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Prudential Retirement

Target Date Fund Joint Hearing

Before the Department of Labor

And

Securities and Exchange Commission

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Thank you for the opportunity to testify.

In defining default investment alternatives for defined contribution plans, the Department of Labor stated that one of its objectives was to ensure that, "...the regulation is sufficiently flexible to accommodate future innovations and developments in retirement products."[1]

My testimony will focus on exactly the kind of "innovations and developments" anticipated in the regulation as this first generation of target-date funds does not finish the job.

Plan participants remain vulnerable to critical risks that threaten their ability to retire when planned. That vulnerability was demonstrated in dramatic fashion during 2008, when even target-date funds designed for participants retiring as soon as 2010 lost as much as 41% of their value[2].

A secure retirement requires more than just a well-diversified investment portfolio. Defined contribution plan participants need to generate lifetime retirement income and protect that future income stream. A worker's ability to retire should not be dependent on the current state of the financial markets.

Target-date funds enhanced with income guarantees are part of the solution.

Here, plan participants keep investing in the target-date fund as they currently do. However, as the fund approaches its target date – and the participants approach retirement – an income guarantee is activated. The specifics may vary, but the guarantee would have five key features:

- First, it generates an "income base" at the time of activation, likely five to ten years before retirement. The income base is used to determine a plan participant's guaranteed level of retirement income. It initially equals the participant's market value, and can never be less than that amount, plus additional contributions.

- Second, the income base may increase in the years before retirement depending on market performance, but it cannot decline.

- Third, after retiring, the participant will receive a guaranteed level of annual income for life set at a percentage, such as 5%, of the income base at retirement. In this example, a $300,000 income base translates into $15,000-a-year in lifetime income.

- Fourth, during retirement, the income base will never decline, as long as withdrawals do not exceed the guaranteed level of annual income. It may even increase, depending on market performance.

- Finally, both before and after retirement, the participant retains full control of his or her assets and is able to withdraw varying amounts of those assets. Withdrawals before retirement will lower the income base proportionally, as will withdrawals after retirement

[1] *Federal Register* (Vol. 72, No. 205), October 24, 2007, page 60460.
[2] "Ibbotson Target Maturity Report: Fourth Quarter 2008," Ibbotson Associates, 2009, page 5.

that exceed the guaranteed level of annual income. Upon death, the participant's assets are available as a bequest to heirs.

It is important to note that these innovations were anticipated in the regulation defining qualified default investment alternatives, which explicitly allow target date funds with benefit guarantees to qualify as a QDIA.[3]

With respect to fees, once the guarantee is activated, a guarantee fee is charged. It is visible, transparent and fully disclosed to both plan fiduciaries and plan participants.

The asset allocation of a target-date fund with an income guarantee safely enables greater equity participation than a typical target-date fund in the years both immediately before and after retirement, and hence potentially greater opportunity for growth.

A target-date fund combined with an income guarantee also provides critical flexibility for the participant if, for example, unexpected health care expenses arise. This flexibility is particularly important because many retirees are likely to find themselves in just that position, with major medical expenses at some point.

Finally, any assets remaining at the time of death would be available as a bequest to heirs. This could be a significant amount, particularly if the markets appreciated during retirement, or if the participant had a short lifespan in retirement.

Combining target-date funds with income guarantees adds additional levels of oversight and protection for plan participants. Since the income guarantees come in the form of insurance contracts, they are subject to the rules and requirements of multiple state departments of insurance. These regulations include specific valuation and reserving requirements to ensure that the insurers can meet the obligations of the guarantees.

Combining target-date funds with income guarantees offers four unique benefits to retirement plan participants:

- First, it provides a simple, automatic source of guaranteed retirement income from the defined contribution plan.
- Second, it provides a straightforward way for participants to begin thinking about their defined contribution plan as a stream of retirement income rather than a pile of cash.
- Third, it offers flexibility to meet unforeseen emergencies, because participants can always take out more or less than their guaranteed amount. Paradoxically, the mere presence of this flexibility may help more people feel comfortable sticking to their plans and preserving their source of retirement income.
- Finally, it provides an incentive for participants to keep their dollars in the qualified retirement plan after retirement. This keeps them under the watchful eyes of plan

[3] 29 CFR 2550.404c-5(e)(4)(vi)

fiduciaries and lets them enjoy the additional oversight afforded to qualified plans by the Department of Labor and other appropriate regulatory bodies.

At Prudential, we know these kinds of solutions are more than theoretical. As of March 31, over 120 plan sponsors and several thousand of their participants have enjoyed the flexibility, control and peace of mind afforded by Prudential's products that utilize the kind of guarantees I just discussed.

As the Department and the Commission consider how to enhance the protections for plan participants, we would ask that you keep in mind the space for "innovations and developments in retirement products", including income guarantees, which can be part of the solution.

Thank you.

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