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COMMENT LETTER

December 13, 2007

ICI Letter to DOL Requesting Clarification of QDIA Regulation (pdf)

December 13, 2007 Mr. Robert Doyle Director, Office of Regulations and Interpretations Employee Benefits Security Administration Suite N-5655 200 Constitution Avenue, NW Washington, DC 20210 Re: Final Regulation on Qualified Default Investment Alternatives Dear Mr. Doyle: The Investment Company Institute applauds the Department of Labor for promulgating a well-reasoned final regulation on default investment alternatives under participant directed individual account plans. The regulation will encourage plan sponsors to select default investment options that are appropriate for long-term retirement savings, in turn resulting in more Americans meeting their retirement income needs. We understand the Department is preparing additional guidance to address interpretive questions arising under the final regulation. We appreciate the opportunity to provide input on the formulation of this guidance. The attached questions cover several interpretive issues identified by Institute members. We have provided proposed answers to certain questions. Where we have not provided answers, there may be sound reasons for more than one possible answer and we believe the Department should provide guidance on its interpretation. We look forward to working with the Department to achieve successful implementation of the QDIA regulation. Please do not hesitate to contact us if we can be of further assistance. Sincerely, /s/ Mary S. Podesta Mary S. Podesta Senior Counsel – Pension Regulation Attachments cc: The Honorable Bradford P. Campbell Kristin Zarenko Investment Company Institute Questions and Proposed Answers on QDIAs Transition Question: For investments in a QDIA made prior to December 24, 2007, when does the fiduciary relief under ERISA section 404(c)(5) become available? Proposed Answer: Fiduciary relief becomes available on the later of December 24, 2007 or 30 days after notice complying with section 2550.404c-5(d) is provided. Although relief begins no earlier than the effective date, it encompasses all assets invested in the QDIA (to which section 404(c)(5) relief is intended to apply). [Basis for proposed answer: We believe this is what the Department intended and, if so, direct clarification would be helpful.] Financial Penalty Restriction Question: Can a QDIA impose a “round-trip” restriction on a defaulted participant during the first 90 days of his or her investment in the QDIA, when the restriction merely prohibits reinvestment in the QDIA for a specified period of time after the participant elects to move out of the QDIA and does not restrict in any way the participant’s ability to move out of the QDIA?1 Proposed Answer: Yes. This type of round-trip restriction (sometimes called a “purchase block”) does not restrict an investor’s ability to move assets out of a fund, but rather merely restricts the ability of an investor to reinvest in that same fund within a specified period of time after moving assets out. When a participant elects to move assets out of a QDIA, that participant has made an affirmative direction with respect

to his or her account and may be treated as no longer defaulted. At that point, there is no difference between a participant who 1 We assume the term "round-trip restriction" as used by the Department in the preamble to the QDIA final regulation does not encompass a requirement to follow a specified procedure to reinvest in a fund within a stated period of time. This type of requirement would not prohibit the participant's ability to reinvest, but rather would affect the method by which the participant can reinvest during that time period. For example, to address market- timing concerns, some funds may require an investor to send written instructions by mail in order to reinvest in the fund within a specified period of time after redemption or an exchange out of the fund. Since a fund investor providing instruction through the mail will not know for certain on which day his or her instructions will be received and implemented by the fund, procedures of this sort ensure that investors are re-investing with a long- term perspective and not merely trying to time daily changes in the market. We would appreciate the opportunity to discuss this issue with the Department further if there are any concerns in this regard or if the Department needs additional information. 2 was defaulted into the QDIA and a participant who had affirmatively elected to invest in the QDIA, and the purchase block restriction can be applied without regard to how long the participant had been invested in the QDIA before moving assets out. [Basis for proposed answer: SEC Rule 22c-2 requires mutual funds to either establish a redemption fee or determine that a redemption fee is not necessary or appropriate. This rule was implemented in the aftermath of the discovery of market timing trading abuses involving mutual funds, in which frequent trading by certain fund shareholders operated to disadvantage long-term fund shareholders. To address market timing, many funds have adopted redemption fees or taken other measures to prevent abusive or excessive trading that may harm long-term fund shareholders. Round-trip restrictions are one such measure.2 In implementing their anti- market timing restrictions, funds typically have made exceptions for certain transactions that do not raise abusive trading concerns. For example, funds generally do not impose redemption fees or other anti-market timing restrictions on transactions that occur under a participant’s election to have his or her retirement account automatically rebalanced at stated intervals to maintain the asset allocation desired by the participant. Funds that impose redemption fees may provide an exception in 401(k) plan automatic enrollment situations to allow participants who were invested by default to move out of the default investment without being charged a redemption fee. Where non-automatic, self-directed transactions involve the potential for abuse, however, a fund must be able to apply its policies to deter market timing. We believe the policies underlying fund round-trip restrictions and the Department’s QDIA rules can and should be reconciled. An automatically enrolled participant who transfers out of a QDIA and then wants to move back in to that fund within a short period of time could just as easily seek to engage in market timing practices as one who affirmatively elects to enroll in a plan. Imposing a round-trip restriction in this context is appropriate and distinguishable from imposing a redemption fee on the participant’s decision to move out of the default fund. In the redemption fee context, the decisions to invest in the default fund and to move out of the default fund are made by two different persons – the plan sponsor makes the first decision, while the participant makes the second decision. In contrast, when a participant moves out of the default fund and then decides to reinvest in the same fund, the participant is responsible for both decisions and the potential for abuse is present. In this case, the policy served by a round-trip restriction is directly applicable. For this reason, and because the participant has clearly exercised control in this case, there is no reason to exclude funds with round-trip restrictions from qualifying as QDIAs or as part of a QDIA.] 2 Mutual fund round trip restrictions do not prevent an investor from redeeming shares of the fund. SEC rules require that mutual fund shares are always redeemable. Mutual fund round trip restrictions prevent a shareholder who has redeemed fund shares from making a new

investment in the redeemed fund within a stated period of time after the redemption. 3 Question: Does the 90-day prohibition on restrictions, fees and expenses re-set when a participant is moved from an initial QDIA (such as a capital preservation product used during the first 120 days) to another QDIA? Proposed Answer: No, the 90-day prohibition does not re-set. It applies only for the first 90 days that a participant is defaulted. Automatic movement into a new QDIA after that time would not cause the participant's account to be subject to another 90-day prohibition. [Basis for proposed answer: At the end of the first 90 days, the participant should have had ample time to consider the implications of how his or her assets will be invested on his or her behalf and to redirect assets according to preference. At that point, there is no reason not to subject the participant to the same fees and restrictions otherwise applicable to all other participants. In addition, the participant no longer may make a permissible withdrawal under Code section 414(w) after 90 days, so there is less reason to re-apply the 90-day prohibition on fees and restrictions.] Question: For a plan that prior to December 24, 2007 is directing contributions into a default investment that satisfies the criteria for a QDIA, how does the 90-day restriction apply with respect to participants who were already automatically enrolled prior to the effective date? For example, for a participant who was automatically enrolled on November 1, 2007, would the 90- day period begin to run on the effective date of the regulation or at the time of the first elective contribution on November 1? Question: How does the 90-day restriction apply where a plan's default investment is an asset allocation model or model portfolio made up of the plan's underlying investment options? For example, if one or more of the funds used in the asset allocation model or model portfolio would impose a redemption fee within the first 90 days of a participant's investment, could the asset allocation model or model portfolio be considered a QDIA? 120-Day Capital Preservation QDIAs Question: For participants who were defaulted into a capital preservation product that satisfies the criteria for a 120-day QDIA prior to the effective date of the regulation, when does the 120- day clock begin to run? For example, for a participant who was automatically enrolled on November 1, 2007, would the 120-day period begin to run on the effective date of the regulation or at the time of the first elective contribution on November 1? 4 Notice to Participants Question: If a plan with immediate participation provides notice on the date of hire but does not allow permissible withdrawals under IRC section 414(w), is relief under section 404(c)(5) available with respect to assets invested in the QDIA prior to the date that is 30 days after the initial notice is provided? Proposed Answer: Yes, relief is available 30 days after the initial notice is provided (rather than upon participation) and encompasses all assets invested in the QDIA. [Basis for proposed answer: This interpretation is consistent with the Department's determination to provide relief for prior investments in other contexts, such as default contributions made to a QDIA prior to the effective date of the regulation.] Default Status Question: If a participant who is automatically enrolled at the plan's default contribution rate later changes his or her rate of contributions, but does not move out of the QDIA, can the participant be treated as affirmatively investing his or her account? Proposed Answer: In the case of an automatically enrolled participant who does not initially select a contribution rate, changing the contribution rate at a later date could be treated as an affirmative election by the participant to direct his or her account such that the participant is no longer considered defaulted. [Basis for proposed answer: When a participant who was enrolled at the plan's default contribution rate later changes the rate of contributions, the participant has exercised control over his or her account and fiduciary relief should be available under section 404(c), assuming the other requirements of section 2550.404c-1 are satisfied.]