

# THE WALL STREET JOURNAL.

Reprinted from the "Guide to Annuities" Special Advertising Section, which originally appeared in *The Wall Street Journal* on November 14, 2007.

## Turning a 401(k) Into Your Own Pension Plan

By Russ Banham

**P**ining for a pension? In this era of defined contribution retirement plans, Baby Boomers fondly remember the feelings of financial security and stability their parents felt knowing a pension check would arrive in the mail every other week.

Now that they're beginning to retire themselves, many Boomers, especially those for whom 401(k) plans are the sole or primary retirement vehicle, wish they, too, had that regular paycheck in the mail. Instead, they're faced with a lump sum of money they'll need to invest on their own. With people living longer these days, what if they outlive these financial assets?

That question is driving a handful of companies to bring back the pension, albeit in a defined contribution-plan context. In the last year, providers have unveiled a range of new products in which a portion or all of an employee's 401(k) assets is invested in annuities promising a steady flow of income for life.

For the most part, employee benefit consultants like what they see. "As defined benefit plans decline in usage, Social Security becomes less of a third leg and defined contribution plans become the primary retirement vehicle, people want guaranteed lifetime income as well as guaranteed investment returns, both of which can be achieved through annuities," says Jim McGhee, senior solution retirement architect at Hewitt Associates.

The new products differ in their approach and scope, but most have taken the tarnish off annuities, an investment product that is, in effect, an insurance policy. Nevertheless, the improvements are substantial. Retirees retain control over their investments and, in some cases, can change their minds about the annuity and maintain the market value of their assets. The fees offered through retirement-plan sponsors are less expensive than annuities bought at retail, thanks to plan sponsorship across the workforce. Best of all, some new annuities literally provide insurance against market downturns, while locking in a market upswing. The result is a defined benefit-like outcome within a defined contribution plan — a guarantee of the bi-monthly pension check revived.

For many retirees, the risks of managing on their own the traditional lump sum payout from a 401(k) plan gives them pause. A survey by employee-benefits consultancy Mercer indicates that 80 percent of plan participants aren't comfortable making plan investment decisions and allocations. Meanwhile, another Baby Boomer turns 60 every 11 seconds — three million

more Americans each year shifting from accumulating savings to distributing their assets.

The anxiety associated with post-retirement investments is understandable. Whereas the investment risk in traditional pension plans is borne by the employer, the post-retirement investment risk of defined contribution plans rests on the choices made by plan participants. "Managing a million dollars in 401(k) assets for many people isn't easy, given the risk of significant market downturns and the possibility of outliving your assets," McGhee says. "Yet, if you asked 100 people at 60 years of age, 'I'll give you \$1 million or \$60,000 a year for the rest of your life,' most would say 'give me the million.' From an economic standpoint, however, \$60,000 a year is the better choice."

Other benefit consultants agree that a guaranteed paycheck every couple weeks provides peace of mind. "People don't want to spend their time diversifying their assets or making sure they won't outlive their savings," says Robyn Credico, national director of defined contribution plan consulting at Watson Wyatt Worldwide. "Annuities offer a way around this, via a guaranteed minimum payment every month or every two weeks."

By investing a portion or all of a 401(k) plan's assets in an annuity, the plan participant cedes the mortality and investment risks to the insurance company, which hedges the financial exposure by absorbing others' similar risks — some people will die sooner and some later. Insurers further offset the financial exposure by investing the fees paid by the plan participants.

Yet the consultants concede that the word "annuity" sends up red flags for many people. "The perception is that you buy an annuity, and in the worst case scenario, you die the next day and the insurance company gets all your money," says Phil Suess, defined contribution investment consulting leader at human resources consultancy Mercer. "The other biases against annuities are their expense and relatively low investment returns." These issues, by and large, have been resolved by providers, Suess adds. "Recent enhancements in annuities have made the products very attractive as retirement vehicles," he says.

## Getting Past the A-Word

Providers like Prudential Financial were well aware of the pejorative taint attached to annuities. "Annuities are stigmatized because of the perception that 'you die and the insurance company wins,'" says George Castineiras, senior vice president of institutional income innovations at Prudential Retirement, a business of the New Jersey-based insurer. "They're the most misunderstood retirement investment out there, and yet they're also what most people seem to want and need. I sat in front of plan sponsors and asked them to tell me what they hated

*Continued on following page*

*Continued from previous page*

most about annuities,” Castineiras says. “I heard about the inflexibility of annuities, the feelings of losing control of your assets and the high cost. We then set about to change those perceptions.”

Many believe that annuities are the next stage in the evolution of retirement planning. “In the past generation, plan sponsors assisted plan participants to save adequately for their retirement years through the provision of 401(k) plans,” Castineiras says. “Then, they helped the participants recognize the importance of diversifying their assets. Now, the job before them is to help ensure they don’t run out of money before they die or become a burden on their children.”

While defined benefit plans took care of this concern in the bygone era, annuities can be tapped for the same provision today — if plan participants can get past the “A” word. “The problem for Baby Boomers is giving over the control of their assets to someone else,” Castineiras says. “This is a generation that has always balked at giving up control — even if it means a steady flow of income the rest of their lives. With Prudential IncomeFlex®, at no stage do participants lose control of their assets. They can choose exactly how much income they want to protect, can cancel this option whenever they want and can take more or less than their guaranteed withdrawals.”

The latter refers to one of the product’s most innovative features. Participants are guaranteed retirement withdrawals at age 65 equal to at least 5 percent of their income base for the rest of their lives — even if the invested value of these assets is depleted by a market downturn. “We’re assuring plan participants that their income base — the notional value that determines future income — will not be reduced by market performance,” Castineiras explains. Participants who elect the IncomeFlex option pay a guarantee fee for its benefits. Taking more than the guaranteed withdrawals will reduce the future guaranteed withdrawal amount.

There’s another positive twist to the IncomeFlex product — a “Happy Birthday” present, of sorts. If the market value of plan assets exceeds the income base on any of the participant’s birthdays post age 50, the product includes a component that increases lifetime payments. “At age 65, you have three values — market value, the minimum 5 percent

guaranteed income growth rate value and the highest look-back value on any of your birthdays,” Castineiras says. “When you’re ready to lock in your annual withdrawals, your income is based on the highest of the three values. For example, if the market value is \$250,000 but your highest birthday value was \$300,000, we will guarantee you a minimum withdrawal benefit of \$15,000 a year for the rest of your life. When you die, any remaining balance goes to your beneficiary.” If a participant decides to opt out of IncomeFlex at the time of retirement, he or she retains the market value of his or her invested assets — no strings attached.

Take the case of Mestek, Inc., which recently introduced IncomeFlex to its 2,500 employees. “Many of our employees are not particularly savvy when it comes to investing, and we felt it was our fiduciary obligation to make sure they’re not short financially at the end of their income stream,” says Dave DeBell, vice president of Westfield, Massachusetts-based Mestek, a privately held manufacturer and distributor of HVAC (heating, ventilation, air conditioning) equipment.

“We had conversations with our outside (retirement) advisor at UBS, who helped us review the IncomeFlex product,” DeBell adds. “We looked into it and liked the idea that even if the market value of the retiree’s assets drops, they are still guaranteed a 5 percent annual growth curve underneath their money. As a fiduciary, I’d be derelict if I didn’t ensure that things of value like this aren’t explored and introduced.” According to the product’s provisions, the 5 percent growth value ends when the individual reaches age 70 or when guaranteed withdrawals begin, whichever happens first.

Noting the volatile fluctuations in the stock market recently, DeBell says those employees that opted for IncomeFlex were blissfully unconcerned. “The vagaries of the market are of no particular interest to them anymore,” he says. “Their income is protected.”

*Russ Banham is a business journalist and is the author of 15 books, including The Ford Century, the award-winning history of Ford Motor Company.*

(Guarantees are based on the claims-paying ability of the insurance company and are subject to certain limitations, terms and conditions. To maintain the IncomeFlex benefit, you must invest in one or more Prudential IncomeFlex Funds.

Like all variable investments, these funds may lose value.)



Prudential IncomeFlex Funds are separate accounts available under group variable annuity contracts issued by Prudential Retirement Insurance and Annuity Company (PRIAC). PRIAC does not provide any guarantee of the investment performance or return of contributions to those separate accounts. PRIAC’s guarantee of certain withdrawals is supported by PRIAC’s general account. Guarantees are subject to certain limitations, terms and conditions. Investors should consider the objectives, risks, charges and expenses of the funds and guarantee features before investing. You should carefully review the Prudential IncomeFlex Important Considerations before investing.

Product availability and terms may vary by jurisdiction. Subject to regulatory approvals.

Prudential Retirement and Prudential Financial are registered service marks of The Prudential Insurance Company of America, Newark, NJ and its affiliates. Prudential Retirement is a Prudential Financial business.