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January 30, 2007

<u>Filed Electronically</u>
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington D.C. 202010
Attn: 401(k) Plan Investment Advice RFI

Ladies and Gentlemen,

Financial Engines respectfully submits the following comments in response to the Department of Labor's request for information on the provision of Investment advice to participants in individual account plans. Financial Engines Advisors L.L.C., a wholly owned subsidiary of Financial Engines, Inc., is a registered investment adviser that provides personalized investment advice and management services directly to plan participants in 401(k) and similar plans. Financial Engines is a leading provider of independent advisory services to large plan sponsors, working with many of the nation's largest employers and retirement service providers.

Financial Engines offers investment advice and portfolio management to help participants achieve retirement security and to assist plan sponsors in discharging their fiduciary duties. Services are delivered via mail, Internet, and telephone, and are designed to reach and impact participants regardless of the amount of time they have to devote to investing or their level of investment expertise. Powered by proprietary technology and proven and documented methodology, Financial Engines delivers independent, unbiased advice and management personalized to each participant's unique goals and financial circumstances.

Financial Engines was founded by Nobel Prize-winning economist William F. Sharpe, one of the fathers of Modern Portfolio Theory. Dr. Sharpe has helped some of the nation's largest pension fund managers invest billions of dollars of retirement assets. Through Financial Engines, these services, previously available only to the largest institutional clients, are now available to individuals.

As of December 31, 2006, Financial Engines offers services to over 5.7 million participants through leading plan sponsors and financial institutions.

One hundred percent of Financial Engines revenues are derived from offering advice and managed accounts. Financial Engines provides strictly objective and independent advice and investment management. Financial Engines does not receive any commissions, soft-dollar payments, 12-b1 fees, or any other revenues from the sale of investment products. No revenue is directly or indirectly received from asset management companies based on investment recommendations. Personalized advice and portfolio management is Financial Engines' sole business focus.

Financial Engines has assembled top professionals from the fields of finance, academics, business, law and government to lead the company and offer every investor the same kind of high quality, personalized, and independent advice previously only available to the wealthy.

Financial Engine's investment methodology is consistent across all recordkeeper partners regardless of whether the company serves as an advisor or subadvisor to the plan sponsor.

Requests for information

Computer model certification:

1. What procedures and information would be necessary and adequate to determine whether the computer model used in connection with an investment advice program satisfies the criteria described in ERISA section 408(g)(3)(B)? For example, would it be necessary to examine underlying computer programs/algorithms, computer software/hardware, or input data including investment specific information; would it be possible to make a determination based on the results of applying the investment advice program to a sample set of the input data? (Commenter are requested to explain by reference to each of the five computer model characterizations described in section 408(g)(3)(B) be summarized above.)

The procedures required to adequately determine whether a computer model satisfies the criteria described in ERISA section 408(g)(3)(B) would include the following steps:

- Examination and evaluation of the investment methodology used to provide investment recommendations to determine whether the process was based on generally accepted investment theory (e.g. modern portfolio theory).

- Evaluation of the methodology used to model investment expected returns, volatilities and correlations, including reviewing sample input data to determine general consistency with the long-term historical record.

- Evaluation of current market information (interest rates, inflation rates, etc.) that may impact asset class expected returns, correlations, and volatility.

- Evaluation of how the investment exposures of investment funds and securities are modeled, including details on categorization of securities.

- Evaluation of the methodology used to model specific investment products, including the adjustments made to asset class expected returns and volatilities, due to instrument-specific factors, such as expense ratios, tracking error, costs due to turnover, etc. This may include reviewing the modeling results for a sample of proprietary and non-proprietary investment products (both actively managed and passive). For instance, a bias could be built into a model by ignoring or underweighting the impact of investment fees in selecting funds.

- Evaluation of the optimization procedure used to construct portfolio recommendations based on the above inputs, including any constraints imposed on the allowable allocations (if any). For instance, a bias could be built into a model by imposing a maximum allowable allocation to passive investment funds, or a minimum exposure to international equities if the only available fund is a proprietary product.

- Evaluation of information about participants that impact the advice. At a minimum, the model should be able to take into account differences due to:
  - o Investment horizon (age)
  - o Desired retirement age
  - o Risk tolerance
  - o Multiple-plans
  - o Outside assets
  - o User-imposed investment preferences (e.g. no international exposure)
- Evaluation of the presentation of the computer model allocations to ensure that there is no bias in the display of investment recommendations. For instance, placing proprietary product recommendations in a more prominent position.
- Ensuring that the model recommendations are able to accommodate all the standard types of investment products found in 401(k) plans, including mutual funds, institutional funds and commingled accounts, company stock, and stable value products.
- Account for the presence of multiple plans, rules, and schemes within a sponsor's retirement benefits. Each plan needs to be accurately modeled. Also, each plan's unique features should be tested to ensure that the forecasts are accurate and that the advice is consistent with the plan's characteristics.
- Evaluating how the presence of outside assets impacts the computer model recommendations in the advised account. For instance, determining how the presence of restricted company stock impacts the recommendations.
- An evaluation of the controls in place to ensure that the model designers are not influenced in any way by the potential for economic gain due to flows into proprietary products. What is the management structure of the modeling team? How are decisions ratified and documented?

2. What types (e.g., technological, financial, other) and levels (e.g., educational, professional experience, professional certification) of expertise would be required to determine whether a computer model used in connection with an investment advice program satisfies the criteria described in ERISA section 408(g)(3)(B)? (Commenters are requested to explain by reference to each of the five computer model characteristics described in section 408(g)(3)(B), summarized above.)

Given the complex nature and methodology of these types of platforms, it will be necessary to obtain considerable technical and financial expertise to evaluate the model against the above criteria. Since there are many degrees of freedom in design decisions, and the fact that seemingly subtle changes in methodology can have a dramatic impact on the character of the recommendations, it would be prudent to seek experienced and objective experts to evaluate an advisor's satisfaction of the ERISA criteria.

Specifically, it would be desirable to retain expertise with graduate-level academic training in fields such as economics, finance, statistics, and mathematics. The goal of the evaluation is to determine whether the model is economically objective in the types of recommendations it provides. This requires experts with knowledge and experience with

portfolio optimization and modeling. Such experts can be found in consulting firms, accounting firms, and similar organizations. It will be important to make sure that the experts have suitable levels of experience (5-10 years or more) with such techniques, and that their firm is not economically dependent on the advisor being reviewed.

3. With respect to currently available computer models or programs for providing investment advice to plan participants or beneficiaries in the form of asset allocation portfolios comprised of plan investment options:

a. What is the process for designing, developing and implementing the computer model/program? What parties are involved? What are their roles? What hardware and software technologies are used to construct computer model investment advice programs? What direct economic costs associated with the process for designing, developing and implementing the computer model/program?

We use a conventional, multi-phase development methodology. The process makes heavy use of prototyping and accommodates multiple levels of user testing and compliance review at major checkpoints in the process. The process works as follows:

1. Product Marketing defines the Marketing Requirements Document (MRD) and detailed Product Requirements (PRD) for a release. This process also includes extensive user interviews and testing with mockups, and legal, compliance, and fiduciary reviews.

2. Engineering develops technical designs and detailed functional specifications for the release; Financial Research develops any finance related specifications

3. Quality Assurance develops a test plan, test designs and automation tools for the release.

4. Engineering develops the software code until it is "Functionally Complete."

5. We then conduct additional user tests with a working product.

6. Engineering completes any additional development and completes unit tests to ensure the code is "development complete."

7. QA verifies that the code is ready for system testing by ensuring that the release meets "Entrance Criteria"

8. QA completes full system test following the previously approved test plan. Financial Research & Development assists with quality assurance to verify the fiduciary elements of the test plan

9. Customers complete user acceptance testing on our primary accepting testing environment.

10. When the release meets "Exit Criteria," it is readied for production release (requires signoff of Engineering VP; Product Marketing VP and QA Director)

Product is released to production; Production Acceptance Testing is executed. If successful, the release is made available to customers; otherwise, it is rolled back.

The primary hardware and software technologies used to construct our Advisory programs are:

o   Java (all of our software is written in Java)

o   Ilog's CPLEX optimizer

o   Tidal scheduler for job configuration and scheduling

o   Microsoft's SQL/Server 2000 as our relational database

o   Yodlee's data aggregation service

o   Microsoft Windows 2000

o   IBM and Dell Intel based servers

The direct economic costs are the people and systems costs for the Technology, Product Management and Financial R&D organizations. On an annual basis the cost of producing and maintaining a computer-based advisory system consistent with the quality of Financial Engines is in excess of $20 million dollars.

b. *What types of modifications are made to the computer model/program after use has begun? Why and how are the modifications made to (use e.g., changes in methodology, technology, economy, marketplace for plan), and how do the modifications affect the investment advice provided? What parties are involved in the modification process, and what are their roles? What direct economic costs maybe associated with the modifications?*

> In the case of Financial Engines, as well as other vendors, the models are updated periodically to provide fresh input data and to add additional functionality as needed to satisfy customer requests. Generally, significant new functionality is added during major product release cycles, which may be on a schedule of every 6-12 months. On a more frequent basis (daily, weekly, monthly), new data on investment returns, prices, and modeling parameters may be enter into the system to update the investment model.

> The costs of modifying the system can vary widely depending on the character and scope of the modifications. Generally, modifications will be detailed in formal specification documents developed by a product management team, perhaps in combination with financial research and development personnel. An Investment Committee must approve any changes that might affect the nature of the advisory recommendations. Then the specifications are developed into functional specifications by a development team under the direction of a release project manager. The code is then written by developers and tested by a separate software quality assurance group. Finally the release is approved by the development project manager. Most of the cost associated with such modifications is related to the costs of employee time, though sometimes new functionality requires new types of input data, which may need to be licensed from third parties (e.g. holdings data).

c. What economic costs and benefits are associated with the use of the computer model/program for providing investment advice, including changes in investment performance and in retirement wealth due to the provision of such advice? What are the indirect costs and benefits such as impact the markets for financial services, including investment advice services, and impact on financial markets, including demand for and pricing of securities?

The primary benefits of the use of computer models in providing investment advice is consistency in the application of the methodology to create recommendations (avoiding subjective bias), and reducing the costs of providing high-quality advice to participants with relatively low balances. The presence of such models in the marketplace has significantly expanded the reach of high-quality investment advice in the marketplace, due to enhanced scale economics. Traditionally, investment advice had been limited to investors with significant financial assets, due to the cost of supporting the standard human-advisor based service model.

The benefits participants typically receive from the use of Financial Engines advisory services include more efficient investment allocations at more appropriate risk levels, resulting in higher expected growth rates and higher probabilities of reaching investment goals.[1] In general, 85% of users of online advice receive a Forecast. Nearly two-thirds receive advice on savings, diversification, risk, and/or company stock and nearly half implement some or all of the recommended changes to their plan. Most users return to the service at least once a year, and Progress Reports allow users to monitor their plan on a quarterly basis.

The use of such models is unlikely to have any impact on the demand for or pricing of investment securities.

4. Would the responses to 3a, 3b or 3c differ in the case of the computer model/investment advice program intended to satisfy the requirements of ERISA section 408(g)(3)(B)?

No.

5. With respect to the department's development of regulatory guidance, what special considerations, if any, should be made for small businesses or other small entities, are their unique costs and benefits for small businesses or other small entities?

Although substantial resources may be required to maintain an appropriate level of investment advice quality, no special considerations that might compromise quality or independence should be made to small businesses or other small entities. Providing a comprehensive computer investment advice model for use in defined contribution plans is a large undertaking, requiring considerable investment and development. In our experience, small businesses will generally lack the scale to develop compelling systems capable of servicing modern defined contribution plans. We would suggest focusing regulatory attention on those aspects of the models that are most at risk of being compromised by economic conflicts of interest.

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[1]Financial Engines does not guarantee future results.

Financial Engines appreciates the opportunity to provide information. We welcome the occasion to work with the Department and to provide any further assistance that may be required. Please contact us should you have any questions.

Sincerely,

Christopher Jones
Chief Investment Officer and Executive Vice President