

Fund Democracy
Consumer Federation of America

June 18, 2007

BY EMAIL AND U.S. MAIL

Ms. Susan Dudley
Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget
725 17th St., NW
Washington, DC 20503

Re: Qualified Default Investments

Dear Ms. Dudley,

It has come to our attention that certain interested parties are lobbying your office to reject the Department of Labor's proposal to exclude capital preservation options, such as stable value funds and money market funds, as qualified default investments.¹ We are writing to urge you to reject these self-interested arguments and instead support the Department of Labor's proposal as written.

Congress enacted the Pension Protection Act to improve America's pension system. A significant, persistent problem with the system has been that workers have inappropriately placed their retirement assets in capital preservation funds and retired poorer as a direct result. Consistent with the intent of Congress, the Department has rightly resisted those who would undo Congress's efforts by recreating one of the very problems the Act was intended to solve. The provision authorizing the Department's rulemaking refers to "default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both."² Including stable value and money market funds as default options would directly contradict Congress's clear direction that default options include a "mix of asset classes." Moreover, while a stable value fund would certainly be an appropriate component in a "mix of asset classes" that was designed to emphasize capital preservation, it would not be appropriate as the exclusive component of a qualified default option.

¹ *E.g.*, Letter from Ann Cammack, American Council of Life Insurers, to Steven Aiken, Office of Management and Budget (Mar. 30, 2007).

² Pension Protection Act of 2006, § 624(a).

We find it appalling that – despite years of research that has consistently demonstrated the inappropriateness of using capital preservation vehicles (*e.g.*, stable value funds and money market funds) as exclusive default options -- any member of the financial services industry would suggest that the government promote the continuation of this practice. Acceding to such self-interested arguments inevitably would result in millions of Americans’ reaching retirement with inadequate savings. At a time when the Social Security and defined benefit legs of the three-legged stool of retirement security are dwindling, it would be reckless for the government to facilitate the depletion of the third leg of defined contribution plans as well. Yet this is precisely what including stable value funds as a qualified default investment would do.

Why is this so? First, capital preservation vehicles, as stated by the Department, “deprive investors of the opportunity to benefit from the returns generated by equity securities that have historically generated higher returns than fixed income investments.”³ Requests that stable value funds be included as default options echo a mattress mentality that promotes the illusion of safety over the reality of modern finance. As an exclusive asset class, stable value funds would provide the lowest expected return for a participant. For example, the Investment Company Institute estimates that “a worker who begins investing at age 30 could expect, on average, to have more than twice the retirement assets at retirement by investing in a lifecycle fund compared to investing in a stable value fund.”⁴ In short, ***including stable value as default options would leave millions of Americans poorer during their retirement years.***

Second, it is widely-accepted that, if capital preservation vehicles are included as qualified default investments, they will be adopted by far too many employers and will attract a disproportionate percentage of retirement assets. Why should an employer take greater litigation risk on a default option such as a life-cycle fund that may lose money in the short-term when it can enjoy a liability safe harbor with a capital preservation investment? Their employees will be worse off, but their litigation exposure will be materially reduced. This is precisely why such a large percentage of plan sponsors have used capital preservation funds as default options.⁵

Far too many participants choose such capital preservation default options,⁶ and, once placed there, they generally stay for an extended period,⁷ for which they pay a heavy

³ *Default Investment Alternatives under Participant Directed Individual Account Plans*, 71 F.R. 56806, 56807 n.6 (Sep. 27, 2006).

⁴ Letter from Brian Reid and Elena Barone, Investment Company Institute to Susan Dudley, Office of Management and Budget (May 31, 2007).

⁵ Letter from Robyn Credico, Watson Wyatt to Employee Benefits Administration, Department of Labor (Nov. 13, 2006) (finding that 45% of survey respondents using a default fund chose a stable value fund or a money market fund).

⁶ Commission on the Regulation of U.S. Capital Markets in the 21st Century, Report and Recommendations at 52 - 53 (March 2007).

price in retirement. Putting the federal government in the position of implicitly recommending capital preservation investments as appropriate long-term investment options will encourage: defaulted participants to remain in those options, non-defaulted participants to choose those options, and employers to offer those options. Following the government's advice, plan participants will be more likely to make the wrong decision by placing all of their assets in what appears to be the "safest" investment, when in fact it is a dangerous long-term option for their retirement security.

The idea that the Department's position interferes in any way with free markets and free choice is patently absurd. The default option is, by definition, where assets are invested for those who have chosen not to choose an option, *i.e.*, to leave the choice to their employer. The moment that a participant decides to make a choice, the Department's position has no effect on the choice he or she makes. If anything, including stable value funds as a default option will *restrict* free choice, because many employers will continue to feel compelled, as demonstrated by past experience, to choose them as their default option in order to reduce the possibility of short-term losses and the attendant liability risk. The Department's proposal eliminates the distorting effect of the legal advantage offered by capital preservation options by placing other options on a more level playing field. Stable value funds will no longer have a distorting and historically harmful risk advantage over superior life-cycle and balanced investments.

The Department's proposal has no effect on an employer's ability to offer a stable value fund as an investment option or default investment option, or on a participant's ability to choose such option. We recognize that a stable value fund can be and often will be: an appropriate component of a participant's asset allocation, selected as an option by self-directed investors who are not defaulted into an option, and chosen by an employer as a default outside of the safe harbor. The Department's proposal has no effect on these scenarios. The *only* effect of the Department's position is to exclude capital preservation options as qualified default options. There should be absolutely no doubt as to the wisdom of the Department's proposal.

Including stable value funds as qualified default investment alternatives would directly conflict with Congress's goal to help Americans accumulate adequate assets for their retirement. We strongly encourage your Office not to interfere with the Department's well-considered proposal to help end decades of overly conservative investing that has directly resulted in Americans' retiring with less wealth in their old age. Limiting

⁷ Brigitte Madrian and Dennis Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. Econ. 1149 (2001) (participants stayed with default option although few hired before automatic enrollment picked that option).

qualified default investments to life cycle funds, balanced funds and other similar investment vehicles is essential to helping many Americans achieve a secure retirement.

Very truly yours,

Mercer Bullard
President and Founder
Fund Democracy

Barbara Roper
Director Investment Protection
Consumer Federation of America

cc: The Honorable Elaine Chao, Secretary of Labor
The Honorable Christopher Cox, Chairman, SEC
Bradford Campbell, Assistant Secretary of Labor (EBSA)
Chester Spatt, Chief Economist, Office of Economic Analysis, SEC
Andrew Donohue, Director, Division of Investment Management, SEC
Joseph Borg, North American Securities Administrators Association