OppenheimerFunds®

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Submitted Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: 2010 Investment Advice Proposed Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: <u>2010 Investment Advice Proposed Rule</u>

Ladies and Gentlemen:

OppenheimerFunds, Inc. ("OppenheimerFunds")[1] appreciates the opportunity to comment on the Department of Labor's proposed rules regarding investment advice for participant-directed individual account plans, implementing section 601 of the Pension Protection Act of 2006 ("PPA"). OppenheimerFunds is a leading provider of retirement plan products and services, including qualified retirement plans, individual retirement accounts and retirement income planning tools and education, and offers a broad range of Oppenheimer mutual funds and other investment vehicles as retirement plan investments to help investors as they seek retirement security.

Among our many retirement-related initiatives, OppenheimerFunds partners with intermediaries and plan sponsors to provide retirement savings information, including investment-related education, to plan participants. We support Congress's and the Department's recent initiatives to enhance Americans' retirement security and specifically to increase the availability of sound investment advice to plan participants. We believe the proposed rule's fee-leveling provisions are a step in the right direction to

[1] OppenheimerFunds is the investment adviser to approximately 100 investment companies that comprise the Oppenheimer family of mutual funds. As of March 31, 2010, OppenheimerFunds, Inc., including subsidiaries, managed more than $160 billion in assets, including mutual funds having nearly 6 million shareholder accounts. Together with its affiliates, OppenheimerFunds also provides retirement plan services to plan sponsors and individuals. Massachusetts Mutual Life Insurance Company ("MassMutual"), an affiliate of OppenheimerFunds, intends to submit similar comments separately.

expand the availability of advice and we strongly support the rule's preservation of the Department's pre-PPA guidance on this topic.

Our comments are focused on the provisions of the proposed rule that deal with computer model advice. Specifically, we believe that the Department should not establish or endorse a particular investment theory in the context of computer model advice, and that discouraging the use of historical investment performance in computer model advice programs would impede, rather than enhance, the availability of sound advice to participants.

The Department should not define what constitutes a generally accepted investment theory or limit which generally accepted investment theories are available to plan participants, except as necessary to ensure unbiased advice.

The preamble to the proposed rule seeks comment on a series of questions related to the establishment of one or more investment theories that should be applied to computer model advice, including whether the Department should establish "a list of criteria that [computer] models must consider to the exclusion of all others".

The proposed rule, invitations for comment and the preamble together indicate that it may be the Department's intent to establish an investment theory unique to investment advice delivered by computer modeling to ERISA plans, or to dictate which generally accepted investment theories may be used to generate investment advice for participants and which may not. Neither approach is called for by the PPA, and either alternative would represent a significant departure from ERISA's longstanding approach to fiduciary considerations and the responsibility for investments.

Congress and the Department have not previously defined what constitutes a generally accepted investment theory for ERISA purposes or otherwise attempted to limit the criteria that may be taken into account as part of a generally accepted investment theory for purposes of providing advice to plan participants. Congress and the Department have likewise declined to mandate specific investments for plans. We believe Congress and the Department have avoided those steps for important practical and public policy reasons and that it would be a mistake for the Department now to embark on that path.

First, the term "generally accepted investment theories" is self-defining. We believe it refers, in general, to investment theories that are widely used and accepted by investors and investment experts. Historical performance is clearly a factor that many investors and investment experts incorporate into investment analysis. Therefore, historical performance is a component supporting generally accepted investment theories. Hundreds of mutual fund tracking services, investment web sites and periodicals regularly publish performance information that millions of investors and investment advisors use to evaluate options and formulate investment advice. By excluding historical performance from consideration under computer model advice programs and thereby dictating which investment theories may be used, the Department would be changing the standard for computer models specified in the PPA.

Moreover, defining "generally accepted investment theories" as proposed, or favoring certain theories over others, would fail to accommodate the healthy evolution of investment theory and investment products. Any rule that favors or excludes certain generally accepted theories is likely to become outdated quickly.

ERISA has proven to be a highly successful and adaptable framework for retirement plan regulation and innovation precisely because of its reliance on guiding principles and its emphasis on thoughtful and informed oversight by fiduciaries rather than rigid rules and the promulgation of "legal lists" of approved investments.

The significant unanticipated market losses suffered by millions of plan participants as a result of the recent global financial crisis were a harsh reminder that investment strategies that produce favorable results for investors under certain market conditions are disadvantageous under different conditions, with a disastrous impact on some investors. As discussed in more detail below, "buy and hold", passive investment strategies that may work well for a hypothetical investor over decades will not always produce the best possible results for actual investors over shorter periods.

In addition, the exclusionary approach taken by the proposed regulations directly contradicts the Department's historical position with respect to the selection of plan investments generally. At the time the Department issued its 'prudence' regulation, it stated:

> [T]he Department does not consider it appropriate to include in the regulation any list of investments, classes of investment, or investment techniques that might be permissible under the 'prudence' rule. No such list would be complete; moreover, the Department does not intend to create or suggest a 'legal list' of investments for plan fiduciaries. 44 Fed. Reg. 37255 (June 26, 1979)

ERISA does not now call for the Department to place limits on a plan's use of commonly accepted investment techniques that satisfy ERISA's fiduciary standards any more that it did in 1979 when the prudence regulation was issued.

Even if the Department is inclined to reconsider the application of generally accepted investment theories in the context of ERISA plans, the computer model requirements of the participant investment advice regulations are not the appropriate place to do so.

Using the participant investment advice regulations to limit the generally accepted investment theories that may be incorporated into computer model advice is not contemplated by the PPA. The PPA does not include a definition of "generally accepted investment theories" or limit which theories may form the basis for computer model advice (other than requiring that a model take into account historic returns of different asset classes over defined periods of time). If Congress believed that certain generally

accepted investment theories are not appropriate in formulating participant investment advice, provisions to that effect would have been set forth in the statute.

The Department should not require that investment advice computer models omit historical performance as a factor in distinguishing among investment options within an asset class.

The proposed rule provides that computer model advice must "avoid investment recommendations that...inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future..." (Paragraph (b)(4)(i)(E)(3)). In the preamble to the proposed regulations, the Department explains the intent of this provision 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. *(emphasis added)*

To the extent the Department's purpose in proposing a restriction on the use of historical performance is to ensure that participants receive unbiased advice, the restriction is unnecessary. Other provisions of the PPA and the proposed regulations provide ample safeguards. Safeguards include a prohibition on advice biased in favor of investments offered by the fiduciary advisor; the requirement that computer models use only objective criteria, and expert certification and audit requirements.

Further, the restriction on the use of historical performance included in the proposed regulations is ambiguous and would have repercussions beyond the development of computer advice models. Plan fiduciaries would rightly be concerned, and we believe very confused, about the implications of the restriction for investment decisions they make in contexts other than computer models. For example, if participant advice computer models do not consider the historical performance of investments, should a fiduciary also ignore historical *under*-performance in deciding whether to retain an investment in a plan menu?

If the Department continues to believe that investment advice to plan participants should be based on factors different than those used by investors in general, then a more detailed, separate analysis and proposal should be undertaken so as not to further delay the implementation of participant advice regulations which have already been finalized, delayed several times, withdrawn and now reproposed. As the Department points out early in the analysis of the proposal, quality investment advice can help participants reduce investment errors and "reap substantial benefit".

We are concerned that discouraging the use of investment performance as a factor in investment advice computer modeling will ultimately put plan participants at a

disadvantage relative to other investors by limiting their access to innovative investment strategies and products. New and more sophisticated investment strategies will continue to emerge and it is very likely that some will incorporate data on historical performance among investments within a single asset class. Discouraging plans from providing participants with advice that incorporates new strategies and products could leave participants behind without access to the best available and most timely advice. The proposed regulations acknowledge as much by excluding lifecycle (target-date) and lifestyle (target-risk) investments from the computer model requirements. It is reasonable to assume that other investment products will emerge with similarly innovative approaches. The regulations should not inhibit the availability of these products to plan participants.

If the Department's proposed restrictions on historical performance are included in the final regulation, or if the final regulation includes a list of criteria that a computer model must consider to the exclusion of others, the direct effect will be that all participant advice under the PPA computer model approach will favor investments with the lowest fees regardless of the investment's historical performance. This will amount to a strong and unprecedented regulatory bias in favor of passively managed investments regardless of market conditions, individual participant preferences and characteristics, and investment product design. Such a bias would also ignore the fact that actively managed investments out-perform passively managed investments in various market conditions and over certain periods, as described in detail below, in favor of a one-size-fits-all approach. The consequences could be significant. If enacted in its present form, the rule would most likely result in millions of participant accounts being redirected into index funds and other passive investments. In a broadly rising market that strategy could benefit participants overall; however, if markets experience a sustained period of slower, less consistent performance, participants invested in index funds would likely miss out on gains produced by active management.

The evidence does not support the Department's conclusions and implications regarding historical performance.

The hoary debate about the relative merits of actively and passively managed mutual funds typically weighs performance statistics covering different categories of funds over different time periods. From a regulatory perspective, the question should not be whether varying circumstances tend to favor one kind of fund over the other but should be whether one approach so overwhelmingly dominates the other in practice that regulation should favor one over the other. While the broadest statistical findings tend to favor passively managed funds, the degree of difference in favor of the passive management style is insufficient to justify such a drastic regulatory determination. Moreover, actual investor behavior indicates that fund purchasers not only prefer active funds, but they systematically favor out-performing actively managed funds over weaker competitors.

Frequently cited studies report that a majority of funds underperform their respective benchmarks. For example, according to S&P, an average of 52% of domestic equity

funds underperformed the S&P Composite 1500 index[2] (gross of any fees) each year between 2000 and 2009. Similarly, for periods ending December 31, 2009:

- Over five years, just over 60% of actively managed U.S. equity funds underperformed this benchmark;
- Over three years 54% underperformed;
- For one year 42% underperformed.

Actively managed funds' critics interpret data like these to impugn the performance and question the utility of active funds. They oversimplify.

First, comparisons between funds and indices, the latter of which are not directly investable, neglect to consider the fees that index-tracking investment vehicles charge their customers. More importantly, these ratios in fact demonstrate that significant proportions of active funds do outperform this benchmark. If 60% of funds underperformed, 40% outperformed. Limiting retirement investors' advice to index or other passive funds would deny meaningful guidance about the full range of investments, including these outperforming funds.

Such a limitation would be less important if investors were proven incapable of selecting outperforming funds; the evidence suggests that they actually choose successfully. The statistics set forth above weight all funds equally. To better understand the choices investors make in practice, funds in each category should be weighted by their respective assets, so that larger funds – the ones that investors favor – will affect the statistical results more than smaller funds, which less successfully attract investors' assets. When managed funds are compared with indices on an asset-weighted basis, the results differ considerably:

- Averaged over five years and equally weighted, domestic equity funds outperformed the S&P Composite 1500 by 10 basis points, but when funds are asset weighted, they outperformed by 76 basis points (1.46% versus 0.69%);
- When asset weighted, actively managed large, small, and multicap (though not midcap) funds five-year outperformance also exceeded their respective benchmark returns;
- Asset weighted returns exceed equal weighted returns for
    - International/global equity funds and
    - 10 of 13 fixed income categories (two others are essentially equal)

Investors appear to discriminate among funds' performance and vote with their dollars, preferring the better performing funds over less successful competitors. Limiting computer model investment advice to a menu of passive funds would deny participants the opportunity to make these selections. The Department should not impose such a draconian restriction on investment advice without overwhelming evidence that certain

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[2] Data from Standard & Poor's Indices Versus Active Funds (SPIVA) Scorecard, Year-End 2009. http://www.standardandpoors.com/indices/spiva/en/us.

categories of investments are simply not in investors' best interests. The available evidence does not support such a conclusion.

Denying plans and participants access to advice about actively managed funds creates an additional problem for asset allocation funds of funds.[3] There is added complexity in these vehicles in that they not only include stock selection but also include asset allocation that changes over time. Asset allocation, itself, requires active management as there is not an allocation benchmark for an investor at any specific point in time. Consequently, there is not a single solution for how that allocation should change over time. In short, there is no broadly accepted index benchmark for life-cycle, asset allocation funds. Requiring advice to include only index or other passive products would reduce investors' access to alternative asset allocations, which by definition are actively managed. Asset allocation is a significant driver of future results, along with individual fund selection. Therefore, choice in asset allocation and roll down are key elements for a lifecycle fund to fit various risk/return appetites.

The academic literature covers the active/passive debate with arguments about market conditions, asset classes, and other variables that favor one approach or the other. The issue is in fact much simpler. Active managers can and do outperform indices, and investors appear to choose funds that do outperform. Those conclusions leave no basis for regulatory preference to the use of either actively or passively managed funds.

For the reasons discussed above, the final rule on participant investment advice should not prohibit or discourage the use of historical performance in computer model or other investment advice programs.

Again, OppenheimerFunds appreciates the opportunity to comment on this proposal, and appreciates the Department's efforts to expand the availability of quality advice for retirement plan participants.

Respectfully submitted,

Lori E. Bostrom
Senior Vice President
and Deputy General Counsel

[3] Although the proposed rule does not require a plan's asset allocation funds to be included in the recommendations generated by a computer model, as discussed in more detail below, the broader implications of the rule would nevertheless discourage plans from offering asset allocation funds at all.