



**The
ERISA
Industry
Committee**

July 17, 2009

By e-mail to e-ORI@dol.gov; rule-comments@sec.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Target Date Fund Joint Hearing
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: File Number 4-582 Target Date Fund Joint
Hearing**

Ladies and Gentlemen:

The ERISA Industry Committee (“ERIC”) is pleased to submit these comments in connection with the joint hearing held by the Department of Labor (the “DOL”) and the Securities and Exchange Commission (the “SEC”) on June 18, 2009, regarding target date funds and similar investment options (the “Hearing”). ERIC respectfully requests that these comments be included in the Hearing record.

ERIC

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America’s largest employers. ERIC’s members provide comprehensive retirement, health care coverage, incentive, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members’ ability to deliver those benefits, their costs and effectiveness, and the role of those benefits in the American economy.

Summary

There is no need for additional regulations or guidance under ERISA specifically aimed at target date funds.

1. Under ERISA, fiduciaries of participant-directed plans are responsible for making available to plan participants a range of investment alternatives, not for selecting a target date fund or any other investment alternative that is appropriate for every single participant.
2. Existing law provides detailed and comprehensive standards that require a “plain-English” presentation of material information about a plan’s investment alternatives to be made available to participants to help them make informed investment decisions under the plan.

3. The variety of approaches taken by target date funds, including the variation in investment allocations and glide paths among target date funds with the same target year, is entirely consistent with ERISA's fiduciary standards.

If the DOL or the SEC nevertheless concludes that additional regulations or other guidance are necessary, ERIC will be pleased to work with the agencies as well as present our views.

Individual Account Plans

All of ERIC's members sponsor individual account plans, including many of the largest individual account plans in the country. The great majority of these plans are "participant-directed" plans under which each participant is responsible for directing how the participant's account balance is invested.

A participant in an individual account plan bears a variety of risks, such as:

- **Investment risk**—the risk of adverse investment experience;
- **Inflation risk**—the risk that inflation will erode the value of the participant's account balance;
- **Longevity risk**—the risk that the participant will exhaust the participant's account balance before the participant dies;
- **Early termination risk**—the risk that, for reasons beyond the participant's control, the participant's employment will end prematurely; and
- **Inattention risk**—the risk that a participant whose circumstances change after initially allocating his or her account balance among the plan's investment alternative will fail to adjust the allocation to respond to the participant's new circumstances.

Although a participant can reduce some risks by diversifying the allocation of his or her account balance, and by periodically reviewing and revising the allocation, there is no investment or investment strategy that can completely protect a participant from risk.

Target Date Funds

A target date fund automatically shifts the allocation of a participant's account balance over time from equity to fixed-income or other more conservative allocation of investments. This automatic adjustment feature helps participants in participant-directed individual account plans to address appropriately the risks of participating in an individual account plan, described above.

Many participant-directed plans offer target date funds as alternatives to funds that do not automatically shift the allocation of a participant's account over time. Under DOL regulations, target date funds may be designated as a plan's default investment alternative.

Target date funds are not, and are not designed to be, a "one-size-fits-all" investment solution for every participant, however. To the contrary, target date funds are designed to meet the assumed needs of hypothetical plan participants, based on their target retirement years. Target date funds do not (and cannot) take into account critical unpredictable and personal factors, such as when an individual participant actually retires, when the participant chooses to receive distributions, the

participant's accumulated savings and risk tolerance, how much the participant will save in the future, what the participant intends to do (and actually does) after retiring, and the participant's health.

Most of the target date funds made available by the plans of major employers are open end investment companies subject to the Investment Company Act of 1940 (*i.e.*, mutual funds). However, some plans have established their own target date funds.

Comments

There is no need for additional regulations or guidance under ERISA specifically aimed at target date funds.

Because ERISA appropriately addresses target date funds, there is no need for additional regulations or guidance under ERISA specifically aimed at target date funds.

- 1. Under ERISA, fiduciaries of participant-directed plan are responsible for making available to plan participants a range of investment alternatives, not for selecting a target date fund or any other investment alternative that is appropriate for every single participant.**

ERISA does not require a fiduciary of a participant-directed plan to select an investment that is suitable for each participant or to ensure that each participant maintains a particular standard of living in retirement. Under the "safe harbor" for participant-directed plans in section 404(c) of ERISA, a plan is required to make available a broad range of investment alternatives sufficient to provide the participant with the opportunity to materially affect the potential return on the participant's account balance and the degree of risk to which the participant's account balance is subject. *See* 29 C.F.R. § 2550.404c-1(b)(3).

In general, plan fiduciaries qualify for the section 404(c) safe harbor by designating a limited number of investment alternatives under their plans. The designated investment alternatives reflect the fiduciary's judgment regarding the investment alternatives that will serve the interests of participants. ERISA does not require a plan to offer any particular type of target date fund or to offer a target date fund at all. For example, some fiduciaries might decide to offer more than one series of target date funds (to give participants a choice of glide paths) while others will conclude that the risk of confusion from offering too many choices outweighs any benefit from offering multiple choices. Still other fiduciaries will decide to develop customized target date funds themselves instead of offering a retail product, while other fiduciaries will elect not to offer a target date fund at all.

If a fiduciary elects to offer a target date fund, the selection of a specific target date fund as an investment alternative reflects the fiduciary's judgment that the selected fund is suitable for a *hypothetical* plan participant. In most cases, this judgment is based solely on the participant's age. The fiduciaries of major employers' plans typically do not have, or have access to, other information that is highly relevant to the suitability of an investment alternative for individual participants—such as the participant's resources outside the plan, continued ability to save before retirement, risk tolerance, expected retirement expenses, and health.

The DOL's default investment regulations make clear that the only factor a plan fiduciary is required to consider in selecting a target date fund as a default investment alternative is

the participant's age or target retirement date. 29 C.F.R. § 2550.404c-5(e)(4)(i); 72 Fed. Reg. at 60461 (“[T]he regulation is clear that . . . considerations [other than age or target retirement date] are neither required nor necessary . . .”). In addition, the regulations appropriately recognize that there is no consensus on how best to balance competing risks and that there is no “one-size-fits-all” solution. Regardless of individual outcomes, “each of [several] qualified default investment alternatives is appropriate.” 72 Fed. Reg. at 60453.

Accordingly, in selecting a default investment alternative, a fiduciary is not required to select the qualified default investment alternative that is most suitable for a participant or the plan. *Id.* Inevitably, a plan's default investment alternative will not be suitable for all participants. The selection of a default investment alternative (whether it is a target date fund or another alternative) cannot serve as a substitute for individualized evaluation by the participant.

In sum, under existing law, the fiduciary's role is limited to selecting a range of suitable investment alternatives for the plan as a whole, while each participant is responsible for making investment elections that are appropriate for him or her.

2. Existing law provides detailed and comprehensive standards that require a “plain-English” presentation of material information about a plan's investment alternatives to be made available to participants to help them make informed investment decisions under the plan.

The material terms of each target date fund that is organized as a mutual fund are disclosed in descriptive materials that are available to plan fiduciaries, participants, and other investors. Similarly, if a plan establishes its own target date fund (or other custom investment alternative), the plan's fiduciary must make available to participants a description of the material terms of the plan's target date fund (and of any other custom investment alternative). Based on these descriptive materials, each participant can make an informed decision as to whether to invest (and how much to invest) in any target date fund that the plan offers.

The existing regulatory framework includes comprehensive standards designed to ensure that the material information is presented in a straight-forward way. For example:

- Existing SEC rules require disclosure of key information about mutual funds, including target date funds, “in plain English in a standardized order.” *See, e.g.,* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, 74 Fed. Reg. 4546, *et seq.* (Jan. 26, 2009).
- ERISA and DOL regulations require plans to furnish summary plan descriptions that are “written in a manner calculated to be understood by the average plan participant.” ERISA § 102(a); 29 C.F.R. § 2520.102-2.
- The default investment regulations require plan fiduciaries to provide to participants “[a] description of the qualified default investment alternative, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses attendant to the investment alternative.” 29 C.F.R. § 2550.404c-5(d)(3). These notices also must “be written in a manner calculated to be understood by the average plan participant.” *Id.* § 2550.404c-5(d).

- The DOL’s regulations under ERISA § 404(c) require plan fiduciaries to furnish “a description of the investment alternatives available under the plan and . . . a general description of the investment objectives and risk and return characteristics of each such alternative, including information relating to the type and diversification of assets comprising the portfolio of the designated investment alternative.” 29 C.F.R. § 2550.404c-1(b)(2)(B)(I)(ii).
- The DOL has proposed regulations on disclosure of fees to plan participants and fiduciaries. *See* Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 73 Fed. Reg. 43014, *et seq.* (July 23, 2008); Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 72 Fed. Reg. 70988, *et seq.* (Dec. 13, 2007).

In a participant-directed plan, each participant is responsible for reading and analyzing the information available and for selecting the investment alternative(s) to which his or her account balance is allocated. Although some plans designate a target date fund (or another fund) as a default investment alternative, that designation is not an endorsement of the fund as an investment “solution” for any participant. *See* ERISA § 404(c)(5) (added by the Pension Protection Act of 2006). To the contrary, the notice describing the default investment alternative must explain the participant’s right to make a different investment election and must give the participant time to make an investment election before the default becomes effective. These notices often encourage participants to make their own investment decisions rather than blindly relying on the default alternative.

Several witnesses at the Hearing expressed concern that plan participants do not read the descriptive materials that are provided to them. To the extent that this is so, the solution is to encourage participants read these materials, not to give participants less information.

Of course, there is always room for improving the quality of communications to plan participants and other investors. Indeed, many ERIC members spend considerable time and treasure to improve their plan communications and to encourage participants to attend to the allocation of their account balances. In order to be effective, any guidance related to disclosure should identify specific concerns with existing communications and should include specific guidelines—with safe harbors—for addressing those concerns.

3. The variety of approaches taken by target date funds, including the variation in investment allocations and glide paths among target date funds with the same target year, is entirely consistent with ERISA’s fiduciary standards.

Target date funds reflect a general consensus among investment professionals that an individual who saves for retirement must accept investment risk and that it is generally advisable for an individual to reduce his exposure to investment risk over time. *See, e.g.,* Tom Lauricella, *A Lesson for Social Security: Many Mismanage Their 401(k)s*, Wall St. J., Dec. 1, 2004, at A1 (“As a general rule, a younger worker should have more money invested in stock funds, which have historically provided a higher rate of return. Older workers should have less in stocks and more in bonds, which provide a reliable income stream and are less volatile.”); Vanguard Center for Retirement Research, *Selecting a Default Fund for a Defined Contribution Plan* (July 2004) (“[T]he idea that risk tolerance varies with age remains a common investment planning principle.”); *see also* Default Investment Alternatives Under Participant Directed Individual Account Plans, 72 Fed. Reg. 60452, 60463 (Oct. 24, 2007) (expressing concern that investing in capital preservation and stable

value products could result in “inadequate retirement savings, as compared with savings that would be generated through investments in the established qualified default investment alternatives”).

Qualified investment experts have a range of views on how fast exposure to investment risk should decline, what should happen after a participant retires, or what level of investment risk is appropriate at any time.¹ The wide range of views on these points is reflected in the wide range of investment allocations and glide paths under target date funds. For example, some target date funds give priority to reducing exposure to investment risk as the target year approaches—at the expense of greater exposure to inflation and longevity risk. Others expose investors to greater investment risk in order to reduce exposure to inflation and longevity risk. Some target date funds are actively managed; others are passively managed.

ERISA’s fiduciary standards were deliberately designed to accommodate a variety of investment strategies. Congress chose not to impose rigid requirements, such as the “legal list” rules that had limited the types of property that a trustee could invest in under English law and the laws of some states. In enacting ERISA, Congress opted for a flexible standard of care—the “prudent man” rule—which focused on the process of investing rather than on specific “approved” investments.

The need for flexibility was discussed extensively during the development of ERISA, and is reflected in the DOL’s regulations under ERISA § 404(a). *See, e.g.*, Rules and Regulations for Fiduciary Responsibility, Investment of Plan Assets Under the “Prudence” Rule, 44 Fed. Reg. 37221, 37225 (June 26, 1979) (“[T]he Department does not intend to create or suggest a ‘legal list’ of investments for plan fiduciaries.”); Private Welfare and Pension Plan Legislation: Hearings Before the Gen. Subcomm. on Labor of the House Comm. on Educ. and Labor, 91st Cong. 476 (1970) (statement of Hon. George P. Schultz, Sec. of Labor) (“In recognition of the dynamic character and development of welfare and pension plans, the [prudent person standard] attempts to strike a reasonable balance between the need for additional safeguards and the desirability of maximum freedom from governmental interference.”); *id.* at 773 (statement of Preston C. Bassett, Council on Employee Benefits) (“[T]he selection of appropriate investments for employee benefit funds should remain decentralized and . . . the establishment of a Federal rule applying to investments should not authorize . . . any . . . agency to lay down highly detailed specifications as to what constitute appropriate investments . . .”).

An eminent legal scholar has identified investment risk and inflation risk—two of the principal risks that participants in individual account plans must bear—as among the key concerns

¹ *Compare, e.g.*, Comments of Joseph C. Nagengast, Target Date Analytics LLC (“No credible rationale has ever been proffered for using a glide path in the distribution phase.”), *with* AllianceBernstein, Target-Date Retirement Funds: A Blueprint for Effective Portfolio Construction (Oct. 2005) (submitted for the record), *and* AllianceBernstein, Anti-Depression Advice for Retirees (submitted for the record), *and* Comments of Richard Whitney, T. Rowe Price Group, Inc., *and* Testimony of Barclays Global Investors; *see also* Tom Lauricella, *Failure of a Fail-Safe Strategy Sends Investors Scrambling*, Wall St. J., July 10, 2009, at A1 (describing continuing evolution of common investment strategies, such as diversification).

accounting for the shift from the English “legal list” rule to the prudent man rule in the United States.²

ERISA thus does not favor one type of target date fund over another—any more than it favors an all-equity portfolio over an all-bond portfolio, or any more than it dictates the type of equity fund or bond fund that a plan should have. ERISA’s limits on investments in employer securities and employer real property are narrow exceptions that prove the general rule that ERISA imposes no general per se limitations on the investment alternatives that plans may offer. *See* ERISA § 407.

In view of the flexibility that ERISA’s drafters deliberately gave to fiduciaries, and the absence of consensus on the most appropriate investment strategy for a target date fund, the variety of available target date funds should be embraced, not discouraged. In accordance with existing regulatory standards, the distinguishing features of the different funds—for example, the investment allocation, glide path philosophy, involvement of fund managers, and fees—are explained in communications to investors, including plan fiduciaries and participants. The desire to make investing simple should not override the importance of innovation, variety, and choice in the fund marketplace.

Existing DOL and SEC regulations appropriately balance the fiduciary’s responsibility for selecting a broad range of investment alternatives and for ensuring that participants have access to material information about the plan’s investment alternatives, with the participant’s responsibility for making investment decisions. If the DOL or the SEC nevertheless determines that additional guidance is required, the new guidance should not disrupt the balance struck by existing law. Any requirements for plan fiduciaries should be objective enough “to provide plan fiduciaries with certainty that they have [satisfied their obligations].” 72 Fed. Reg. at 60461.

* * *

ERIC appreciates the opportunity to submit these comments. If the DOL or the SEC has any questions about our comments, or if we can be of any further assistance, please let us know. We appreciate the opportunity to work with you on these important issues.

Sincerely,

Mark J. Ugoretz
President

² *See generally* Howard R. Williams, *The Prudent Man Rule of the Pension Reform Act of 1974*, 31 Bus. Lawyer 99, 100 (Oct. 1975) (identifying (1) inflation, (2) the “legal list” rule’s inadequate protection of trust corpus (due in part to the fact that the lists could be changed by state legislatures), and (3) the restrictiveness of legal lists as three key factors contributing the flight from the “legal list” rule to the prudent man rule).