
Prudential Retirement Weds GLWB to TDF

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Searching for a product that will help it capture rollovers from 401(k) plans and give its plan sponsors an income option for participants, Prudential Retirement has wedded its existing in-plan income guarantee, IncomeFlex, to its new line of EasyPath target-date funds (TDFs).

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Here’s how it works: A participant in a Prudential-managed 401(k) plan could enroll—voluntarily or by default—into one of nine new EasyPath TDFs with retirement year targets ranging from 2015 to 2055. Like other TDFs, the EasyPath funds grow more conservative over time, but will always have at least 60% in equities.

Ten years before the participant’s TDF maturity date, the IncomeFlex lifetime income rider would automatically switch on, locking in a minimum income base at an annual cost of one percent of assets. The rider puts a floor under the income base, protecting participants from sequence-of-returns risk—the risk that a bear market will occur shortly before they retire.

“The migration of the [lifetime income guarantee] to the qualified plan environment is the future,” said Mark Foley, vice president of the Innovative Simplicity program at Prudential Retirement.

For insurance companies, \$10 trillion-plus in qualified retirement plans represents a much larger market for the GLWB rider than the \$1 trillion-plus variable annuity niche will ever be. Qualified plans are the massive glaciers from which rivers of rollover money will flow.

“The vendors want to find ways to continue to service those employees once they retire, whether it be through rollovers or an annuity stream,” noted Trischa Brambley, president of Resources for Retirement in Newtown, PA. “If participants like their plan and are familiar with the vendor’s name, then the opportunity to sell them something into retirement is something most vendors would like to pursue.”

For plan sponsors, the question is more complicated. They feel an obligation to offer in-plan income options, but they don’t want lifelong responsibility for former employees. So they’re proceeding with caution, if at all, in choosing income options.

“The plan sponsor community is still coming to grips with what happens when people leave the program,” said David Wray, president of the Profit-Sharing Council of America, a trade group composed of plan

sponsors.

“Small companies are overwhelmed,” he added. “They don’t have the expertise or scale to get best practices, and they’re concerned that employers who take the next step take responsibility. When you choose an insurer to provide an income stream, you’ve made a decades-long commitment. That’s not something you do lightly.”

TDFs—the controversial QDIA

Prudential Retirement manages about \$156 billion for some 3.6 million plan participants. Of that, about \$150 million has been invested in the the original IncomeFlex program across 120 or so plans. The carrier plans to roll out IFX Target to Prudential-managed plans and also license it to other plan providers. As of late April, plan providers Mercer and Hewitt Associates were already signed up.

Prudential hopes IFX Target will ride the coattails of the popular target date funds, which the Pension Protection Act of 2006 blessed as a qualified default investment alternative (QDIA) for automatic enrollment of plan participants. In 2007, TDFs attracted \$58 billion in new deposits—more than all other fund categories combined.

“The TDF has become the most popular QDIA,” added Foley. “We know TDFs are challenged, but rather than ask, are they good or bad, we asked, How can we make them better? How can we make them do what they’re intended to do?”

By “challenged,” Foley referred to the ongoing debate over the adequacy of TDFs as retirement savings vehicles. Many fund companies offer them, but there’s no industry standard. Funds with identical target dates may have different asset allocations, different risk levels, and earn different rates of return.

Indeed, Prudential cited research by Ernst & Young showing that retirees who rely solely on TDFs for retirement income have a one-in-three chance of running out of money if they tap savings at an inflation-adjusted rate of five percent. IFX Target is intended to make sure TDF investors don’t run out of money.

The Easy Path TDFs are predominantly index funds with a REIT as an alternative investment. ““The glide path is a little different from [our] other TDFs. You start out at 90% equities and glide down. But as you move into the retirement phase, you keep a higher equity and alternative allocation, which never goes below 60%,” Foley said.

In addition to the 100 basis-point annual fee for the lifetime income guarantee. The guarantee provides a five percent annual lifetime payout at age 65 (4.5% for joint coverage). Income can start as early as age 55 with a 4.25% annual lifetime payout, or after 70 with a 5.75% payout. The annual expense ratio for all of Prudential’s 2015 to 2055 EasyPath TDFs will be 59 bps.

Under the guarantee, the income base would step up to the account value, if higher, on the investor’s birthday. “We reserve the right to increase the fee at the step up,” Foley said. “But there’s never a withdrawal charge or penalty for taking money out. Operationally, this works and feels like any other investment option. You have the flexibility to walk away at any time.”

Portability is a big hurdle for in-plan income options, according to Wray. As people move from job to job, and income guarantees become more common, participants could accumulate a hodge-podge of small accounts that might be inconvenient for them and unprofitable for providers.

Foley said IFX Target is portable at the participant level and at the plan sponsor level. If participants leave their employers or their plan sponsor changes providers, their money can stay with Prudential. But the participant would lose the guarantee if he or she moved the insured assets into another company's products.

So far there's little or no consensus among qualified plan experts on the merits of the handful of participant income options that have been launched so far—such as IncomeFlex, the MetLife/Barclays SponsorMatch program, the Genworth ClearCourse plan or the Hueler's online single premium immediate annuity (SPIA) platform.

"This new offering is representative of the innovation that has been constant and ongoing in the 401(k) system since it came into being," said Wray. "There is clearly interest in finding new ways to deliver some kind of guarantee in 401(k) plans." His group doesn't evaluate or comment on specific products.

Brambley noted, however, that "anything that has the words 'guarantee' or 'preservation of capital' in it will sell."

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