**Oral Testimony of**

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**Before the**

**U.S. Department of Labor**
**And**
**The U.S. Department of the Treasury**

**For the**

# Hearing on Certain Issues Relating to Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

**Tuesday, September 14, 2010**
**U.S. Department of Labor**
**Washington, DC**

## Introduction

- Good morning. My name is Christine Marcks, and I am the President of Prudential Retirement, a business of Prudential Financial.
- Prudential Retirement provides administrative, plan management, investment, and income products and services to retirement plan sponsors and their plans' participants in the public, governmental, private, and not-for-profit sectors.
- We provide those products and services to nearly 6,500 retirement plans—with more than 3.6 million individual participants and annuitants, representing $181 billion in total account values, as of June 30, 2010.

## Context

- Today, I will briefly share our views on American workers' growing need for guaranteed, lifetime, retirement income and the importance of meeting that need within the existing framework of employment-based retirement plans, which is core to our vision for "redefining retirement" for tens of millions of workers and their families.
- I would then be privileged to outline some recommendations on **how** to address that need through specific regulatory

guidance and clarifications we believe are necessary to make this vision a reality.

- Let me begin by providing some context for the need for these recommendations.

## Framing the Need for Change

- While guaranteed income programs are currently available in the retirement-plan marketplace, several impediments restrain plan sponsors from making these programs available and plan participants from electing them.
- First of all, a guaranteed lifetime income form of distribution, within a defined contribution plan, is a **new concept** for many American workers.
- As you know, DC plans have replaced DB plans—traditional pensions—as the primary workplace-based retirement vehicle for millions of American workers.
- Unfortunately, and unlike traditional pensions, most DC plans do not offer guaranteed lifetime income solutions.  And among those organizations that do offer a lifetime income option, many participants are reluctant to use their plan assets to elect and purchase one.
- And because DC plan accumulations are likely to be the largest amount of money many workers ever accumulate, even

a less-than-sizeable account balance can create an illusion of wealth—the mistaken impression that one will have enough to live on throughout his or her retirement years.

- That illusion causes many participants to underestimate—if they consider it at all—the need to purchase a solution that guarantees a stream of income they cannot outlive.
- And even if the risk of outliving one's retirement savings is recognized and understood, many participants reject any solution that locks them into an irrevocable commitment or an inflexible payment stream.
- Finally, some participants may also fear the loss of a solution's full benefit—that they or their beneficiaries will simply lose money—if they die prematurely.

## Insurers' Responses to Participants Concerns

- To respond to these concerns, insurers, including Prudential, have created new forms of guaranteed lifetime income solutions, such as Guaranteed Minimum Withdrawal Benefits, or GMWBs.
- GMWBs address participant concerns by providing guaranteed lifetime income, while also providing access to one's account value at any time.  GMWBs provide protection for retirement income against the risk of falling markets alongside the

potential to gain from rising markets. Participants have the flexibility to control their assets, and the ability to include spousal benefits, as well.

- A more thorough discussion of GMWBs and their benefits is contained in our written submission.

**Recommendations to the Agencies**

- I would like to turn now to our recommendations.
- To facilitate a more favorable environment for guaranteed lifetime-income solutions, employers and participants require greater clarity and guidance. As such, we have identified the following five areas that need the attention of the Agencies:

    1. Modernize and update Interpretive Bulletin 96-1 to provide assurances to plan sponsors regarding the type of information and materials that can be provided to participants about guaranteed lifetime income without being considered investment advice;
    2. Issue guidance that encourages plan sponsors to disclose annuity values, in addition to lump-sum values, on participants' account statements;

3. Clarify that the additional fees associated with guaranteed lifetime-income solutions do not make these products per se imprudent for use as Qualified Default Investment Alternatives;
4. Confirm the well-established principle that the prudence of a fiduciary's actions is judged on circumstances at the time an investment decision is made or reviewed, not in light of subsequent events; and
5. Finally, improve the Annuity Selection Safe Harbor for selection of lifetime income options.

- I will devote most of the remaining time to providing details on improvements to the Safe Harbor. Our written testimony provides further details on all our recommendations.

**<u>Improvements to the Safe Harbor for Selection of Lifetime Income</u>**

- Plan sponsors find the availability of regulatory Safe Harbors to be very useful as they evaluate products and services. At the same time, plan sponsors find the lack of a Safe Harbor, or the lack of clarity about Safe Harbors in certain key areas, to be a significant barrier to offering products and services within a plan.

- We recommend, therefore, that the Department of Labor issue guidance about the annuity selection Safe Harbor to clarify its application to guaranteed lifetime-income solutions.
- We have three brief recommendations, which are supported in more detail in our written testimony.
    - First, the Department should explicitly extend the Safe Harbor, and, if necessary, appropriately modify it, to include a broad range of guaranteed lifetime-income solutions. The fact that a particular guaranteed-income solution is not a traditional immediate annuity should not be a factor in deciding whether the Safe Harbor applies. The more important consideration is whether the solution appropriately protects participants against longevity and investment risks in a manner similar to a traditional distribution annuity.
    - Second, the Department should also provide greater certainty about how frequently fiduciaries need to evaluate the financial strength of the provider of a guaranteed lifetime-income solution. We ask the Department of Labor to confirm that a fiduciary who evaluates the product provider's financial condition at the time the provider is initially selected must conduct subsequent reviews. When conducting these ongoing

reviews, the fiduciaries should evaluate the same factors initially considered and at a frequency appropriate to existing circumstances, but no less than once per year.

- Third, we believe the Department of Labor should reconsider its previously issued guidance and provide a list of factors that fiduciaries should use to assess financial strength. We suggest that these factors include many of those detailed in Interpretive Bulletin 95-1. Specifically, these would include the level of the insurer's capital and surplus; the quality and diversification of the annuity provider's investment portfolio; the size of the insurer relative to the proposed contract; the lines of business of the annuity provider and other indications of an insurer's exposure to liability; credit ratings; the availability of additional protection through state guaranty associations; and the extent of the insurer's guarantees and the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts. We would be pleased to work with the Department in identifying this information and where it can be obtained. In order to avoid any misunderstanding by plan fiduciaries, we ask the Department also to clarify that a plan fiduciary will have protection under the safe harbor if the fiduciary gathers relevant information and prudently evaluates it.

- We recognize this third recommendation is different from the position we took in response to the proposed regulation.
- Since the regulation was finalized, however, our experience and the feedback we have received from plan sponsors indicate fiduciaries struggle to identify and gain comfort with the specific criteria they need to consider.
- Therefore, we believe it would be useful to provide a clearer road map for fiduciaries by detailing the list of factors they should evaluate when they assess the financial strength of a provider.

## Conclusion

In closing, I want to congratulate the Agencies for recognizing and seeking solutions to address the growing need to redefine retirement through the use of guaranteed- lifetime-income solutions, and I thank you for the opportunity to share our thoughts on this important issue and welcome any questions you may have.

**Prudential Financial's**

**Written Statement for the Record**
**for the**
**Hearing on Certain Issues Relating to Lifetime Income Options for Participants and Beneficiaries in Retirement Plans**

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## Topic 1: Certain Specific Participant Concerns Affecting the Choice of Lifetime Income Relative to Other Options

As stated in the Hearing Notice, there has been reluctance on the part of some participants to choose a lifetime-income option as the form of distribution from their defined contribution plan for the following reasons:

1. <u>The Lifetime Income Form of Distribution in Defined Contribution Plans is a "New" Concept for Workers</u>

   In the past, defined contribution plans were viewed as supplementary savings plans, and most workers depended on their employer's defined benefit (DB) plan to provide them with monthly income in retirement. Those who also participated in a defined contribution (DC) plan generally didn't perceive the need for a distribution in the form of lifetime income from their DC plan. With the reduction in the number of DB plans in recent years, many workers have only recently been confronted with the fact that they must save for their own retirement and, at the time of retirement, must decide how to manage the money they have saved. For a variety of reasons many are hesitant to convert the funds in their DC plans to a lifetime-income option and instead select a lump-sum distribution.

2. <u>Wealth Illusion of DC Plan Account Value</u>

   For many, the account balance in their DC plan is the largest amount of money they have ever accumulated. Without a strong frame of reference, seeing a large account balance can create the mistaken impression that they will have enough to live on throughout their retirement years and that they really have no need to "manage" this money to have it last through their lifetime and their spouse's lifetime. This is known as the "wealth illusion."

3. <u>Unwillingness to Give up Control of Assets for Guaranteed Lifetime Income</u>

Plan participants who are given the option of an immediate annuity instead of a lump sum are faced with having to turn over what for most is a large sum of money to an insurer in return for a promise of lifetime income. That's a decision many individuals are reluctant to make. Participants want a measure of control, flexibility and ownership of their assets in the event they are faced with a major expense, such as a medical emergency. With most traditional annuities, individuals are required to annuitize and thus surrender the ability to access their assets. Some newer and non-traditional forms of guaranteed lifetime-income solutions, such as guaranteed minimum withdrawal benefits (GMWBs), address these concerns by providing individuals access to their account values and the flexibility to control their funds. (GMWB, which can only be issued by an insurer, is a guaranteed living benefit option available with a variable annuity. It promises participants future guarantee of minimum periodic withdrawals for life while providing them a measure of control, flexibility and ownership of their assets. In Topic 5 we discuss guaranteed living benefits and GMWB in greater detail.)

4. <u>Aversion to the "Risk Pooling" Concept Inherent with Immediate Annuities</u>

Experts know the most economically efficient way to ensure that a worker will have lifetime income in retirement is to purchase a single-life immediate annuity. Such an annuity is very efficient because of risk pooling. The insurer issuing the annuity assumes the risk that the worker will live longer than his or her life expectancy and pools that risk with other annuity purchasers. Among such a large group, some individuals will live longer than expected; others will die prematurely. Pooling the risk – using some or all of the money of the deceased to pay for the living - lets the insurer issue annuities to everyone at favorable rates. Unless a retiring worker believes he or she will live longer than expected (and family history may reasonably lead to this belief), the worker may be reluctant to buy a product that could end up subsidizing someone else's lifetime income.

5. <u>Fears of Market Loss with Non-Guaranteed Form of Retirement Income</u>

Ongoing financial-market volatility has elevated many worker concerns about their retirement nest eggs, which suffered dramatic market losses after they had begun taking non-guaranteed forms of retirement income, such as those through a managed payout fund. A GMWB or a traditional annuity issued by an insurer, which guarantees a minimum monthly income for life, can eliminate this concern.

6. <u>Fees and Complexity of Insured Guaranteed Lifetime Income Forms of Distribution</u>

Some have claimed that variable annuities with guaranteed lifetime-income benefits, which can only be issued by an insurer, are "too expensive" and "too complex." While there certainly are fees associated with a solution that requires an insurer to assume the risk of a retiree running out of money and provides protection against downside market risk, many individuals with such contracts believe those guarantees have been worth the cost. This was especially true for those who were nearing retirement during the past few years and would have otherwise seen their retirement income drop substantially if it were not for the downside market risk protection for future retirement income payments afforded by the guarantees under guaranteed minimum withdrawal benefit contracts. In the case of in-plan guaranteed lifetime-income payments participants also benefit from institutional pricing resulting from "economies of scale" and from discounts in fees negotiated by plan sponsors. As to complexity, Prudential has found that when these solutions are properly explained, sponsors and participants understand and value them.

7. Longevity Risk Associated with "Lifetime Income" Solutions that are not Guaranteed for Life

   Retirees are concerned that they may outlive their assets. Lifetime-income solutions are available that estimate how much money a retiree can withdraw from accumulated assets on a monthly basis, based on anticipated life expectancy. Since a retiree cannot really predict "length of life," concerns about longevity risk are not addressed by such systematic withdrawals. An insurance solution that guarantees to pay monthly income as long as the retiree lives does address this concern. According to research conducted by Greenwald and Associates, 72% of participants said the ability to "get payments guaranteed to continue for as long as you live" was an important factor for buying a guaranteed lifetime-income solution.

8. Lifetime Income Solutions That Are Not Guaranteed Do Not Protect Spouses

   Some workers are concerned about lifetime-income solutions that do not assure spouses that they will not outlive their assets. Annuity solutions issued by an insurer address this concern by providing spousal benefits in their contracts.

The first four concerns, above, contain the primary reasons why participants have been reluctant to opt for a traditional lifetime-income solutions when they retire. These reasons and concerns were the primary drivers for the development of guaranteed living benefit solutions—both as in-plan solutions and as retail products. We will describe these solutions more fully in our response to Topic 5.

**Topic 2: Information to Help Participants Make Choices Regarding Management and Spend Down of Retirement Benefits**

Recommendation: The Department of Labor should…

- Modernize and update Interpretive Bulletin 96-1 to provide employers with the assurance that if they provide information and materials regarding guaranteed lifetime income, including examples that describe innovative guaranteed lifetime-income options and information to employees on the risks they will face in retirement, it will be considered participant education and not the provision of investment advice.

All stakeholders in the retirement plan industry (including plan sponsors) need to change the way they provide education to defined contribution plan participants regarding the management of retirement-plan assets and the distribution, or "spend down," options available to participants. As the Agencies are aware, defined contribution plans were once viewed primarily as supplemental savings vehicles, and, until recently, the focus of educational campaigns has been on helping participants make informed investment decisions to *accumulate assets*. In fact, the Department of Labor's Interpretive Bulletin 96-1 provides plan sponsors with fiduciary relief for participant investment education. Today, however, we're witnessing a dramatic transformation of the retirement landscape, as traditional defined benefit plans continue to be frozen or terminated, and as defined contribution programs continue to emerge as the primary employer-based retirement-income source for most workers.

In the DC plan construct, the responsibility for generating retirement income and the risks associated with this endeavor now fall on the shoulders of workers. It is not solely about *accumulating assets* but also ensuring that those assets are used effectively to generate a secure amount of guaranteed lifetime income. This creates challenges for the average worker that extend well beyond simply "accumulating assets." As a result, participant education must also move beyond investment decision-making and must cover topics such as: how to generate retirement income; the benefits and risks involved in different distribution approaches, and the solutions workers have available to help them manage the risk and responsibility of generating retirement income for an uncertain life expectancy.

Beginning when workers first enroll in their plan, it is imperative to let them know that the plan's primary purpose is to generate retirement income and to provide them with periodic updates about their future projected retirement income amount, as well as their current account balance. Today, many participants place most or all of their focus on accumulating assets and are lulled into complacency by the so-called "wealth illusion" of viewing their retirement plan as a capital accumulation vehicle, which is reinforced by seeing their retirement account balance presented only as a lump-sum amount. Conditioning plan participants to think in terms of future retirement income will help place the emphasis where it belongs and will, in fact, encourage greater savings, since workers will better understand and be more aware of the differences between their current projected retirement income and what will actually be needed in retirement.

Specifically we recommend updating Interpretive Bulletin 96-1 to:

- Generally state that providing information and materials regarding guaranteed lifetime income can be considered participant investment education.
- Add examples that specifically address guaranteed lifetime-income options with sufficient flexibility so they can encompass innovative solutions such as guaranteed minimum withdrawal benefits (GMWBs). Currently, there is widespread uncertainty about the applicability of existing regulatory guidance

to guaranteed lifetime-income options, as well as to the distribution phase of retirement planning in general.

- Explicitly permit the provision of information to employees, especially as they enter their pre-retirement years, on the risks they will face in retirement, specifically as they enter their pre-retirement years, on the risk they will face in retirement, specifically investment risk, longevity risk and inflation risk.

**Topic 3: Disclosure of Account Balances as Monthly Income Streams**

Recommendation: The Agencies should…

- Issue guidance that encourages plan administrators and service providers to issue participant account statements that describe the accrued benefit in the form of an annuity or other guaranteed lifetime-income value, in addition to simply a "lump sum."

Currently, most benefit statements received by DC plan participants provide only the total account value. Plan participants who receive account balance information solely in the form of a lump-sum value can, or in many cases do, have a false sense of wealth and security.

In contrast, disclosure of account balances as guaranteed lifetime income stream would give participants an accurate sense of the potential retirement income that their savings will generate. This disclosure would be an important component of a broader educational campaign aimed at increasing awareness about the retirement-income phase and help raise awareness and drive participants to increase contributions or modify investment strategies to close projected income gaps. Participants clearly would benefit from receiving statements that disclose not only lump-sum values, but also illustrate annuity or other guaranteed lifetime-income values. The addition of illustrations to the participant's benefit statement would draw needed attention to the primary objective of the plan—generating sufficient retirement income—and not merely to accumulating a sizeable nest egg regardless of the participant's retirement time horizon. As important as this information is to plan participants, it is unlikely that plan administrators and service providers will furnish it if the legal framework for doing so is unclear.

We ask the Department of Labor to promote the disclosure of account balances in the form of a guaranteed lifetime-income stream by issuing guidance that encourages plan administrators and service providers to issue participant account statements that describe the accrued benefit in the form of an annuity or other guaranteed lifetime-income value, in addition to lump sum form. Such guidance should permit a simple illustration of what the current account balance would generate as retirement income if the participant were currently eligible to take a distribution of the account balance and use it to purchase an annuity with distribution beginning at a future date, for example age 65. The illustration would be accompanied by a statement of the material assumptions used in computing the income amount. For simplicity, plan administrators and service providers should be permitted to use published rates, such as those used by the Pension Benefit Guaranty Corporation, as a safe harbor for generating the illustration assumptions. This simple method would not require the development of hypothetical future earnings, contributions or inflation expectations, all of which would add burdens and complexities for plan sponsors, as well as potentially confuse the average participant. If a participant elected to personalize illustrated benefits with certain assumptions, retirement-income planning tools are widely available from plan sponsors or through external resources available in the marketplace. In the case of plan sponsors that currently offer annuities or other guaranteed lifetime-income solutions, the Department of Labor should permit the use of underlying assumptions and purchase rates under the products for illustration purposes.

To help facilitate this important educational component, we urge the Agencies to support the passage of the Lifetime Income Disclosure Act S.2832 and similar measures contained in the Small Business Add Value for Employees Act of 2009 (SAVE Act) H.R. 4742 requiring the illustration of account balances on benefit statements.

**Topic 4: Fiduciary Safe Harbor for Selection of Lifetime Income Issuer or Product and Related Fiduciary Concerns**

Recommendation: The Department of Labor should…

- Extend the safe harbor to cover a broad range of lifetime income options;
- Confirm how frequently fiduciaries need to consider the financial strength of a product provider; and
- Provide a list of specific factors for use in evaluating financial strength of a product provider.

With respect to fiduciary matters other than the safe harbor, the Department of Labor should:

- Confirm that a fiduciary's actions are judged on circumstances at the time a decision is made rather than in light of subsequent events;
- Clarify that the additional fees associated with downside market risk protection and guaranteed lifetime-income payouts do not make these products per se imprudent for use as Qualified Default Investment Alternatives; and
- Confirm the scope of a fiduciary's duties in connection with an investment that is used as a QDIA.

<u>Annuity Selection Safe Harbor</u>

Plan sponsors find the availability of regulatory safe harbors to be very useful in evaluating products and services. At the same time, plan sponsors find the lack of a safe harbor, or the lack of clarity in certain key areas, as a barrier to offering products and services under a plan. Therefore, we recommend that the Department of Labor issue guidance concerning the annuity selection safe harbor that clarifies its application to guaranteed lifetime-income solutions in three key areas:

- First, explicitly extend the safe harbor, and if necessary appropriately modify it, to include a broad range of guaranteed lifetime-income solutions. The fact that a particular solution that provides guaranteed lifetime income is not a traditional immediate annuity should not be a factor in deciding whether or not the safe harbor applies. More important is whether the solution protects participants and beneficiaries against longevity and investment risks in a manner similar to a traditional distribution annuity.

- Second, provide greater certainty regarding how frequently fiduciaries need to evaluate the financial strength of the provider of a guaranteed lifetime-income solution. Currently, the safe harbor offers fiduciaries the option of evaluating financial strength at either the time the provider is selected for distribution of benefits to a specific participant or when the provider is selected, generally, to distribute benefits at future dates. The fiduciary that chooses to make the determination in advance of distributions to specific participants is required to periodically review the continuing appropriateness of that determination. We ask the Department of Labor to confirm that a fiduciary evaluating a guaranteed lifetime-income solution is permitted to evaluate the product provider's financial condition at the time the provider initially is selected, as long as periodic reviews follow. Regarding the nature of subsequent reviews, we ask the Department to confirm that, in general, fiduciaries should review the same type of information considered in the initial evaluation of the provider and at a frequency appropriate to existing circumstances, but no less than once per year.

- Third, after several years of attempting to use these standards, we believe (for the reasons stated below) that the Department of Labor should reconsider its previously issued guidance and should provide fiduciaries with a list of factors to evaluate in assessing financial strength. If the provider can supply fiduciaries with a certification regarding financial information, then, upon prudent evaluation, fiduciaries would be deemed to have satisfied their duty to evaluate the financial condition of the provider. We suggest the factors that the providers supply to fiduciaries track many of those detailed in Interpretive Bulletin 95-1, specifically as they relate to the selection of an annuity provider for the purpose of benefit distributions from a defined benefit pension plan. Specifically, the factors would include the level of the insurer's capital and surplus; the quality and diversification of the annuity provider's investment portfolio; the size of the insurer relative to the proposed contract; the lines of business of the annuity provider and other indications of an insurer's exposure to liability; credit ratings; the availability of additional protection through state guaranty associations; and the extent of the insurer's guarantees and the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts.

We recognize the recommendation in point three is contrary to the position we took in response to the proposed regulation on the selection of annuity providers for individual account plans. But since the promulgation of the regulation, our experience and the feedback we have received from plan sponsors have shown that fiduciaries have struggled to identify and gain comfort with the appropriate criteria to consider in meeting the requirements for the safe harbor. Therefore, we believe it would be useful to provide fiduciaries with a clearer road map by detailing the list of factors they should evaluate in assessing the financial strength of a provider.

Related Fiduciary Concerns

Plan sponsors also inform us that the lack of clarity on certain key fiduciary issues, as they related to guaranteed lifetime-income solutions, is a barrier to offering these solutions. Therefore, we recommend that the Department of Labor issue guidance in the following areas:

- First, confirm the well-established principle that the prudence of a fiduciary's actions is judged on circumstances at the time an investment decision is made, not in light of subsequent events. This confirmation is important in the context of guaranteed lifetime-income solutions. Some plan sponsors decline to consider offering guaranteed lifetime-income solutions because of a mistaken belief that they will have fiduciary liability if the insurer's financial strength deteriorates in the future, even if the sponsor periodically monitors the financial strength of the insurer.
- Second, clarify that guaranteed lifetime-income solutions are not per se imprudent for use as QDIA merely because they require the payment of fees—in addition to investment management fees—that compensate the product provider for offering various guarantees. This clarification would address the concern of plan sponsors that certain fees (e.g., guarantee fees that compensate a product provider for offering guaranteed minimum withdrawals) somehow make a lifetime-income solutions *per se* imprudent for use as a QDIA because of concerns that the contractual guarantees may never get fully utilized by a participant. We don't share that view; instead we believe that a fiduciary must evaluate any particular fee as a component of the overall determination about whether the total fees to be charged to participants are reasonable in relation to the underlying investments and services to be provided.
- Third, confirm the scope of a fiduciary's duties in connection with an investment that is used as a QDIA. We ask the Department to clarify that a fiduciary may, if the fiduciary determines it prudent, (1) use more than one investment as a QDIA under the plan (e.g., different funds for different groups of participants) and (2) replace a QDIA or modify the terms on which an investment is used as a QDIA (e.g., discontinue use of an investment as a QDIA but only for contributions made after a certain date). We specifically ask the Department to offer an example indicating that QDIA protections remain available if a fiduciary prudently decides to retain an investment as a QDIA for contributions invested prior to a certain date but replace it for

contributions invested after that date. Such an example would be particularly useful to fiduciaries who are considering using a lifetime income solution as a QDIA and unsure whether QDIA protections would be available in the future if the fiduciary determines that an insurer's product is inappropriate for additional investments. In determining the prudence of retaining an investment as a QDIA for past contributions, a fiduciary may consider, for example, that participants have been charged fees – in addition to investment management fees- for guarantees that would be forfeited if the fiduciary replaced the investment as a QDIA for both past and future contributions.

We recommend that the Department of Labor recognize that enhanced participant education is, by itself, an insufficient way to reach our common goal of helping workers retire with more lifetime financial security. Given this fact, guidance from the Department on the QDIA safe harbor is especially important. Behavioral finance research in the 401(k) arena shows that many plan participants will not pay attention to the message … or, even if they do, will fail to take appropriate action due to what the researchers call "participant inertia," a difficult-to-overcome tendency to "leave things as they are." We have experienced this with our in-plan GMWB. Despite surveys showing us that plan participants would be "very interested" in investing in an investment option that delivers a guaranteed stream of retirement income, a relatively small percentage of plan participants have actively elected this option. We, therefore, have encouraged plan fiduciaries to consider offering a GMWB as a QDIA. Participants defaulted into a guaranteed lifetime-income product would be notified of when the guarantee would commence, receive disclosure of additional fees and have the opportunity to opt-out. The recent proliferation of plan sponsor-directed defaults for the accumulation of assets has worked, due in no small part to legislation enacted and regulatory safe harbors promulgated as part of The Pension Protection Act of 2006, which encouraged the widespread and successful adoption of automatic enrollment, automatic escalation, and qualified default investments. We strongly believe that employers who wish to help ensure retirement security for their workers should also consider defaulting participants into a solution that features guaranteed retirement income.

**Topic 5: Alternative Designs of In-Plan and Distribution Lifetime Income Options.**

In our response to Topic 1, we set forth various reasons that workers are reluctant to choose a lifetime-income option as their form of distribution. These included: resistance to "new" ideas; the "wealth illusion" created by large lump-sum account balances; an unwillingness to give up control of that lump sum; concerns about fees and complexity of guaranteed lifetime-income solutions; the inflexibility and the irrevocability of traditional guaranteed lifetime-income options; opposition to risk pooling; the need for a spousal benefit; and concerns about "longevity risk," specifically running out of money in retirement.

As we stated in our response to Topic 1, experts know the most economically efficient way to ensure a worker will have monthly income in retirement is to purchase a single-life immediate annuity. However, while such annuities have been available for many years, few retirees select them because of a reluctance to give up control of their assets and opposition to buying a product that, of necessity, requires risk pooling.

In the past decade, insurers have responded to workers' concerns about lifetime income in general—and immediate single-life annuities in particular—by developing guaranteed living benefits. These solutions are now available as both in-plan and retail options, and may take one of a number of forms: The most popular provide either 1) a guaranteed minimum annuitization benefit or 2) a guaranteed minimum withdrawal benefit (GMWB) upon retirement.

The emerging favorite is the GMWB. In fact, 84% of new variable annuity purchasers in the fourth quarter 2009 elected the feature. Additionally, 86% of those with a withdrawal benefit, such as what is offered by a GMWB, said it was an important factor in buying the variable annuity. The benefits of GMWBs, and how they address traditional participant concerns about lifetime-income options, are addressed in greater detail below.

For both types of guaranteed living benefit products, the contracts have two different sets of values: the contract or market value and the protected or guaranteed value.

- The contract value is the market value of the investments, which may change on a daily basis depending on market conditions and the specific investments selected by the individual. Under some offerings, individuals are given a choice of investments from an array of equity, bond and stable value portfolios.

- The protected value is a value established by the insurance company through a calculation that is stated in the contract. This value will be the basis of the annuitization benefit or the guaranteed withdrawal benefit once the individual retires or otherwise starts taking monthly income. Generally, the protected value is the higher of the contract value or one or more guaranteed values designed to protect the individual against market volatility and/or investment underperformance. The guaranteed values are described in greater detail below.

These contracts provide protection against market losses and the opportunity to participate in market gains. In the last few years, as the market value of deferred variable annuities suffered from substantial market downturns, the protected value of annuities with guaranteed living benefits continued to rise. Individuals holding such contracts did not complain about the so-called "high fees" of the guarantees; rather, they were relieved that their guaranteed monthly income in retirement remained steady and secure.

The GMWB not only provides protection against market downturns, it also addresses the greatest concern of retirees: having to give up control of their assets. Individuals can withdraw the current contract value of their annuity at any time they wish, even after they have begun receiving guaranteed monthly lifetime income.

Prudential's in-plan GMWB solution

With regard to in-plan solutions, one example is Prudential's in-plan GMWB solution, which combines many of the most-attractive aspects of traditional annuities—such as certainty, stability and guaranteed lifetime income—with the flexibility and control that those offerings typically lack. It does this by integrating a GMWB with the asset-allocation and target-date funds already found in many defined contribution plans.

Our in-plan solution is designed to operate on a day-to-day basis just like any other defined contribution plan investment option. Participants can invest in the solution by directing payroll contributions or by transferring existing balances. They can remove money by transferring out of the fund or taking withdrawals from the plan. The fund has a unit value or share price that moves up or down daily to reflect the market value of the underlying fund.

Since participants receive income through withdrawals rather than annuity payments, there is no irrevocable decision that requires them to surrender control over their invested account balance. Withdrawing more than the defined guaranteed amount will proportionately reduce future guarantees, but participants are empowered to evaluate the trade-offs and determine what is most appropriate for their individual situation. Aside from this proportional reduction, there are no transaction fees, surrender charges or other financial penalties.

The guaranteed lifetime annual withdrawal amount is defined as a percentage of the protected value, when participants begin taking income. The percentage, which is disclosed and communicated in advance, will vary depending on the participant's age. It is often five percent at age 65. Participants who take "early retirement" between ages 55 and 64 will receive a lower annual amount of income. Those who "defer" starting their retirement income, those aged 70 or higher, will receive a higher annual amount.

Participants control when to start taking income. They also control whether the income guarantee covers just their own life, or also extends to their spouse. The optional Spousal Benefit guarantees annual income for as long as either spouse lives. Because two lives are protected, there is a nominal reduction in the amount of income provided for the same amount of account balance, but there are no additional fees.

Our in-plan solution includes protection against market volatility just before participants start taking income by putting a "floor" on the amount that will be used to calculate their income. We call this the protected value. This protected value initially begins as the amount of total contributions to the product. Once a year on a proscribed date, a comparison is made between the protected value (plus any contributions over the year) and the market value of the living benefit. If the participant's market value is higher, the protected value increases to that level to incorporate any positive market performance, thus establishing a new, higher floor on which guaranteed income payments will be made at retirement.

Similarly, positive market performance after income begins can generate an increase or "step-up" of the participant's annual guaranteed lifetime income. If market performance is not favorable, such increases may not occur, but—more importantly—negative market performance will not reduce the participant's annual guaranteed lifetime income.

Because its guarantees offer participants real economic value, the option does come with a stated, disclosed cost. At 1.00% per year for most investments, that cost compares quite favorably with comparable guarantees available to retail investors.

When used with target-date funds, the guarantees typically take effect 10 years before a given fund's target date, which reflects the expected retirement date of investors in the fund. Thus the guarantees, and the fees required to pay for them, are a cost only when they are most likely to have value to participants.

Our in-plan solution is one example of how a guaranteed lifetime-income solution—with the flexibility and control offered by any other plan option—can be successfully integrated into defined contribution programs, providing plan participants with a retirement-income stream that cannot be outlived.

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