

New Relief Offered to Fiduciaries Under the Pension Protection Act of 2006

By Fred Reish, Bruce Ashton & Stephanie Bennett

The Pension Protection Act (“PPA”) provides new protections for fiduciaries by extending the application of ERISA section 404(c) to blackout periods, default investments and the mapping of participant accounts.

By way of background, fiduciaries of plans that comply with 404(c) are given protection against some fiduciary breach claims for investment decisions in plans where participants direct their investments. 404(c) provides fiduciaries of compliant plans with relief from liability for the investment decisions made by participants (that is, fiduciaries are protected from the imprudent use of the investment options by participants – but are still legally responsible for the selection and monitoring of the investments).

If participants fail to direct their investments, however, the fiduciaries are responsible for prudently investing their accounts for them. When the fiduciaries make the decisions, 404(c) protection is lost, because the participants did not exercise control. This is true even if the fiduciaries use a default investment for this purpose. Although most plans want to obtain the fiduciary protection afforded by 404(c), many plans fall short due to the stringent requirements of the DOL regulation. Thus, while the new protections afforded under the PPA are welcome relief, to the extent plans are required to comply with the 404(c) regulation, the relief may be illusory.

BLACKOUT PERIODS AND MAPPING

The PPA extends 404(c) protection (i) during blackout periods, if the plan sponsor otherwise meets the requirements of ERISA in connection with authorizing and implementing a blackout period, and (ii) for mapping that constitutes a “qualified change in investment options,” so long as certain conditions are met. This relief is available for plan years beginning after December 31, 2007 (with a delayed effective date for collectively bargained plans).

Blackout Periods

Prior to the PPA, it was not clear how 404(c) applied during a blackout period. In theory, a 404(c) compliant plan should have maintained its 404(c) protection because the 404(c) regulation only requires that participants be allowed to make investment changes once a quarter and few blackouts last longer than that.

The PPA makes two changes. First, it provides that 404(c) relief is generally not available during a blackout period. Second, however, the PPA provides that, if the fiduciaries implement a blackout period in accordance with ERISA, the fiduciaries will not be liable for any losses occurring during that period. (The language of the statute makes it clear that the fiduciary relief from liability is available regardless of whether the plan complied with 404(c) prior to the blackout.)

However, that protection ends with the blackout. To have 404(c) protection after the blackout, the plan must comply with 404(c) generally, or with the QDIA rules (see below), or with the mapping requirements (see below).

Mapping

Mapping is treated somewhat differently under the PPA. Mapping occurs when a fiduciary removes and replaces an investment option, and transfers participants’ money from the removed option to the new investment option. Prior to the PPA, relief under section 404(c) was not available where participant assets were mapped to a replacement investment option.

In order to be a “qualified change in investment options” (the new term used in the PPA), the following requirements must be met:

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- Participant investments must be moved to an investment option that is reasonably similar “in risk and rate of return” to the characteristics of the investment option offered immediately before the change;
- Participants must receive written notice of the change at least 30, but not more than 60 days, before the effective date of the change;
- The notice must include a comparison between the old and new investment options and must explain that, absent affirmative investment instructions from a participant to the contrary, the participant’s account will be invested in the new investment option, which has characteristics reasonably similar to the characteristics of the old investment option;
- Finally, the plan must have satisfied the conditions of the 404(c) regulation prior to the change.

The requirement that, in order to get 404(c) protection, the participants’ money must be mapped to investments with similar risk and return characteristics poses practical problems for plan sponsors and fiduciaries. Specifically, who will make the determination that the replacement investment has reasonably similar risk-and-return characteristics? Also, who will be responsible for drafting the notice comparing the old and new investment options? Obviously, fiduciaries will have to make those decisions, but will they be able to adequately assess whether the replacement investment satisfies these requirements? As a practical matter, most fiduciaries are ill-equipped to make those types of decisions because they lack the technical expertise. As a result, they will need to rely on the advice of financial advisers, investment advisers or providers. The provision of that advice may cause concern for advisers and providers.

Finally, fiduciaries may be vulnerable to a later claim that the replacement investment was not similar in risk and rate of return to the removed investment. If so, what does a fiduciary need to do to protect himself? In addition, what level of documentation does a plan sponsor need to substantiate that the replacement investment is similar in risk and rate of return? As with all fiduciary decisions, in order to protect themselves, the fiduciaries must engage in a prudent process, reviewing information on the characteristics of the investment being removed and of the proposed replacement investments. (The recommendations of an adviser or provider can be critical evidence of a prudent process.) There is no specific answer for the amount or type of documentation the fiduciary will need to substantiate that the replacement is similar in risk and rate of return. But the fiduciaries must gather, review and maintain the documentation that a prudent person would want to review to make that decision.

DEFAULT INVESTMENT OPTIONS

For participant-directed plans, fiduciaries are required to exercise independent discretion and judgment in investing the money of those participants who do not direct their own investments. If the fiduciaries select a particular investment for that purpose – as they often do – it is called the “default investment” or “default account.”

Prior to the PPA, when participants failed to invest their accounts, the fiduciary could not obtain relief under 404(c) for the prudence of the default investment, because a critical component of 404(c) relief is that the participant must exercise control over the investment of the assets in his account. The PPA grants new relief for plan years beginning after December 31, 2006, by adding a new section 404(c)(5) to ERISA. This section extends the relief afforded by 404(c) to fiduciaries who invest participant assets in certain default investments.

Section 404(c)(5) provides that, in situations where participants have an opportunity to direct their investments but fail to do so, those participants will be treated as having exercised control over their accounts if they are invested in a qualified default investment alternative (“QDIA”). In that regard, the PPA directs the Department of Labor (“DOL”) to issue regulations defining the types of investments that will qualify as QDIAs. While the protections afforded by 404(c)(5) are available to all default investments that qualify as QDIAs, the protections are especially significant to plans with auto enrollment as a substantial portion of participants are invested in the default investment. Thus, by providing a default investment that meets the QDIA requirements and auto-enrolling participants in that investment, the fiduciaries are afforded the relief of 404(c)(5) for all auto-enrolled participants.

On September 27, 2006, the DOL issued a proposed regulation. The requirements contained in the regulation are delivered in the following portion of this Bulletin. Importantly, the proposed regulation provides that the relief under the PPA for QDIAs is available regardless of whether or not the plan meets the requirements of 404(c). Of course, the fiduciary is still responsible for the prudent selection and monitoring of the QDIA.

Requirements for QDIAs

The DOL proposed regulation provides five requirements for a QDIA. The QDIA:

1. may not hold or acquire employer securities unless (i) the employer securities were held or acquired by a registered investment company or pooled investment vehicle that is independent of the plan sponsor

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or any affiliate, or (ii) the employer securities were acquired as a matching contribution from the employer or at the direction of the participant;

2. must not impose financial penalties or otherwise restrict the ability of a participant to transfer his or her benefit to another investment alternative;
3. must either be managed by a fiduciary (under section 3(38) of ERISA) or an investment company registered under the Investment Company Act of 1940;
4. must be diversified to minimize the risk of large losses; and
5. must be one of three types of investments (an age-based lifecycle or target date fund; a balanced fund, including risk-based lifestyle funds; or a managed account).

Unfortunately, the regulation does not provide guidance on what is meant by “financial penalty” or “otherwise restrict” in the second requirement. For example, it is unclear whether an investment that imposes a contingent deferred sales charge, redemption fee or surrender charge may be a QDIA. If those terms are defined broadly to include any type of financial charge or restriction, it would seem that investments which impose any fee upon transfers or restrict certain transfers may not be QDIAs. (We recently submitted two Comment Letters with the DOL on the proposed regulation; one on November 10, 2006 and the other on November 13, 2006. Please see the attached November 13th Comment Letter, which suggests that a more specific definition is needed for those terms.) Hopefully, the DOL will resolve this confusion by defining those terms in the final regulation.

The third requirement, that the QDIA must either be a mutual fund or that it be managed by a fiduciary, is also problematic. Because of that requirement, most asset allocation models will not qualify as QDIAs--even though they have been highly successful tools for improving participant investing.

Notice Requirement

In addition to meeting the QDIA requirements above, the plan must provide a “broad range of investment alternatives” and the participants must:

1. receive a notice, within a reasonable period of time before each plan year, which explains their right to direct the investment of their accounts and explains how their accounts will be invested if they do not make an affirmative election; and
2. have a reasonable period of time after receiving the notice and before the default investment to make an election to direct the investment of their accounts.

The proposed regulation provides that, for purposes of the notice requirement, a “reasonable period of time” means that the notice must be furnished to participants at least 30 days in advance of the first default investment and annually thereafter. The notice must be written in a manner calculated to be understood by the average plan participant and must contain:

1. a description of the circumstances in which assets will be invested in the QDIA;
2. a description of the investment objectives of the QDIA, including its risk and return characteristics and fees and expenses;
3. a description of the participant’s right to move his investments to another investment alternative without financial penalty;
4. a description of how participants can obtain information about the other investment alternatives.

Most plans will be able to include the notice with their enrollment materials and provide that package to newly eligible participants more than 30 days before their enrollment date. However, for plans that use immediate automatic enrollment or immediate eligibility, it is unlikely that the notice could be provided 30 days in advance of the first default investment. Thus, the 30-day notice requirement may have the effect of discouraging employers who would like to take advantage of the relief afforded by 404(c)(5) from using immediate eligibility. In order to remedy this, we believe that the final regulation should provide a shorter notice period in those circumstances or, alternatively, provide that plans with immediate eligibility will be deemed to have satisfied the notice requirement if participants are furnished with a notice concurrent with their enrollment or shortly thereafter. (Our November 13th Comment Letter on the proposed regulation includes that suggestion.) We should point out that, if the final regulation does not solve this problem, the fiduciaries should nonetheless be protected (i.e., be entitled to QDIA treatment) for participant investments made 30 days after a notice is given.

The concerns over the timing of the notice are on-going. Consider, for example, a plan with monthly enrollment dates. For such a plan, assuming that there will be newly eligible employees enrolling in the plan every month of the year (*i.e.*, monthly entry dates), the plan sponsor is responsible for providing notices on 13 occasions over the course of the plan year, that is, the initial notice to newly eligible participants at least 30 days before every month throughout the year and an annual notice. We believe that plan sponsors would like to issue fewer notices and still comply with the requirement that the notice be furnished “within a reasonable period of time of at least 30 days.” While the regulation does not define the outer limits of “within a reason-

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able period of time,” we would like for the final regulation to provide that 90 days is not unreasonable. If that is the case, practically speaking, a plan sponsor can issue fewer notices and still comply with the regulation. For example, if the plan sponsor issues 90-day notices, the plan sponsor would be able to issue 5 notices (4 notices throughout the year plus the annual notice) as opposed to 13.

As mentioned above, there are two notices required under the proposed regulation, the initial notice and the annual notice. The proposed regulation provides that the annual notice requirement can be met by including the four items of information, discussed above, in the summary plan description. Although the regulation does not include separate content requirements for the notices, from a practical standpoint it would seem that the initial notice would be worded slightly differently than the annual notice, especially when one considers the recipients. The initial notice is provided to all newly eligible employees, and while the regulation is not entirely clear, it would seem that the annual notice would only need to be provided to participants who are invested in the QDIA by default.

In addition to the concerns regarding the timing of the notice, there is an additional consideration — that is, the content of the notice. The proposed regulation requires that the notice include a description of the QDIA (including a description of the investment objectives, risk-and-return characteristics – if applicable – and fees and expenses attendant to the investment alternative). Read literally, the requirement to include a description of the investment objectives and risk-and-return characteristics will prove to be difficult to comply with and overly burdensome. For example, if a plan uses age-based or target maturity funds, and if it offers eight funds with varying targeted dates, a notice would either need to be customized for eligible employees by age groups or, alternatively, the investment information would need to be provided to all eligible employees on all eight of the funds. Since it may be difficult, particularly for small- and mid-sized plans, to provide the customized

information, it seems likely that many plans will include information on all of the funds. In order to avoid this, the DOL should consider modifying the regulation to clarify that the notice only requires a brief, general statement of the overall purpose of the QDIA, with references to other more detailed information (for example, to the prospectus).

Existing Default Accounts

Unfortunately, the proposed regulation does not provide guidance concerning the methodology, if any, by which fiduciaries can convert existing default accounts in non-qualifying investment vehicles into 404(c)(5) protected QDIAs. In our November 13th comment letter to the DOL regarding the proposed regulation, we suggested that a provision be added to the regulation indicating that, if the plan fiduciaries have defaulted participants into an investment alternative that does not satisfy the requirement of the regulation, then the fiduciaries should be able to “re-default” the participant to a QDIA. Similarly, if the fiduciaries had defaulted participants into investments that would satisfy one of the three alternatives in the regulation, but would not be entitled to the 404(c)(5) fiduciary protections (because, e.g., the defaults pre-dated the effective date of the statute or the notice did not satisfy the detailed requirements of the regulation), the fiduciaries should be allowed “re-notice” and/or to “re-default” those participants in order to obtain the 404(c)(5) protections.

CONCLUSION

Although the PPA provides welcome relief to fiduciaries, the guidance fails to address important issues. Hopefully, the DOL will provide the needed clarification. If the DOL provides guidance that is clear and complete, and that can be implemented cost-effectively, the new law will accomplish its goal of protecting fiduciaries, while providing quality investments and valuable information to participants. ❖

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Re: **Comments on the Default Investment Alternatives Under Participant
Directed Individual Account Plans; Proposed Rule (29 CFR Part
2550.404c-5)**

Ladies and Gentlemen:

I am writing to submit a single, focused comment on your proposed regulation under ERISA §404(c)(5), as adopted by the Pension Protection Act of 2006.

Summary

The provisions of the proposed regulation are unclear as they relate to the application of the investment management requirement for age-based and risk-based model portfolios. For example, it is unclear whether an investment manager satisfies the section 3(38) requirement that it have "the power to manage, acquire, or dispose of any asset of a plan" when it makes the decision to modify or to not modify the asset allocations within a model portfolio. This situation commonly arises where the primary plan fiduciaries select the mutual funds to be included in the plan, but an independent party is engaged to determine the allocations of the model portfolios among those investment options. When the independent party determines the asset allocations for the model portfolios, it necessarily results in the acquisition, disposition of or holding of the underlying investments. However, because that decision is the result of an asset allocation decision, it could possibly be viewed as not being a direct decision to acquire or dispose of the underlying assets, even though it obviously has that effect. As a result, clarification is needed that the third party who determines and manages the asset allocations qualifies as an investment manager under ERISA section 3(38)(A). Further, it should be clarified that, even though the independent party is a fiduciary investment manager for purposes of the qualified default investment alternative (because of the discretionary management of the asset

allocation), the independent party does not, because of that activity, become a fiduciary for the purpose of selecting or monitoring the investment options in the plan.

Background

The proposed regulation provides at section 2550.404c-5(e)(5) that a qualified default investment alternative (QDIA) must be:

“(i) An investment fund product or **model portfolio** that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant’s age, target retirement date (such as the normal retirement age under the plan) or life expectancy . . .

(ii) An investment fund product or **model portfolio** that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole . . .

(iii) An investment management service with respect to which an investment manager allocates the assets of a participant’s individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant’s age, target retirement date (such as normal retirement age under the plan) or life expectancy.”

[Emphasis added]

The proposed regulation also provides at section 2550.404c-5(e)(3) that the QDIA must be either (i) managed by an investment manager as defined in section 3(38) of ERISA, or (ii) an investment company registered under the Investment Company Act of 1940 (that is, a mutual fund). It is noteworthy that the requirement for an investment manager is not limited to the third alternative, that is, the alternative for an investment management service. Instead, it appears that an investment manager may also be used for the model portfolios described in the first and second categories of investment vehicles.

Section 3(38) of ERISA defines an investment manager as:

“The term ‘investment manager’ means any fiduciary (other than a trustee or named fiduciary, as defined in section 402(a)(2))--

(A) who has the power to manage, acquire or dispose of any asset of a plan;

(B) who (i) is registered as an investment adviser under the Investment Advisers Act of 1940; (ii) is not registered as an investment adviser under such Act by reason of paragraph (1) of section 203A(a) of such Act, is registered as an investment adviser under the laws of the State (referred to in such paragraph (1)) in which it maintains its principal office and place of business, and, at the time the fiduciary last filed the registration form most recently filed by the fiduciary with such State in order to maintain the fiduciary’s registration under the laws of such State, also filed a copy of such form with the Secretary; (iii) is a bank, as defined in that Act; or (iv) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) has acknowledged in writing that he is a fiduciary with respect to the plan.”

Among the requirements in the statutory definition of an investment manager is that the manager actually manage plan assets. Where an investment manager directs the purchase, holding or sale of specific assets, the concept of management is easily understood and applied. However, in cases where asset allocation models or model portfolios are used (both of the risk-based and age-based varieties), the primary plan fiduciaries (for example, the plan’s investment committee) may select the underlying investment options for the plan. That is, the investment options used in the model portfolio are those that have previously been selected, and that are continuously monitored, by fiduciaries other than the investment manager. In that sense, when using a model portfolio, an investment manager would not select the specific investments that are bought, sold or held in connection with the implementation of the model portfolios or in connection with adjustments to those portfolios as a result of the management of the asset allocation models.

On the other hand, the investment manager would (i) determine the asset allocation model or models, (ii) be subject to a fiduciary standard for that determination, (iii) have the responsibility to continuously monitor the asset allocation percentages (and modify them as appropriate), and (iv) thereby determine when the holdings in the underlying investment options should be increased or reduced to adjust for changes in the allocations to the component

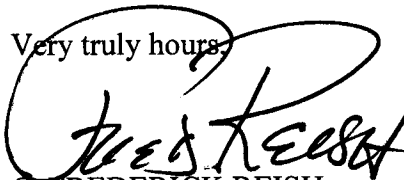
asset classes. The natural consequence of a decision to maintain the status quo of the model, to increase the allocation to certain asset classes within the model, or to reduce the allocations to asset classes within the model, would be to cause the continued holding, or the purchase or sale, of underlying investments. As a result, it appears that the role of the manager of the asset allocation model would be that the manager was a fiduciary because of the ability to manage the decisions concerning the holding, selling or purchasing of assets in proportion to the investment allocation models. Thus, if the other section 3(38) criteria for an investment manager were satisfied, such a manager would be an investment manager under that section and, accordingly, the managed model would qualify under subsections (e)(3) and (5).

Request for Clarification

Accordingly, I request the following clarifications in the final regulation itself or, if not there, in the preamble for the final regulation:

1. Each of the three alternatives under subsection (e)(5) can be satisfied through the use of an investment manager as described in subsection (e)(3).
2. The manager of an asset allocation model or model portfolio would qualify under section 3(38) of ERISA (if the other criteria in that subsection were satisfied) because the determination of the allocations of an asset allocation model or model portfolio necessarily result in decisions concerning the holding, purchase or disposition of the underlying investments, which would satisfy the requirement that an investment manager manage the assets of a plan.
3. Unless the investment manager is otherwise a fiduciary related to the selection and monitoring of the investments offered by the plan for participant direction, the investment manager of an asset allocation model would be a fiduciary for asset allocation decisions (that is, for the QDIA), but would not be a fiduciary with responsibility for the selection and monitoring of the underlying investments, and the written acknowledgment of this limited scope would satisfy (C) under section 3(38) of ERISA.

Thank you for your consideration of these comments.

Very truly yours,

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Re: **Comments on the Default Investment Alternatives Under Participant Directed Individual Account Plans; Proposed Rule (29 CFR Part 2550)**

Ladies and Gentlemen:

I am writing to submit comments on your proposed regulation under ERISA §404(c)(5), as adopted by the Pension Protection Act of 2006.

My specific comments concerning the proposed 404(c)(5) regulation are as follows:

1. Subsection (c)(3) of the proposed regulation requires that a notice be given to participants at least 30 days in advance of the first investment in a qualified default investment alternative (QDIA).

Obviously, that will be impossible for plans that admit eligible employees to participation immediately, or within 30 days of employment. It would also be impossible to satisfy for employers who automatically enroll employees into their plans upon commencement of employment or within a short time thereafter. The problem is made worse by the fact that there is a trend among employers for reducing eligibility periods, and that is particularly true of employers who adopt automatic enrollment. In effect, this provision discourages employers from using immediate eligibility, which cannot possibly be the intended effect.

The most direct solution would be to permit shorter notices where a plan provides for immediate or prompt enrollment. On the other hand, if the Department is unwilling to reduce the notice period, then it should specify a "correction" method. For example, the Department might provide that, in those cases, the investment will be deemed to satisfy the QDIA requirements after a 30-day notice has been given to the employee, either concurrent with the commencement of participation or concurrent with the beginning of the following plan year. In other words, where employers are helping their employees save for retirement by an early enrollment provision, there should be a method whereby they can satisfy the QDIA requirements (and obtain their 404(c)(5) fiduciary protections) either concurrent with or within a relatively short time after, the enrollment of the participant.

2. Subsection (c)(3) also requires that an annual notice be provided to participants or beneficiaries (on whose behalf an investment in a qualified default investment alternative may be made). While that language works well for the initial notice, it does not work for the subsequent annual notices.

For the subsequent annual notices, there will be three categories of participants and beneficiaries.

The first will be a soon-to-be newly eligible employee who would be receiving his initial notice. Realistically, the initial notices will be worded differently than the annual notices, at least by many plan sponsors, fiduciaries and providers. That is because, among other reasons, those notices will be handed out during the course of the year as participants become eligible on date of hire, on the first day of the first month following the date of hire, quarterly, and so on (depending on the specific entry dates chosen by the plan).

The second group will be participants and beneficiaries who have elected other investments and who are not in the QDIA. Obviously, there is no need for them to receive annual information about the default investments.

The third group will be the participants and beneficiaries who are invested, via the default process, in the QDIAs--the "affected participants." The proposed regulations should be modified to make clear that the annual notice applies only to these affected participants. To do otherwise would confuse participants and add administrative burdens onto employers and fiduciaries because of the need to respond to questions, to explain why a participant was given notice that did not apply to him, and so on.

3. Subsection (c)(4) provides that, in essence, “under the terms of the plan,” materials provided to the plan relating to the QDIA (such as prospectuses and proxy voting materials) must be provided to the participant. Unfortunately, a literal reading of this language suggests that plans must be amended in this regard in order for 404(c)(5) fiduciary protections to be available.

I suspect that this provision was intended to be similar to current regulation section 2550.404c-1(b)(2)(B)(1)(ix) which requires that similar materials be passed through to participants “to the extent that such rights are passed through to participants and beneficiaries under the terms of the plan.”

As a practical matter, with very few exceptions, the only plans which provide for the pass through of this type of information are plans which offer a company stock investment.

As the result of the use of the phrase “under the terms of the plan,” virtually every participant-directed plan in America would need to be amended in order to comply with the conditions of the proposed 404(c)(5) regulation. Obviously, that would be a considerable expense and burden. To make matters worse, most plans are prototypes and, as such, may not be amended without losing their prototype status.

I recommend that the regulation be changed to provide that this requirement be expressed as an operational requirement, rather than as a plan document requirement.

4. Subsection (c)(5) provides that a participant must be able to transfer any amounts invested in a QDIA “without financial penalty.” Elsewhere in the 404(c)(5) regulation package, there are also prohibitions on other restrictions on transfers.

Plan sponsors and fiduciaries need additional guidance from the Department on this issue. For example, a key concern is whether a reasonable redemption fee would be considered a financial penalty. As the Department is aware, one of the consequences of market timing in participant-directed plans has been the imposition of redemption fees by mutual funds. It is not uncommon for mutual funds, including lifestyle and lifecycle funds, to impose a redemption fee of, for example, 1% if the funds are reallocated within 30 days of being invested. Most redemption fees are in the range of 1% to 2% and the covered time period would be between 30 and 90 days of the date of the initial investment. Keep in mind, though, that if an employer has a twice-a-month payroll, there will always be deferrals that are deposited within 30 days of an investment in a QDIA, should the

participant transfer his full account. As a result, the Department needs to clarify that reasonable, and relatively minor, charges are not considered financial penalties or other restrictions. The Department also needs to clarify whether other possible reductions in the value of QDIA investments (such as a market value adjustment or a surrender charge) will be considered a financial penalty or other restriction and, if so, under what circumstances.

In addition, the Department needs to clarify its concern about other restrictions. (This is in reference to the language in 2550.404c-5(e)(2) which states “otherwise restrict the ability of the participant as beneficiary to transfer, in whole or in part, his or her investment from the qualified default investment alternative to any other investment alternative available under the plan.”) In my experience, most plans permit transfers on any day on which the major financial markets are open for business. As a result, the vast majority of plans would satisfy the requirement that a transfer be allowed at least once within a three-month period. If that is the Department’s only concern, then the regulation would not impose any unreasonable burdens on participant-directed plans. On the other hand, if the Department has other concerns, then it should make those known. If it does not have specific concerns, then it would be helpful for the Department to outline, perhaps in the preamble for the final regulation, the types of broad concerns that it has.

As it now stands, the proposed regulation does not provide adequate guidance. As a result, there is a concern in the private sector that the Department or the courts may, after the fact, decide that certain common practices are not permissible--at least in the context of the 404(c)(5) protections.

5. Subsection (d)(2) requires a description of the QDIA (including a description of the investment objectives, risk-and-return characteristics--if applicable--and fees and expenses attendant to the investment alternative).

First, with regard to the description of the investment objectives and risk-and-return characteristics, this requirement, if read literally, will prove to be difficult to comply with--in the sense that it will be expensive and overly burdensome. For example, if a plan uses age-based or target maturity funds, and if it offers eight funds with varying targeted dates, a notice would either need to be customized for eligible employees by age groups or, alternatively, the investment information would need to be provided to all eligible employees on all eight of the funds. Since it would be difficult, particularly for small- and mid-sized plans, to provide the customized information, then they would need to include in the notice the information on all funds. The effect of that would be (1) to confuse participants

and (2) to create lengthy notices. When combined with the other required information, it is not inconceivable that the notice could be five to 10 pages long. Once a document becomes that lengthy, it has limited value to the participants because of the difficult concepts and technical language, as well as the length. In addition, much of the information would not be relevant to a particular participant, since it would apply to other age groups.

In addition to those problems, this requirement puts plan providers and fiduciaries in a difficult position of quoting from, or paraphrasing, prospectuses that are written by mutual funds. The mutual fund prospectuses are drafted by the mutual funds both to inform prospective investors of their investment objectives and to protect the mutual fund from possible claims and lawsuits. As a result, the prospectuses tend to be drafted in a defensive and very broad manner, often limiting the value of the information in the prospectus. Nonetheless, plan sponsors, fiduciaries and providers would be reluctant to deviate from the prospectus language because they could not legally commit the mutual fund to a style of investment management that was different than the stated purpose in the prospectus.

I suggest that, in order to provide meaningful information to participants, but at a level that is reasonable and practical for plan providers and fiduciaries, the Department should modify the regulation to clarify that it only requires a brief, general statement of the overall purpose of the QDIA. The regulation should provide that the general statement of the purpose must be supplemented by a reference to the prospectus or similar materials for investments other than mutual funds.

The proposed regulation also requires that the notice contain information about the fees and expenses. Again, this requirement should be limited and cross references should be permitted. For example, for a mutual fund, the notice could have an attachment with the expense ratio of the mutual fund (or, for target maturity funds, of the mutual funds) as they exist at the current time or at the prior year end. But, it should also be made clear that this does not contemplate disclosure of transaction fees, for example, redemption fees, contingent deferred sales charges, or other transactional charges or adjustments. Instead, the participants should be directed to where they can obtain that information. That is, there should be clear disclosure, but not all the information should be required to be included in the notice.

The cross references could be similar to the explanation contemplated in subsection (d)(4).

6. Unfortunately, the proposed regulation does not provide guidance concerning the methodology, if any, by which fiduciaries can convert existing defaults in non-qualifying investment vehicles into 404(c)(5) protected QDIAs. I recommend that a provision be added to the regulation that provides that, if the plan fiduciaries have defaulted into an investment alternative that does not satisfy the requirement of the regulation, then the fiduciaries should be able to "re-default" the participant to a QDIA. That would be done by providing the participant with the required notice and then re-defaulting the participant, if the participant did not direct the investment of his account into with other investment options or, alternatively, if the participant did not direct the fiduciaries to continue to hold his account in prior default option.

Similarly, if the fiduciaries had defaulted participants into investments that would satisfy one of the three alternatives in the regulation, but would not be entitled to the 404(c)(5) fiduciary protections (because, *e.g.*, the defaults pre-dated the effective date of the statute or the notice did not satisfy the detailed requirements of the regulation), the fiduciaries should be allowed to "re-default" those participants in order to obtain the 404(c)(5) protections.

As a final comment, I applaud the Department on its work in the analysis and drafting of the proposed regulation. I believe that the result will be that many more participants are well invested and, as a result, have greater levels of income in retirement.

Thank you for consideration of these comments.

Very truly yours,


C. FREDERICK REISH

CFR:shm