May 4, 2010

Submitted Electronically
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 American Benefits Council (Council), the American Council of Life Insurers (ACLI), and the Investment Company Institute (ICI) appreciate this opportunity to submit joint comments on the Department's proposed investment advice rule implementing section 601 of the Pension Protection Act (PPA). Information on our organizations is at the end of this letter.

We are writing to express our shared commitment to expanding opportunities for plan sponsors to offer, and plan participants to access, professional investment advice that can help participants effectively accumulate and manage their retirement savings.[1] We think this is very important and appreciate the Department's continued efforts to finalize rules implementing the PPA's investment advice exemption. We also strongly support the Department's commitment to preserve guidance on investment advice issued prior to the PPA, including the SunAmerica Advisory Opinion (2001-09A). Many existing investment advice programs in 401(k) plans rely on that guidance and any reversal or change to prior guidance would have risked the continued availability of investment advice to plan participants.

We also write to express our concern, however, about the Department's conclusions regarding the use of historical performance in evaluating investments. In addition, we are concerned about the possibility that the Department will seek in the final rule to define generally accepted investment theories or effectively require plan fiduciaries in other contexts such as the selection

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[1] The Investment Company Institute also has filed a separate comment letter on the proposal.

of a plan's investment fund line-up to favor particular investments or particular investment styles. As we discuss below, ignoring past performance is inconsistent with generally accepted investment practices and having the Department opine on how plan assets should be invested would be a radical departure and a mistake.

Finally, our organizations support a clarification to the rule's description of the fee leveling condition, described below.

The Department Should State that Historical Performance is an Appropriate Factor to Consider

The proposal adds a new condition that would require computer models to avoid inappropriate investment recommendations based on distinctions among investments in an asset class that "cannot confidently be expected to persist in the future." In the preamble, the Department explains this new condition as follows:

> While some differences between investment options within a single asset class, such as differences in fees and expenses or management style, are likely to persist in the future and therefore to constitute appropriate criteria for asset allocation, other differences, such as differences in historical performance, are less likely to persist and therefore less likely to constitute appropriate criteria for asset allocation. Asset classes, in contrast, can more often be distinguished from one another on the basis of differences in their historical risk and return characteristics.

Given the Department's explanation, we are concerned that the new condition effectively prohibits a computer model from taking into account the historical performance of an investment option. This result would not be consistent with generally accepted investment practice. Historical performance is considered routinely by investment professionals in evaluating mutual funds, insurance company pooled separate accounts, collective trusts, and other investment options.

Adopting this condition with the Department's explanation would call into question long-established practices in many other contexts in which fiduciaries who select and monitor investment options or investment managers take into account historical performance of the investment option or manager. For example:

- Plan fiduciaries of participant-directed defined contribution plans consider, among other factors, the historical performance of investments when selecting the investment menu for plans, and monitor that performance over time against similar funds. Fiduciaries routinely replace funds that underperform relative to their peers.

- Plan fiduciaries of defined benefit plans who engage investment managers routinely consider, among other factors, the historical performance of the investment manager in managing similar assets, and monitor the investment manager's performance over time.
- Computer models currently available under the SunAmerica advisory opinion routinely use historical performance, among other factors, in selecting among funds on a plan menu within an asset class.
- Disclosure rules require that historical performance be provided to participants and investors, precisely because this information is relevant to the decision to select a particular fund. The PPA exemption itself requires a fiduciary adviser to disclose "the past performance and historical rates of return of the investment options available in the plan." Historical performance is a key disclosure in mutual fund prospectuses and would be a key disclosure in the Department's proposed participant disclosure regulation.

We believe that historical performance is not the only criteria that should be considered, and in fact employers and other plan fiduciaries should and do consider performance alongside other factors like fees. It is also generally accepted that historical performance should be considered net of fees and that long term performance is generally a better measure than short term performance. But that does not lead to the conclusion that historical performance generally should not be considered.

Second, the new condition is unnecessary. Congress gave to the eligible independent expert the task of determining, among other things, whether a computer model properly takes historical performance into account consistent with generally accepted investment theories. We do not believe it is necessary or appropriate for the Department to interfere with the independent expert's certification.

We recognize that the Department may be concerned about inappropriate uses of historical performance. We recommend, however, that the Department drop the new condition and instead simply require that the eligible investment expert look at how the computer model takes historical performance into account in certifying the model in order to determine that the approach is consistent with generally accepted investment theories. Alternatively, the Department could revise the proposed condition to state that a computer model may not be "inappropriately weighted with respect to any investment option"—incorporating the statutory language in ERISA section 408(g)(3)(B)(v).

The Department Should Not Attempt to Define Generally Accepted Investment Theories or Favor One Investment Style

The proposal asks for comment on a series of questions related to the PPA requirement that advice generated by a computer model be based on generally accepted investment theories. The questions suggest the Department may seek to define generally accepted investment theories and codify the types of information that a computer model should (and should not) consider in making recommendations, and the conclusions that the computer model must draw from that information. The questions also suggest the Department believes a computer model should favor passive investments, such as index funds. We urge the Department not to attempt to define generally accepted investment theories or embark on a process that will micromanage plan investing.

First, an exercise to define generally accepted investment theories has implications far beyond computer models under the PPA exemption and would be a radical departure in the administration of ERISA. It necessarily would be viewed as the government setting standards on how employee benefit plan assets should be invested.[2] Since the enactment of ERISA, the Department has never before sought to define what investments or types of investments might or might not be appropriate for plans, instead leaving those decisions to plan fiduciaries under ERISA's prudent expert standard. The Department's approach has allowed theories underlying investment of plan assets to evolve over time, under broad principles of diversification and prudence taking into account the needs of the plan and participants. Rules that indirectly required plans to invest assets in a particular way by favoring a popular type of investing would freeze innovation and, to the extent imperfect, do harm to all participants. Any attempt to codify generally accepted investment principles by the Department could only reflect the current thinking of some investment advisers and would be counterproductive.

Second, we think it sets a dangerous precedent for the government to usurp the role of fiduciaries by placing its thumb on the scale for one kind of investment—index funds. These decisions are best left to the prudent decision making of employers considering the individual needs of the plan. Index funds of many kinds are widely available from mutual fund providers and as investments under pooled separate accounts, and often used in pension plans. Employers commonly include one or more index funds in a 401(k) plan's line-up; one survey found that 70 percent of plans offered a domestic equity index investment option in 2008.[3] Indexing is

[2] It might even be viewed as implied government standards for investing other personal assets, corporate assets and trust assets, which are all subject to various fiduciary standards.

[3] Profit Sharing/401k Council of America, *52nd Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2008 Plan Experience* (2009).

particularly popular with domestic large-cap funds. ICI data shows that in 2009, of assets held in 401(k) plans in large-cap blend domestic equity mutual funds, index funds represented 59%. These data show that index funds are well-known in the marketplace and plan fiduciaries consider them for inclusion in a plan's line-up, and that participants use them.

To the extent the Department is concerned about costs and views index funds as favorable because of their lower costs, the Department's proposal already requires that computer models take the fees and expenses of an investment option into account. Our organizations support that computer models take fees and expenses into account, but believe that investments should not be evaluated solely based on fees.

Finally, a long inquiry into the details of generally accepted investment theories will simply delay the final regulations. It is important that these regulations be finalized so that the plan sponsors and their service providers can begin to consider making advice under the PPA exemption available.

<u>The Department Should Clarify the Fee Leveling Condition</u>

The Department revised the fee leveling condition to make clear that the compensation of the fiduciary adviser and its employees must comply with the condition. As written, however, the provision is somewhat ambiguous in that it would prohibit compensation "that is <u>based in whole or in part on</u> a participant's or beneficiary's selection of an investment option" (emphasis added). This suggests that a flat commission earned on an investment—that is, a commission that is the same regardless of the investment option chosen—would not be permitted because the commission is "based on" the selection of the investment. The fee leveling condition in the PPA, however, is intended to prohibit compensation that *varies* and thus might create a conflict of interest for a fiduciary adviser.

The rule should be clarified to prohibit fees and other compensation that "<u>vary</u> based in whole or in part on a participant's or beneficiary's selection of an investment option." This change would be consistent with the Department's prior guidance on the fee-leveling condition in the PPA, including in Field Assistance Bulletin 2007-1, and with the intent of the proposal expressed in the preamble.

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Our organizations would be happy to discuss our concerns in more detail. We share the Department's goal of increasing opportunities for retirement savers to access investment advice. We urge that a final rule, with the changes we have recommended, be adopted promptly.

Respectfully Submitted,

Jan Jacobson	James Szostek	Mary Podesta
Senior Counsel	Vice President	Senior Counsel
Retirement Policy	Taxes & Retirement Security	Pension Regulation
American Benefits Council	American Council of Life Insurers	Investment Company Institute

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The American Benefits Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.94 trillion and serve almost 90 million shareholders.