by the fiduciary adviser for the advice given, and (2) investment-related (typically asset-based) fees charged with respect to investments recommended by the adviser.

Academic research suggests that many investors are unaware of these investment-related fees that are deducted from the return of their investments.<sup>3</sup> We believe that requiring clear disclosure of all of these fees that are ultimately borne by the investor – whether or not these fees are paid to the fiduciary adviser – will go a long way to ensuring that investors are aware of the total fees they pay for the professional management of their accounts.

2. **Any investment limitations of the adviser's model should be clearly disclosed.** The Department should require the disclosure of the limitations, if any, that are built into the model. For example, if a particular adviser did not consider certain asset classes or individual equities as appropriate in a retirement portfolio, those limitations should be disclosed.
3. **The fact that IRA beneficiaries are not required to sign-up for an IRA provider's advice program should be full disclosed.** Finally, IRA beneficiaries should be informed that the beneficiary is not obligated to receive IRA investment advice as a condition of receiving IRA custodial or trustee services from the adviser or an affiliate.

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<sup>3</sup> See Barber, Brad M., Odean, Terrance and Zheng, Lu, "Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows" (December 2003). <http://ssrn.com/abstract=496315>.

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Vanguard greatly 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 Dennis Simmons of Vanguard's Legal Department at 610-669-4065 or me directly.

Sincerely,

/s/ R. Gregory Barton

R. Gregory Barton  
Managing Director