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Department of the Treasury
Internal Revenue Service
CC:PA:LPD:PR (IRS REG-115809-11) and (IRS REG-110980-10)

RE: Comments on 2012 Proposed IRS Regulations:
IRS REG-115809-11, Longevity Annuity Contracts;
and
IRS REG-110980-10, Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options under Defined Benefit Pension Plans

Ladies and Gentlemen:

Thank you for your leadership on the proposed regulations concerning longevity annuity contracts under defined contribution plans and partial annuity distribution options under defined benefit plans. On behalf of Financial Engines, I appreciate the opportunity to submit to the Department of the Treasury (the Department) and the Internal Revenue Service comments for its consideration on these important proposed regulations.

Financial Engines, Inc. (NASDAQ:FNGN) is a leading independent investment advisor offering retirement help to over 8 million plan participants.[1] We also provide discretionary professional management services to more than 560,000 participants[2] in defined contribution plans and help them with their retirement planning needs from saving and investing for retirement to creating steady lifetime income in retirement.

As Managing Director of Financial Engines' Retiree Research Center, I have done extensive research on longevity annuities.[3] In addition, Financial Engines has conducted research on economic and behavioral issues related to lifetime income, publishing a number of papers in academic and industry journals. Our 14 years of experience providing independent advisory services to millions of employees have given us insights into the lifetime income preferences of both plan participants and plan sponsors.

We are very supportive of the proposals by the Department to remove barriers to effective use of longevity insurance. Complexities involving required minimum distributions represent a significant impediment to using longevity insurance in defined contribution and IRA accounts. Updating current regulations to deal with these complexities opens up a new avenue for many

[1] As of December 31, 2011. Advisory services provided through Financial Engines Advisors L.L.C., an SEC registered investment advisor.
[2] As of December 31, 2011.
[3] Scott, Jason S. "The Longevity Annuity: An Annuity for Everyone?" *Financial Analysts Journal*. 64(1) (January – February): 40-48. 2008.

1804 Embarcadero Road • Palo Alto, CA 94303 • Telephone: (650) 565-4900 • Fax: (650) 565-4905

Americans to achieve retirement security. We commend the Department for considering these important changes. We provide the following comments to assist in clarifying several key elements of the proposed regulations to further advance the goal of expanding lifetime income choices.

Comments on Longevity Annuity Contracts (IRS REG-115809-11)

Benefits of longevity annuities

My research has shown that the use of longevity annuities is a very efficient way to protect against longevity risk. In an example from my published research[4], an 11.5% longevity annuity allocation provides the same effective insurance benefit as a 60% allocation to an immediate annuity. Given that individuals value access to liquidity, a longevity annuity provides an important way for individuals to simultaneously maintain high levels of liquidity while still gaining significant protection against outliving their assets. In this example, taking advantage of the longevity annuity resulted in a 33% income boost compared to trying to self-insure against longevity risk. While individuals have historically been reluctant to annuitize large fractions of wealth, we believe a longevity annuity in conjunction with a strategy for early retirement spending provides a compelling balance of liquidity and longevity protection.

However, a significant barrier to using retirement assets to acquire longevity annuities has been the required minimum distribution rules. The proposed regulation effectively addresses this issue and represents a major step forward in helping provide individuals with the building blocks necessary to create lifetime income.

Comments on Partial Distributions IRS REG-110980-10

The appeal of lump-sum distributions

The prospect of retirement can be daunting. Near-retirees are faced with many decisions and questions: *What is life like without a paycheck? What are expenses likely to be? What is and is not covered by Medicare? Will I need to downsize my house? Should I defer Social Security?* If this individual is covered by a defined benefit pension plan, another decision must be made – *Should I take my pension benefit as a lump-sum payout or as an annuity*? More concretely, the decision could be, for example, $1,000 per month for life, or $200,000 in a lump-sum payout. Given all the uncertainty associated with a retirement future, it is no wonder many individuals opt for the flexibility of a liquid $200,000 compared to a promise of a lifetime payout of $1,000 per month. An all-or-nothing income decision right at retirement often results in individuals choosing all liquidity and no income.

The proposed regulation can help address this issue by providing an alternative to the all-or-nothing decision. By encouraging defined benefit plans to offer partial annuitization options, individuals will have options that include some income security as well as some liquidity. This flexibility can result in increased income security.

[4] Scott, Jason S. "The Longevity Annuity: An Annuity for Everyone?" *Financial Analysts Journal*. 64(1) (January – February): 40-48. 2008.

We offer clarifying comments in three areas:

<u>Define annuitization to include longevity annuities</u>

The proposed regulations identify a desire to “make it simpler and easier for a plan to offer an optional form of benefit that is a combination of a single-sum payment and an annuity.” We would encourage the Department to further clarify what constitutes an “annuity.” In particular, we would suggest that proposed regulations explicitly identify a lump-sum and longevity annuity combination as potentially desirable from a plan participant perspective.

As described in my previous comments and, as detailed in the proposed longevity annuity regulations, a longevity annuity offers an efficient mixture of liquidity and insurance. If the concept of a large liquid portfolio combined with a small longevity annuity contract proves to be a desirable combination, then encouraging that combination on the defined benefit distributions should be a priority for the Department.

Extending the previous example, a person may currently be offered the option to choose between <u>either</u> $1,000 per month <u>or</u> a $200,000 lump-sum. With partial annuitization options, the person might be offered an option that is $100,000 lump-sum and $500 per month starting immediately. However, a third, and perhaps more desirable option, might be $170,000 lump-sum and $1,000 per month beginning at age 85. This third option essentially reproduces the liquidity / security balance envisioned in the current longevity annuity proposed regulations.

<u>Allow participants to defer liquidity decision</u>

We believe that one of the major contributors to the decision to opt for liquidity over security is the timing of the decision. Given all of the daunting uncertainties facing individuals at retirement, choosing liquidity is not too surprising. However, the decision could well be different if individuals could decide after having the opportunity to experience retirement for a specified period of time. No longer would retirement be quite so unknown, and individuals might find that secure income is more desirable. Evidence from immediate annuity sales suggests that annuities may be more desirable later in retirement. For example, a recent LIMRA study of 55,000 immediate annuity sales in 2008 and 2009 found that the median purchaser was female and 73 years old.[5]

Given the potential for participants to demand high levels of flexibility at retirement and to desire income guarantees soon thereafter, we would encourage the Department to allow flexibility regarding the timing of the lump-sum decision. For example, we believe a defined benefit plan that allows participants to convert annuity payouts to a lump sum at any time *after* retirement would encourage participants to try lifetime income. A defined benefit plan that provides lifetime income by default, but can be converted to a lump-sum at any later date, would eliminate the need to make an irreversible decision at retirement and allow participants to make lifetime income decisions later in retirement when they are presumably much better informed about their actual needs and circumstances. If allowing a lump sum decision at any future date proves too costly from an actuarial

[5] LIMRA. 2010. “Guaranteed Income Annuities (2010).”

perspective, then we recommend offering this flexibility for three to five years post retirement. Given mortality rates during these early retirement years are typically low, the actuarial impact of this provision on the income potential should be modest.

Facilitate lump-sum distribution rollovers into employer-sponsored defined contribution plans

Lump-sum distributions from defined benefit plans typically become IRA rollovers. While each plan and each participant's situation will be different, in many cases it is advantageous for a defined benefit participant to use their employer's defined contribution plan instead of an IRA for rollover dollars. The defined contribution plan is more likely to have favorable pricing on investment products and annuity options. In addition, the defined contribution plan is, in many cases, the only source of asset allocation and retirement income advisory help available to lower balance participants. Access to investment advice help in the retail marketplace is generally limited to those investors with higher balances (e.g., $250,000 or more). We believe regulations that facilitate the rollover of lump-sum distributions into an employer's defined contribution plan would make it possible for all participants to benefit from institutionally priced products and services that they would otherwise not be able to access.

The Department could encourage this, for example, by allowing the employer-sponsored defined contribution plan to be the rollover default for defined benefit lump-sum distributions. By having defined benefit lump-sum distributions automatically put into the defined contribution plan, the Department would encourage participants to continue to use lump-sum distributions for retirement purposes and would provide many individuals with access to higher quality and lower cost investment and advisory services than they would find in a retail environment. These services would also be subject to high standards of fiduciary selection and monitoring.

Financial Engines appreciates the opportunity to comment on the proposed regulations. We welcome the opportunity to work with the Department and to provide any further assistance that may be helpful. Please contact us should you have any questions.

Very truly yours,

Jason Scott

Jason S. Scott
Managing Director, Retiree Research Center

cc: Mark W. Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary (Retirement and Health Policy), Treasury
George H. Bostick, Benefits Tax Counsel, Treasury
William M. Evans, Department of the Treasury
Harlan Weller, Department of the Treasury
Jamie Dvoretzky, IRS
Peter J. Marks, IRS