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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210
Attention: Lifetime Income RFI

Re: RIN 1210-AB33: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

On behalf of MetLife, I am hereby submitting our response to the Request for Information Regarding Lifetime Income Options ("RFI") issued by the Departments of Labor and Treasury and the IRS (the "Agencies") on February 2, 2010.

MetLife thanks the Agencies for the opportunity to respond to the RFI. We also commend the Agencies for issuing the RFI and initiating this very important discussion.

The RFI recognizes the changing landscape of the retirement plan system. MetLife's own research recognizes this dynamic, and also identifies a fundamental issue compounding the changes. Our Retirement Income IQ Study (conducted in 2003 and again in 2008) tested basic retirement income concept knowledge among individuals within five years of retirement. The results indicate significant knowledge gaps exist regarding average life expectancy and other retirement income issues. For example,

- Among the most disturbing findings of the 2008 study was that six in ten Americans (60%) underestimated their average life expectancy
- Almost half (49%) underestimated the amount of pre-retirement income they will need once they retire
- Almost seven in ten (69%) pre-retirees overestimated how much they can draw down from their savings – with an alarming 43% said they believed they could withdraw 10% or more each year while still preserving their principal – even though most retirement experts suggest a withdrawal rate of no more than 4% annually.

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This lack of understanding is particularly concerning because it puts consumers at a disadvantage from the start. Poor retirement planning assumptions are then compounded after retirement by much longer life expectancies. These findings point to the underpinnings for a "perfect storm" of unprepared retirees running out of assets.

The 8th Annual *MetLife Study of Employee Benefits Trends* Study also highlights some very important retirement trends:

- On the positive side, active employer engagement in their qualified retirement plans is increasing and is important to help employees realize adequate income in retirement.
- There is also emerging interest from employers in automatic enrollment, automatic escalation and default annuitization in larger companies to help employees act on their intentions to save.
- That said, despite employee interest, employers have not increased their focus on providing financial advice, guidance and retirement education.
- And to compound the issues, there is still a large disconnect between employers' and employees' interest in employers providing a way to turn an employee's 401(k) savings into a guaranteed stream of retirement income. Forty-four percent of employees surveyed said they would like their employer to offer an annuity option as part of their defined contribution plan, whereas only 10% of employers say they are interested in offering an annuity option as part of their defined contribution plan.

These findings all point to the critical role that annuities play in providing retirement plan participants with guaranteed income solutions, solutions that today's workers and tomorrow's retirees need to create a financially secure retirement. At a time when individuals need help in making the most of their retirement assets, immediate annuities, for example, produce substantially more income per dollar of assets than any other approach. Immediate annuities have the unique ability to generate more income now while covering the risk of running out of money later.

MetLife stands ready to assist you in any way possible as you continue this critical national dialogue. Please feel free to contact me at 212-578-2984 if you have any questions or need any additional information.

Sincerely,

William J. Mullaney
President
U.S. Business

Department of Labor and
the Department of the Treasury RFI
May 3, 2010

MetLife®

Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Executive Summary

Background

The retirement landscape has changed dramatically since the creation of the 401(k) plan in 1978. Historically, large numbers of Americans relied on traditional defined benefit plans; today, most Americans are relying, in large part, on defined contribution plans as their primary source of retirement savings. In most cases, defined contribution plans were designed – and are maintained today – as supplemental retirement savings vehicles not generally structured to provide guaranteed lifetime income.

Why is lifetime income so important? One of the greatest risks facing retirees is longevity risk – the very real risk of outliving retirement savings. Individuals who spend down their retirement assets based on their life expectancy will run out of savings if they live longer than expected, which half the population will do. On the other hand, many individuals who spend as if they will live well beyond their life expectancy will run the risk of under spending, forcing significant changes in lifestyle for fear of running out of money. The only product capable of avoiding these both of these adverse results is an annuity.

Until now, policymakers have focused their attention on coverage and savings rates. However, with increased longevity, the continued decline of the defined benefit plan system, and the impending retirement of 47 million baby boomers – the first boomer turns 65 in 2011 – the Administration's focus on strengthening lifetime income for Americans is both needed and timely. MetLife commends the Agencies for issuing this RFI and for beginning this very important discussion.

Policy Recommendations

The RFI asks a number of questions regarding the barriers to employers offering and participants choosing income annuities in defined contribution plans. The Agencies have requested recommendations to overcoming those barriers. Among the public policy changes that should be implemented are the following recommendations:

To encourage employers to offer guaranteed lifetime income in defined contribution plan:

1. The DOL should simplify the defined contribution plan provider selection regulations by providing an objective safe harbor for the selection of an annuity provider based on the fact that an annuity provider has passed the review of state regulators.
2. The DOL should consider revising the QDIA regulations to require that QDIAs contain an in-plan accumulation annuity component.
3. The DOL and Treasury Department should issue the following:
    a. Guidance clarifying how joint and survivor spousal rules apply to trial annuitization and guaranteed insurance products.
    b. Educational information for employers highlighting trial annuitization.

To encourage individuals to choose lifetime income products:

1. The DOL should take four steps with respect to participant education and advice. The first two relate to IB 96-1 and the second two relate to guidance with respect to advice provided through computer models.
    a. First, guidance is needed to clarify what education may be provided to participants about the distribution phase without that guidance being treated as fiduciary advice.

   b. The current investment elements of IB 96-1 should be expanded to clarify that education regarding investment in in-plan accumulation annuities and guaranteed insurance products is within the reach of the IB.
   c. The DOL should issue "SunAmerica-like" guidance with respect to the distribution phase. In other words, a financial institution would be allowed to contract with an independent expert that would develop and apply a computer model for providing distribution advice based on generally accepted decumulation principles.
   d. The final step for the DOL to take is to incorporate in-plan accumulation annuities and guaranteed insurance products into the SunAmerica and PPA computer models.
2. The DOL should provide enhanced education to plan sponsors about their ability to offer partial annuitization and the benefits that partial annuitization can provide to participants.
3. Congress should consider requiring plans that offer annuities to offer partial annuitization.
4. 401(k) plan account balances should be communicated as lifetime income on annual benefit statements, in addition to the total account balance.
5. If annuitization rates do not increase significantly in the next three to five years due to the voluntary approaches MetLife suggests that the DOL and Treasury Department should then consider mandatory default annuitization. If the voluntary approach does not work, then the mandatory option should be structured so that 50% of the individual's account balance would be defaulted into the lifetime income option. This may also be accomplished with a trial annuity which would allow retirees to test drive monthly guaranteed income payments with the option to opt out during the trial period. This requirement should not apply to employers with fewer than 100 employees or to employers offering an active defined benefit plan with only lifetime income benefits (and no lump sum options).
6. MetLife encourages Congress to consider permitting defined benefit plan sponsors to eliminate lump sum distribution options.

To further facilitate annuitization, MetLife recommends the following tax law changes:

1. The Required Minimum Distribution (RMD) laws should be changed to exempt longevity insurance from RMDs until the benefit payment begins.
2. A targeted tax incentive should be provided for the purchase of an immediate income annuity.

To facilitate the use of in-plan accumulation annuities:

1. MetLife suggests that the DOL consider revising the QDIA regulations to require that QDIAs contain an in-plan accumulation annuity component.

Conclusion

MetLife thanks you for the opportunity to share our thoughts and experiences with you relative to this very important topic. From a societal perspective, the government should enable its citizens to create lifetime income security. As a society, we – including the government, employers, and the financial services industry – collectively have a role in providing the education and tools to participants so that their efforts to save for their retirement are not squandered, but instead are rewarded with retirement security.

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Glossary of Terms

There is a wide variation in the terms used in the lifetime income area, in part because of the evolving nature of the product offerings. To clarify this discussion, the following glossary of terms are referenced throughout this document.

- **Annuity** or **Income Annuity:** Periodic payments that are guaranteed to last for the life of an individual and/or the individual's beneficiary.
  - **Immediate Annuity:** Periodic payments that begin no later than 12 months after purchase and are guaranteed for:
    - the annuitant's life and/or the beneficiary's life, or
    - a certain period of time (five to thirty years – "period certain"), or
    - any combination thereof.

    The annuitant may choose fixed payments that do not vary, or variable payments that are based on performance of underlying investments.
  - **Deferred Annuity**: Periodic payments that begin at a future date and are guaranteed for:
    - the annuitant's life and/or the beneficiary's life, or
    - a certain period of time (five to thirty years – "period certain"), or
    - or any combination thereof.
  - **Fixed Immediate Annuity:** The purchase payment is invested in the insurance company's General Account. Benefit payments are fixed at a constant value for the duration of the annuity.
  - **Variable Annuity:** The purchase payment is invested in a selection of portfolios (sub-accounts) and often include investments in fixed accounts (General Account). Each sub-account is tied to an investment fund, the performance of which, less expenses, will impact the benefit payments.

- **Guaranteed Lifetime Withdrawal Benefit ("GLWB"):** Under a GLWB, the participant's assets that are invested in a target date or balanced fund, move at a specified age (e.g., age 50) into the guaranteed fund component. From that point forward, each additional contribution and any positive market performance may increase the benefit base from which future withdrawals are calculated. The assets are then "wrapped" with a guaranteed percentage withdrawal amount, for example 4% or 5% of the benefit base, which is then the amount that is paid out annually. The participant retains total control over the assets and may choose to liquidate at any point in time as long as there is a market value. If the assets fall to zero, the insurance company steps in and continues to pay the guaranteed withdrawal amount; this payment comes from the insurance company's General Account. The underlying asset pool is generally a traditional balanced fund. This approach provides the most flexibility in terms of control of assets.

- **Guaranteed Minimum Income Benefit ("GMIB"):** Contributions into the annuity establish what is known as an "income base" and this amount compounds at a stipulated rate (typically 5%). On each contract anniversary, if the actual account value exceeds the compounded income base, the contract owner can lock in the gains by stepping up the income base to the higher amount (subject to age limits). The income base continues to compound even when markets, and thus the account value, decline (the income base is not available as a lump sum). In addition, a contract owner can take withdrawals during the accumulation phase. As long as the annual withdrawals do not exceed the income base compounding rate, the income base value stays the same even if the withdrawals and/or market performance cause the account value to drop to zero. To begin lifetime income payments under the rider, the contract must be annuitized. The amount received is the greater of the current account value at standard annuity payout rates or the income base at conservative GMIB payout rates guaranteed under the rider.

- **Guaranteed Minimum Withdrawal Benefit ("GMWB"):** Under a GMWB, the structure works similarly to the GLWB described above. The primary difference is that the withdrawals guaranteed in retirement are for a specified period of time and are not necessarily tied to the participant's lifetime. For example, the guaranteed withdrawals will be for a predetermined specified period of years. If the participant lives beyond that time, the guaranteed payment ends. The participant retains control of any remaining assets.

- **In-plan accumulation annuity:** An annuity contract that is offered as an allocation option under a defined contribution plan that allows plan participants to allocate a portion of their 401(k) plan contributions to a deferred income annuity and thus accumulate guaranteed pieces of future income over time. Participants acquire deferred annuity amounts at various interest rates (the interest rate analogue to dollar-cost averaging into the market) rather than electing an annuity at the point of retirement when interest rates could be low. These in-plan annuities also offer a specific annuity payment benefit for every dollar that is invested.

- **In-plan distribution annuity option:** An annuity that is offered directly by a defined contribution plan as a means of distributing a participant's account balance under a plan. Under this option, the plan sponsor specifies one or more specific insurance companies to provide the annuity benefits as specified in the plan.

- **IRA rollover annuity option:** An option to roll over assets from a defined contribution plan to an IRA annuity or to an IRA holding an annuity contract.

- **Trial annuitization:** Following accepted default principles, this approach would allocate a portion (e.g., 50%) of a retiring participant's defined contribution plan assets automatically into a lifetime income annuity at the point of retirement. These assets would be automatically directed into an income program for a trial period (such as one or two years) unless the participant affirmatively elects a different form of payout permitted under the retirement plan. The purpose is to give retirees an opportunity to "test drive" the benefits of receiving a retirement income "paycheck." At the end of the trial period, participants would again have the ability to opt for alternative forms of payment. Those who made no affirmative choice within a specified period would continue to receive income annuity payments because the program converts automatically from trial-period income annuity to a permanent income annuity, typically at the same income amount.

Section 1: Why is the lifetime income issue so important to protect the retirement security of Americans?
[This addresses question 1 in the RFI]

Evolution Of The U.S. Retirement System

The retirement landscape has changed dramatically since the creation of the 401(k) plan in 1978. Historically, large numbers of Americans relied on traditional defined benefit plans; today most Americans are relying, in large part, on defined contribution plans as their primary source of retirement savings.

By and large, our parents and grandparents did not need to worry about lifetime income issues. Many in the WWII Generation and the Silent Generation worked for corporations that offered defined benefit pension plans. When workers retired, their "paychecks" continued for as long as they lived. They felt secure knowing that they worked hard throughout their life and, when they retired, they and their families would not run the risk of running out of money.

Unfortunately, over the last two decades, the number of private defined benefit pension plans has declined precipitously. In 1986, there were 172,642 defined benefit plans, and 544,985 defined contribution plans. By 2000, the number of defined benefit plans had dropped to 48,773 and defined contribution plans peaked at 686,878. Since 2000, defined benefit plans have remained roughly level, with 48,982 plans in 2007. Although defined contribution plans have dropped slightly each year since 2000, with 658,805 in place in 2007, they still overshadow the number of defined benefit plans today. (See Exhibit 1).

In most cases, defined contribution plans were designed – and are maintained today – as supplemental retirement savings vehicles. As such, they are generally not structured to provide guaranteed lifetime income. Early defined contribution plans provided employees with a supplement to their defined benefit plans, plans that produced a pension check related to the employee's final or career average pay. However, several factors have changed the paradigm associated with defined contribution plans, creating a new problem for plan sponsors and their participants. For example:

- Employee mobility, especially among younger workers, reduced the perceived need for a defined benefit plan to help manage workers into retirement.

- A significant proportion of defined benefit plans added and encouraged lump sum distributions, which were generally less expensive for employers, and more attractive to employees. These distributions helped facilitate the early retirement incentive programs that became widespread in the 1990's.

- Increasing numbers of defined benefit plan sponsors have frozen ("soft" or "hard") their plans or converted them to hybrid cash balance defined benefit plans. The soft freeze excludes new entrants, while allowing benefit accruals to continue for covered employees. The hard freeze eliminates any future accruals for participants covered under the plan The converted cash balance plan removes the direct connection between the level of pre-retirement pay and the amount that the cash balance plan could produce in income under a systematic withdrawal or annuitization form of payout.

- The complexities associated with establishing and maintaining a defined benefit plan have led increasing numbers of companies to utilize defined contribution plans as their only retirement programs. This is particularly true with smaller firms and those with less tenured workforces. As

such, many Americans will be relying on 401(k) plans or personal IRAs as their only retirement plan in the future.

From a societal perspective, the government should enable its citizens to create lifetime income security. As a society, the stakeholders – the government, employers and the financial services industry – collectively have a role in providing the education and tools to participants so that their efforts to save for their retirement are not squandered, but instead are rewarded with retirement security.

Until now, policymakers have focused their attention on increasing retirement plan coverage and savings rates. However, with increased longevity, the continued decline of the defined benefit plan system and the impending retirement of 47 million baby boomers – the first boomer turns 65 in 2011 – the Administration's focus on strengthening lifetime income for Americans is timely. After all, the baby boom generation is the first cohort to be meaningfully affected by the shift from defined benefit to defined contribution plans.

Why Is Lifetime Income So Important?

One of the greatest risks facing retirees is longevity risk – the real risk of outliving retirement savings. According to the Annuity 2000 Male and Female Mortality Tables, a male age 65 today has a 50% chance of living beyond age 85, and a 25% chance of living beyond age 92. Similarly, a female age 65 today has a 50% chance of living beyond age 88, and a 25% chance of living beyond age 94. For a married couple age 65 today, there is a 50% chance of one spouse living beyond age 92, and a 25% chance that one will live beyond age 97. (See Exhibit 2).

Individuals who spend down their retirement assets based on their life expectancy will run out of savings if they live longer than expected. And individuals who spend as if they will live well beyond their life expectancy will run the risk of underspending, forcing significant changes in lifestyle for fear of running out of money. In addition to simply living for more years, the of cost health-related expenses, especially in the final few years of life when custodial care is most likely, are expected by many experts to be very significant, and would occur when funds are most likely to be scarce.

The longevity risk faced by an individual retiree is more significant than the investment risk faced at retirement. Whereas individuals can decrease the investment risk by changing their investment strategy, there is no way that individuals can, on their own, reduce their longevity risk because they cannot accurately predict how long they will live nor do they have a way to recreate the pool associated with a large group, unless they have a form of guaranteed lifetime income.

Longevity risk cannot be reasonably addressed through investments alone. The only product capable of allowing participants to plan for these uncertainties is an annuity. An income annuity, issued by an insurance company, is a guarantee for the lifetime of the annuitant (the person receiving benefits). The use of pooled risk is still an individual's best and most cost-effective defense. When a group is assembled and mortality experience is pooled, the individual is relieved of the need to accumulate significantly more money than otherwise would be needed to guard against living beyond his/her savings. An average retiree, for example, would need to have saved about one-third more to attempt to replicate the power of a mortality pool and, even then, could still risk running out of money. With mortality pooling, an individual only needs savings sufficient to last over the average lifetime of the group. On an unpooled basis, an individual's savings will need to last significantly longer than that average lifetime to provide a comparable chance that he/she will not outlive those savings.

The pooling concept is a powerful one that is at the heart of all insurance products (as well as the mortality element within Social Security and defined benefit plans). Longevity creates a much smaller

risk for large defined benefit pension plan sponsors since the "law of large numbers"[1] permits them to fund for the average life expectancy of the entire group of retirees. When a large group of retirees is pooled, the income benefits received by a retiree who lives longer than expected are offset by those retirees who die before their life expectancy.

Another advantage of receiving some or all of one's retirement savings in the form of guaranteed lifetime payments is that it allows one to receive a steady retirement "paycheck." All their working lives, Americans budget and make their spending decisions (e.g., where they live, where they send their children to school, how often they can dine out, etc.) based on the amount of their paycheck. An income guaranteed to continue for life not only protects against longevity risk, it allows an individual to plan their spending, which may help them to not overspend or underspend in retirement.

On a related note, it is important to distinguish between lifetime income payments and life expectancy payments. Lifetime income payments (i.e., income annuities), guaranteed by insurance companies, will insure payment for the individual's lifetime. In the event the participant dies sooner than expected, lifetime income payments can also be structured to provide for a spouse or other beneficiary. Life expectancy payments (e.g., systematic withdrawals) "assure" payments over life expectancy but may decrease over time depending on investment performance or may actually fall to zero prior to the individual's death. While they will pay out the value of the account to the estate or beneficiary upon the death of the participant, this is balanced by the greater risk that the funds will be exhausted short of the individual's life in at least half of all cases.

[1]The Law of Large Numbers: A statistical axiom which states that the larger the number of exposure units independently exposed to loss, the greater the probability that *actual* loss experience will equal expected loss experience.

Section 2: Common misperceptions about income annuities
[This addresses question 2 in the RFI]

Income annuities can generate, by far, the highest level of lifetime income per dollar of retirement assets put to work. Income annuities are uniquely positioned to address a major challenge that will arise in the financial lifetimes of all retirees and those approaching retirement – how to make their income last as long as they live. Although income annuities provide exceptional value in terms of meeting this longevity challenge, persistent negative perceptions and confusion on the part of the media, plan sponsors and their participants regarding annuitization have made acceptance of this solution difficult. The conversation needs to shift to educate all parties that retirees must not only invest for retirement but also insure for retirement. This RFI is the start of a national dialogue on the value of lifetime income solutions and, MetLife expects that, through this process, the misperceptions surrounding income annuities will be dispelled.

The following is a collection of the most common misperceptions – and the associated realities:

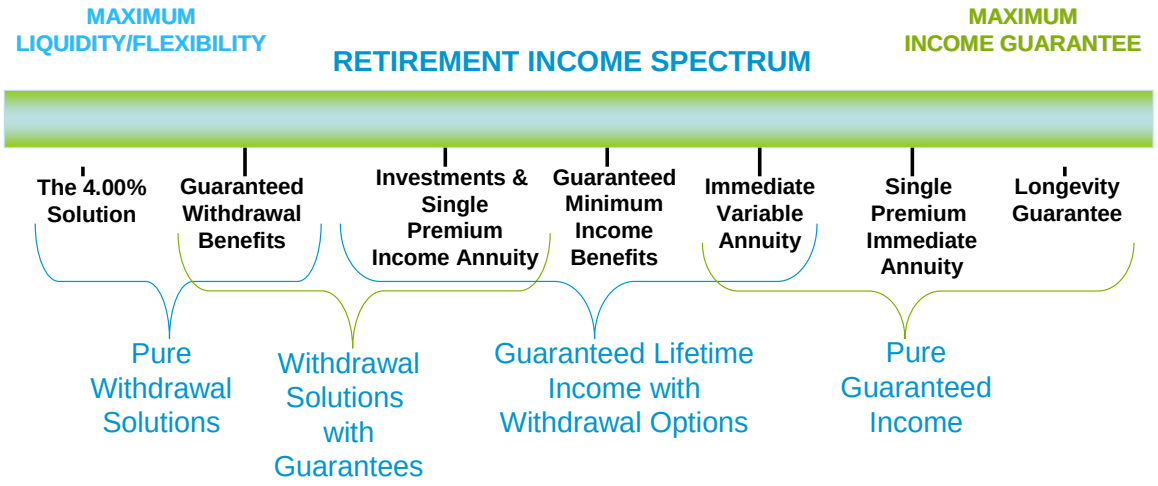
Misperception	Reality
An income annuity is an all-or-nothing solution.	Plans should be designed to provide partial annuitization. Effective retirement planning is a holistic endeavor. There are many financial needs to be addressed in retirement. One product cannot possibly meet all these needs. Instead of answering *whether or not* the account balance should be fully annuitized, the question is *how much* should be annuitized.
Income annuities are irrevocable and lack liquidity for emergencies or unforeseen events.	It is true that traditional income annuities often provided no liquidity. However, an increasing number of income annuities in the market today, provide for liquidity during all or part of the annuitization period and provide a choice of full or partial withdrawals. Since it is recommended that only *a portion* of the account balance be annuitized the remaining portion of the account balance is available to meet liquidity needs.
Income annuities lead to a loss of control of assets.	This is certainly true if annuitization is viewed as an all-or-nothing solution. However, when income annuities are included as *part* of the overall retirement plan the individual retains full control of the portion not allocated to income annuities.
Income annuities are expensive.	This is an “apples to oranges” comparison. With an annuity, an individual is paying for a benefit that investments cannot provide: the guarantee that you will not outlive your money. Much like life insurance provides financial security in the event of an early death, income annuities provide financial security in anticipation of a long life.

Misperception	Reality
Income annuities do not keep up with inflation because the income payments do not change over time.	While most traditional fixed income annuities do not provide explicit protection against inflation, the development of inflation-indexed income annuities does address inflation risk. However, this often generates questions about the cost of this protection. Inflation-protected income annuities have a lower starting income level than income annuities without an inflation adjustment. It is also possible to purchase cost-of-living-adjustments ("COLAs") which provide a flat percentage increase every year (e.g., 1%, 2% or 3%).
Buying in a low interest rate environment is a bad investment.	If you defer purchasing an income annuity until interest rates rise, your income during this waiting period must come from systematic withdrawals out of your retirement savings. However, during this time you are not taking advantage of the mortality credits that are inherent in an income annuity. This causes the systematic withdrawals to be more expensive than simply buying an annuity, even in a low interest rate environment. In addition, while waiting for interest rates to rise, you remain subject to market risk.

Section 3: How have lifetime income products evolved to meet the needs of today's retiree?
[This addresses questions 3, 4, 5, 6, and 7 in the RFI]

Overview

There is a full spectrum of retirement income options available today that range from maximum liquidity/flexibility at one end to maximum guaranteed income at the other, which the chart below illustrates. These solutions include fixed payments that never change (regardless of market conditions); withdrawal features (full or partial); a full range of income payout options; a return of premium guarantee; inflation protection options; and a death benefit. These products may be found in the retail market and, increasingly in the defined contribution market.



The annuity products in the defined contribution market today have been adapted from products in the retail market. In order to work within the distribution channel (primarily web and call centers) some features have become simpler to understand, more flexible, and, in some cases, even portable, all while retaining the product's core focus of ensuring guaranteed lifetime income.

Personal Pension Plans

Insurers have introduced in-plan accumulation annuities that are designed for workers while they are actively saving for retirement. These new products allow employees to create their own "personal pension." Offered as a complement to, or as an option within, a 401(k) plan, this type of product is unique in that each contribution an individual makes is immediately converted to a specific future income benefit that is guaranteed to last a lifetime. By making contributions within a 401(k) plan, workers are able to invest over time and use a dollar-cost averaging approach to purchase a future income stream. Some of these programs, such as the Bank of America/Merrill Lynch Retirement Group's Personal Pension Builder,[2] are offered as a standalone accumulation fund inside a 401(k) plan. In turn, at retirement participants may elect to receive a guaranteed stream of income.

In a recent development, deferred fixed income annuities are being added to target date funds as their fixed income component. In this situation, the annuity allocation automatically increases as the plan participant gets closer to retirement. The annuity allocation within the target date fund, for example, might start at 5% at age 25 and grow to more than 50% at the point when the participant plans to retire.

[2] MetLife is the deferred fixed income annuity provider.

One example of this is BlackRock's SponsorMatch™,[3] which enables a participant's contribution to be allocated to both passively managed equity assets and retirement income. Importantly, BlackRock focused on the benefit of the employer match providing guaranteed lifelong income for participants. At retirement, participants automatically receive a lifetime income stream with an annual 2½% cost of living adjustment unless they choose to opt out of the annuity and receive a lump sum instead.

Longevity Insurance

The single biggest challenge that financial advisors have in creating retirement income plans is assuming an exact date of death. Therefore they select a date of death too far into the future (for example age 100) thereby creating a situation in which most retirees will underspend. One of the newer products that the insurance industry has introduced in the last few years is longevity insurance – a deferred income annuity – that would be purchased at the point of retirement but would not begin payments until the individual reaches average life expectancy (generally age 80 or 85). This product is specifically designed to allow individuals to address their longevity risk. They set aside a portion of their retirement savings now in order to generate a steady stream of guaranteed income in the later years when it may be needed most. It also allows them to manage their other retirement assets to a limited time horizon.

For a typical retiree, allocating 10%-15% of wealth to a longevity annuity creates spending benefits comparable to an immediate annuity allocation of 60% or more. Viewed another way, a sample calculation using annuity purchase rates found that a 65-year-old male retiree could increase his guaranteed spending by more than 21%, during the deferral period of 20 years, by allocating less than 8% of his portfolio to an age 85 longevity annuity.[4]

Using today's interest rates, a longevity insurance product with a one-time purchase of $10,000 by a male at age 65 would provide annual lifetime income beginning at age 85 of $4,328 with a death benefit or $7,658 without a death benefit. With this product, individuals are not only able to insure against the risk of outliving their life expectancy, they can spend more of their remaining assets during the intervening years, since they have a set time horizon (e.g., 20 years) during which to spend these assets. This allows individuals to maximize their spending capacity prior to the commencement of annuity payments.

Enhanced Benefit Features

While annuities have always offered the flexibility to provide a benefit for one's spouse (joint and survivor) and term certain periods (ranging from 5 to 30 years), additional features are also available. For example, an individual may select either an annual cost-of-living-adjustment (1%, 2% or 3%) or inflation-adjusted annuities that track the Consumer Price Index ("CPI"). Additionally, partial withdrawals and premium refund features are now available. While these benefits provide enhanced flexibility there is also a cost associated with each feature. To address the individual's unique needs, these options enable them to customize their income benefit.

Living Benefits

In the retail market, living benefits programs (defined in the glossary of terms as GMIB, GLWB and GMWB) have been extremely popular. Several insurers have now adapted these programs for the

[3] MetLife is the deferred fixed income annuity provider.
[4] *The Longevity Annuity: An Annuity for Everyone?* Jason A. Scott, Financial Engines, Inc., June 2007. For an electronic copy: http://ssrn.com/abstract=992423

defined contribution marketplace. These products have been primarily offered on a stand-alone basis, which means that participants must elect the product and determine the percentage of their ongoing contributions that they wish to allocate to this fund. There is ongoing discussion as to whether these funds are Qualified Default Investment Alternatives ("QDIA") eligible.

Product Innovations Pose Questions, Potential Challenges For Recordkeepers, Plan Sponsors

The downside to innovation is that many sponsors' recordkeepers are not yet fully prepared to include these in-plan options in their fund line-up. At a high level, these enhancements would require indicative data transfer to the insurer with file feeds going back to the recordkeeper. While this is not necessarily an insurmountable obstacle, recordkeepers would like to see product feature uniformity from insurers. Because each insurer's products vary in design, they have different data requirements. Sponsors view this as problematic because it means if they select one product, it may only be offered on one recordkeeper's platform. In turn, this makes their decision to change recordkeepers in the future potentially challenging; this is referred to as employer portability. The recordkeeping and insurance industries, having heard these concerns from sponsors and from each other, are working together under the auspices of an industry association, The SPARK Institute, to come to consensus on standard file and data formats. The ultimate goal is to ensure that a plan sponsor would be able to change recordkeepers and without having to eliminate an in-plan accumulation annuity option.

Participant portability has also been perceived as an issue although, as a general rule of thumb, the products in market allow for participant to rollover their assets into an IRA. If participant changes jobs, they may be able to leave their retirement income assets in their former employer's plan or they may be able to rollover into the companion IRA product; typically this will have higher fees. Participants may not understand these options and may just liquidate their fund thereby losing the benefits that they have already paid for and accrued. And some products may only allow for liquidation because they do not yet provide a companion rollover solution.

In-Plan Accumulation Annuity Products

There are several types of in-plan accumulation annuity products that are available in the market today, which include deferred fixed income accumulation annuities that are available as stand-alone products or integrated into target date funds. There are also living benefits (GMIB, GLWB and GMWB) as an in-plan accumulation annuities that are available in either a balanced or a target date fund at a pre-specified age.

When in-plan accumulation options are available there is generally an option that provides the participant, at the point they terminate employment or retire, the opportunity to roll over the benefit to an IRA that preserves the guarantees they accumulated while employed. However, in most cases, the fees will increase since these funds have been moved out of the workplace and into a retail contract.

IRA Rollovers

All defined contribution plans allow participants to roll their assets into an IRA at the point of termination. Typically, this means that participants can take their money and either purchase an IRA that offers an array of mutual funds, or they can purchase an IRA rollover annuity. These are both retail products and the participant makes the selection on their own without guidance from the plan.

Some employers are also making institutional IRA rollover annuity platforms available to their

participants, such as the Hueler Income Solutions® platform.[5] Under this arrangement, a participant is provided with multiple insurers to choose from and these annuities are offered at institutional prices, thereby offering a higher benefit at a lower cost. Access to on-line quotes and other relevant information is also provided that allows the participant to compare and contrast prices and features before purchasing the immediate annuity.

Other Retirement Income Management Programs

There are other retail income management programs, for both qualified and non-qualified assets, that include:

- Payout mutual funds, which distribute assets over a selected time period.
- Managed payout funds, in which the participant receives an income stream until the expiration date, at which point the original investment is returned.
- Systematic Withdrawal Programs ("SWIP"), in which a stream of payments expressed as a fixed percentage (generally 4%) of the declining portfolio is paid.

It is important to note, however, that these products do not guarantee that income streams will be paid throughout the lifetime of the payee. While these programs have their place in an overall retirement plan, they do not provide guaranteed lifetime income, and as demonstrated over the past 18 months, they are not immune to market fluctuations.

The Cost Impact Of Adding Product Features

In its simplest form, a life income annuity will provide a fixed periodic payment over the lifetime of a single individual, with payments ending upon the death of that individual. This form of income benefit is also typically the least expensive and therefore will provide the highest payment level for a specific contribution amount.

The cost of a traditional life income annuity will increase as features are added that either:

- lengthen the average expected term of the annuity by adding a minimum guaranteed payment period, or a second life over which payments are to be made,
- increase the future guaranteed payment amount by including an annual cost-of-living benefit increase, or
- provide the individual with increased liquidity by adding a feature that permits ad-hoc withdrawals over some defined period.

The following table provides an approximate impact on cost of some of the more common features that are typically selected. This example reflects an income annuity purchased at age 65 with monthly income payments starting immediately.

[5] MetLife is one of nine insurance companies on the platform providing immediate income annuities.

Income Annuity Benefit Form	Income Factor*
Single Life Income	1.000
Single Life with 10-Year Guarantee Period	0.970
Single Life with 20-Year Guarantee Period	0.890
Life Income Payable over Two Lives**	0.860
Life Income - 50% Payment Continued to Second Life**	0.925
Single Life with 2% Annual COLA	0.825
Single Life with 3% Annual COLA	0.745
Trial Annuity	0.970

* Income factors calculated based upon the Annuity 2000 Table D (50/50 blend of male and female mortality), a fixed interest rate of 5%, and no adjustment for expenses. April 2010.

** Both lives assumed to be age 65 at time of annuity purchase.

Section 4: Why don't more employers offer annuities under their plans?
[This addresses questions 14 and 39 in the RFI]

With the decline of the defined benefit plan system, there is more reason than ever to include income annuities in defined contribution plan designs in some form. So why do so few plan sponsors offer income annuities? Research with employers as well as anecdotal experience indicate five reasons:

1. There is little employee demand for income annuities, rendering any costs and burdens unjustified.
2. Offering income annuities requires plan fiduciaries to prudently select one or more annuity providers, thereby creating potential liability. Without significant employee demand, companies have little reason to expose themselves to such fiduciary liability.
3. Most defined contribution plan recordkeepers do not have the ability today to administer in-plan accumulation annuity options.
4. Some plan sponsors believe that the defined contribution plan is only a savings vehicle, and that participants should be responsible for managing their retirement income without employer involvement.
5. Offering income annuities increases administrative costs, including application of the spousal consent rules, the optional survivor annuity rules, and the preparation and administration of more complicated participant communications (with the corresponding increase in participant questions).

The impending retirement of the baby boomer generation, with fewer defined benefit pension plans, will bring to light the need for retirement income planning and the importance of having a component of guaranteed income in retirement. This is an opportunity to transform the way plan sponsors and participants view defined contribution plans. All stakeholders working together need to accomplish four things, which are addressed later in this document, to overcome these barriers:

1. Enhance participant education, which will lead to a "reframing" of defined contribution plans from savings plans to retirement income plans, and make it easier for participants to make good choices, creating more demand for annuities.
2. Ease the fiduciary burdens imposed on plan sponsors in selecting an annuity provider.
3. Facilitate plan administration by simplifying and clarifying compliance requirements.
4. Address the recordkeeping challenges with respect to in-plan accumulation annuities.

In-plan accumulation annuities are slowly emerging as an innovative solution to the decline of defined benefit plans and the resulting need for guaranteed lifetime income. However, as in-plan accumulation annuities are still so new to the marketplace, and, to date, there has been little adoption. Currently, 7% of employers report that they offer these programs and 2% say they plan to offer them within the next year. Conversely, 91% of sponsors do not offer or plan to offer (in the next year) retirement income solutions as in-plan options.[6]

It is interesting to note that innovations in the defined contribution marketplace often take time to be adopted. For example, self-directed brokerage accounts were first introduced in 1993 with less than 1% of plans utilizing this option. By 2009, 26% of plans offered a self-directed brokerage account, although only 1% of all plan assets are allocated to this feature.[6] Likewise, when target date funds were introduced in 2001, approximately 5% of plans offered them. By 2009, 71% of plans were offering these funds.[7] One can assume that the safe harbor provided for target date funds in the Pension Protection Act of 2006 significantly helped the adoption rates given that in 2005, 28% offered target date funds and by 2007, 58% did.[6]

[6] *Hewitt Trends and Experience in 401(k) Plans* (2009).
[7] Hewitt Associates.

Section 5: Why is it important that employers offer income annuities at retirement under their plans?
[This addresses question 8, 9 and 14 in the RFI]

From a public policy perspective, it is important for plan sponsors to offer lifetime income solutions to their participants at the point of retirement. In MetLife's experience, the most effective way to engage employees in the value of creating guaranteed lifetime income is to offer an in-plan distribution annuity option as there is an implied "endorsement effect." Also, when sponsors clearly articulate that partial annuitization is available, there is greater utilization. Furthermore, strong education and communication programs dramatically impact participant behavior.

However, it is important to note that only 14% of plans offer in-plan distribution annuity options today[8] and a few plan sponsors offer an institutional IRA rollover annuity instead. Therefore, most participants have to find a retail IRA rollover annuity provider on their own if they want to secure lifetime income.

Reasons Why Plan Sponsors Should Offer In-Plan Distribution Annuity Options

- A plan sponsor may be able to provide their participants with a higher guaranteed income benefit and lower cost due to the plan's ability to negotiate group contract pricing, as they would with any other employee benefit offerings (e.g., dental, disability insurance, etc.).
- Plan sponsors generally have a higher degree of financial acumen than plan participants. They are, therefore, more likely to follow a consistent and reasoned due diligence process and are more likely to select a suitable high quality insurance company to provide annuity benefits.
- Employees often look to employers for guidance, and education provided in connection with the plan lifetime income option may be helpful.
- A plan offer is more convenient for the participant because there is a buying process in place.
- Participants have ERISA protections that include benefit claims and appeal procedures and recourse against fiduciaries that do not fulfill their fiduciary responsibilities.

Other Considerations

- Some sponsors have chosen to offer institutional IRA rollover annuities to their participants instead of in-plan distribution annuity options because they perceive that there is limited fiduciary liability.
- Longevity insurance products are not easily purchased with defined contribution plan assets due to the Required Minimum Distribution rules.
- The pricing will be different depending on which approach is selected; in-plan distribution options are required to be priced on a unisex basis, which is generally advantageous for females and disadvantageous for males. The opposite is true under IRA rollover annuities since sex-distinct pricing is allowed, whether they are offered on an institutional or retail basis.
- Qualified Joint & Survivor Annuity rules must be followed for an in-plan distribution annuity but not for an IRA rollover annuity.

MetLife believes that clarifying the fiduciary selection regulations would increase utilization of lifetime income options by plan sponsors and participants.

[8] *Hewitt Trends and Experience in 401(k) Plans* (2009).

Section 6: How can employers be encouraged to offer in-plan distribution annuity options and IRA rollover annuity options?
[This addresses questions 25, 26, 27, 30, 31 and 32 in the RFI]

The RFI asks a number of questions about either encouraging or requiring employers to offer lifetime income annuities as distribution options. MetLife believes the first step is to encourage employers to offer lifetime income annuities through increased awareness, education and incentives. Mandates should only be considered if and when there is evidence that efforts to encourage voluntary action have not worked.

As discussed in Section 4, the following are five reasons that employers do not offer income annuities.

1. There is little employee demand for income annuities, rendering any costs and burdens unjustified.
2. Offering income annuities requires plan fiduciaries to prudently select one or more annuity providers, thereby creating potential liability. Without significant employee demand, companies have little reason to expose themselves to such fiduciary liability.
3. Most defined contribution plan recordkeepers do not have the ability today to administer in-plan accumulation annuity options.
4. Some plan sponsors believe that the defined contribution plan is only a savings vehicle and that participants should be responsible for managing their retirement income without employer involvement.
5. Offering income annuities increases administrative costs, including application of the spousal consent rules, the optional survivor annuity rules and the preparation and administration of more complicated participant communications (with the corresponding increase in participant questions).

Below are MetLife's suggestions to address these reasons:

The Defined Contribution Plan Annuity Provider Selection Regulation Should Be Simplified

In-plan distribution annuity options

With increasing litigation surrounding the administration of defined contribution plans, plan sponsors are reluctant to engage in activities that may expose them to additional litigation, including the offering of income annuities as distribution options. Congress and the DOL have been sensitive to the changing nature of the retirement plan system and the need to provide clarity regarding a fiduciary's duties. As a result of a provision included in the Pension Protection Act of 2006 (the "PPA"), the DOL issued new regulations in 2008 on the fiduciary standard to be applied by defined contribution plan sponsors when selecting an annuity provider. The new standard, incorporated in DOL's regulation 29 CFR § 2550.404a-4, contains a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.

The new standard has addressed some of the concerns raised by plan sponsors with the "safest available annuity" standard promulgated by the DOL with respect to defined benefit plans, including the statements that the fiduciary does not have to choose the "safest" annuity available, and that the fiduciary duty generally applies at time of selection (with an ongoing duty to monitor the selection as to prudence with regard to future annuities provided). However, in light of our generally litigious society, plan sponsors continue to express concerns regarding any plan decisions that may expose them to future lawsuits. Thus, even with the simplification of the fiduciary standard that the DOL promulgated, plan sponsors are still expressing reservations about their ability to implement the standard without exposure to undue risk.

From MetLife conversations with plan sponsors, the most daunting aspect of the new guidance continues to be the requirement – and their ability – to assess an insurer's financial stability. **With employers expressing concerns regarding their ability to satisfy the financial stability requirement under 29 CFR 2550.404a-4, MetLife urges the DOL to further simplify that requirement by providing an objective safe harbor.** MetLife suggests developing of a safe harbor based on the following analysis. It is inefficient and unrealistic to structure a system whereby each defined contribution plan sponsor must do a thorough review of the financial stability of the same annuity providers. With state regulators annually analyzing every insurer's financial stability, there is little purpose in plan sponsors performing the same analysis. And it is unrealistic to expect any plan sponsor to do a thorough review, or pay an expert for a review, of the financial stability of, for example, a Fortune 500 insurer.

MetLife's proposal is to explore the possibility of a safe harbor based on the fact that an annuity provider has passed the review of state regulators. For example, **under a possible safe harbor, a plan fiduciary could, in the absence of extraordinary circumstances justifying further inquiry, treat an annuity provider as satisfying the financial stability requirement of the fiduciary standard if: (1) the annuity provider or an affiliate is licensed to do annuity business in at least 26 states, and (2) the annuity provider's "risk-based capital" ("RBC") ratio is in excess of the Company Action Level, as defined by the National Association of Insurance Commissioners ("NAIC").**[9]

Such a rule has strong policy underpinnings. The business of insurance is regulated by the states. Insurance regulators are charged with ascertaining that insurance companies are operating on a financially sound basis. They take action if it appears that an insurer will be unable to fulfill the promises made to its policyholders. This includes taking over the management of an insurer ("Authorized Control Level" of RBC) through a conservation or rehabilitation order to get the insurer back into a strong solvency position. Although the primary responsibility for this regulation is the domiciliary state of the insurer, in areas where federal oversight is required, logical rules have developed. In the area of required reserve valuation assumptions, which may vary across states, the Internal Revenue Code Sections 807(d)(4)(B)(i) and (5)(A) demonstrate examples of applying a 26-state threshold to the insurance industry to develop a single federal standard.

State solvency standards require insurers to report liabilities at levels that generally exceed the expected economic costs of their promises. Additionally, states require a board-appointed actuary to take personal responsibility for an Opinion regarding the adequacy of the company's assets to discharge its liabilities. The actuary provides a Memorandum detailing the analyses, primarily the testing of future cash flows under multiple scenarios that support the Opinion. These memoranda are reviewed annually by the states, and quinquennially in detail by the domiciliary state.

MetLife recognizes that the fiduciary inquiry regarding investments is analytically different from the fiduciary inquiry regarding annuity distribution options. But there is nevertheless an analogy that can be drawn to the investment area. The analogy is not a substantive analogy, but rather a process analogy.

Briefly, not every plan sponsor can realistically perform a full fiduciary review of every investment option. In reality, no one expects a 50-person company to do, directly or indirectly, a thorough review of all the following with respect to every mutual fund that is offered: an examination of the fund's

[9] RBC represents an amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments. Each year the company calculates its capital based on the RBC formula. It also calculates the capital required for risk, the "Company Action Level" RBC. The ratio of a company's capital to it's "Company Action Level" RBC is generally referred to as its RBC ratio. However, the regulator rules use a ratio based on the "Authorized Control Level" RBC, which is 50% of the "Company Action Level" RBC. The NAIC system details specific actions to be taken by the company or the state insurance regulator if this ratio declines.

portfolio, including an assessment of each industry in which the fund is invested; a study of the fund's managers, including their tenure, their research support, the prospects for their retention, their investment style and their risk tolerance; a comparison of the fund's investment profile with all emerging economic and market trends; and an analysis of the investment firm itself and its corporate structure. If this were the standard, there would be only a handful of defined contribution plans offering mutual funds in existence today.

In reality, the 50-person company generally asks questions such as: Is the fund family well respected? Does the fund have a sufficiently long and good performance history, net of fees? Is the fund chosen by other plans? Is there anything in the news that would call into question the fund's future?

A similarly realistic standard has not emerged in the annuity provider area simply because the lack of employee demand has enabled employers to avoid dealing with the annuity provider issue. But if the objective is to facilitate the offering of annuities, it will be necessary to allow employers to effectively rely on the analysis of other experts – state regulators – rather than forcing all plans across the country to do their own comprehensive analysis.

Please note that, even with this suggested safe harbor on the financial stability requirement the plan fiduciary would still need to do an independent review as required under 29 CFR § 2550.404a-4 that would appropriately consider the cost (including fees and commissions) of the annuities and the insurer's experience with respect to the administrative servicing of the annuities.

In-plan accumulation annuities

There is confusion regarding the application of the fiduciary rules to in-plan accumulation annuities. MetLife believes that under current law, the fiduciary rules apply as follows: in-plan accumulation annuities, although insurance products, are treated as investments and are subject to those fiduciary standards. However, to the extent that in-plan accumulation annuities are also being offered to participants as distribution options, the annuity provider selection fiduciary standards also apply. Under the new products, both events occur simultaneously: the in-plan accumulation annuities are offered as investments and the same annuities are available as distribution options. In that case, such annuities must be analyzed from a fiduciary perspective both as investments and as distribution options. If, on the other hand, an in-plan accumulation annuity is only offered as an "investment," the annuity provider rules would have no application. MetLife believes that this is the law today, but a clear articulation of this legal framework would be helpful.

Tax Qualification Rules Should Be Updated To Address The Changing Retirement System

Since the use of annuities in defined contribution plans is evolving, it would be helpful for the government to provide comprehensive guidance clarifying the treatment of annuities.

- The election to invest in an in-plan accumulation annuity does not trigger the requirement that a participant obtain spousal consent to distributions in a form other than a qualified joint and survivor annuity ("QJSA"). Investment elections do not trigger the QJSA rules; only distribution elections do. This is clearly the law, but a statement to this effect would be helpful.

- It should be clarified that the distribution of a deferred income annuity to a participant from an in-plan accumulation annuity does not trigger the QJSA rules to the extent that the contract preserves the participant's distribution options under the plan. In that case, it is a distribution under the contract that can be subject to the QJSA rules. Again, this is clear under the law, but stating it would be helpful.

The issues become more difficult, and even more in need of clarification, with respect to some of the evolving annuity products, such as trial annuities, GLWBs and GMWBs. Under these products, a participant makes an election to receive benefits in a specified form. Under that form, the benefits are distributed initially in a non-annuity form as a withdrawal benefit, and then later may be distributed in an annuity form.

A participant may elect a trial annuity under which periodic payments are made for a period of time and then, unless they opt out of the trial, lifetime annuity payments begin. The QJSA rules may apply in the following manner with respect to a trial annuity. Under the initial distribution election, the participant elects an annuity even though the annuity distributions are deferred. Therefore, the initial distribution election triggers the QJSA spousal consent rules because the participant is electing a deferred life annuity. This analysis is consistent with Private Letter Ruling 200951039.

An example illustrates MetLife's concern with the legal framework. Assume that the value of a participant's account is $100,000 and the participant elects a trial annuity with a two-year trial period. Assume that the present value of the trial payments is $10,000 and the present value of the deferred annuity is $90,000. Generally, by reason of the election of the deferred annuity, the spousal consent rules would apply to 90% of the account as long as there is a separate accounting of such 90%. See Treasury Regulations § 1.401(a)-20 Q/A-4. This means, in turn, that during the two-year period, the plan must consistently monitor any additional withdrawals by the participant. If any such withdrawals would reduce, or further reduce, the value of the deferred annuity, spousal consent would be needed. This could be a significant administrative burden.

Accordingly, MetLife suggests that guidance clarify that it is permissible to apply the spousal consent rules in the following manner. When the deferred annuity is elected, the plan could deem there to be no separate accounting of the 90%, so that spousal consent is needed with respect to the two-year trial period (because the trial period payments do not constitute a QJSA). The spouse's consent to the trial period payments could be structured as a general consent under Treasury Regulations § 1.401(a)-20 Q/A-31(c) whereby the spouse consents to any acceleration or modification of payments during the trial period, including an election to receive a lump sum distribution at the end of the trial period. Similarly, the spouse's general consent could apply to whatever pattern of payments the participant chooses after the trial period. This would be easier to administer, is consistent with the regulatory structure and gives spouses complete control by leaving it to them as to whether to provide a general consent.

Another way to view trial annuities would be to treat both the trial period payments and the deferred annuity as part of a single stream of payments with a single annuity starting date, so that the spousal consent rules apply upfront at the commencement of the trial. Thus, spousal consent may be obtained once upfront and not periodically as distributions are made.

Similarly, with respect to GMWBs and GLWBs in defined contribution plans, MetLife requests that the law be clarified to provide that the initial distribution election triggers the QJSA rules. Whichever analysis described above is applied regarding trial annuities should also be applied to GMWBs and GLWBs. So, the election of a GMWB or a GLWB could be treated as an election of a deferred annuity that triggers the application of the QJSA rules with respect to the entire account. In that case, a spouse's general consent could satisfy the spousal consent requirements with respect to any subsequent acceleration or modification of payments during the withdrawal period. GMWBs and GLWBs could be viewed as providing a single stream of payments with a single annuity starting date, so that the spousal consent rules would only apply once upfront and not periodically as distributions are made.

Section 7: Why do individuals not choose lifetime income products and how can those barriers be removed to encourage greater annuitization?
[This addresses questions 2, 10, 11, 12, 13, 17, 18, 19, 20, 21, 22, 23, 24 and 38 in the RFI]

Participants who have saved in their company-sponsored defined contribution plans have focused almost exclusively on asset accumulation: building the largest nest egg possible. Given that these plans were originally designed as supplemental savings plans, this outcome is not surprising given the significant education that has been provided. In fact, all stakeholders should be commended for encouraging this behavior. However, building a large nest egg is only one part of the retirement equation. The other part is the distribution phase – how to spend down that nest egg to ensure one doesn't outlive their assets. There has been little attention paid by individuals to the risks they will face in retirement. Many have not considered this challenge, let alone which products and strategies will allow them to convert their assets into retirement income.

Lack Of Awareness Points To A Perfect Storm

As discussed in Section 1, the greatest risk facing retirees is longevity risk – the real risk of outliving their retirement savings. Surprisingly, there is little comprehension by individuals about how long they are likely to live and what impact this will have on their retirement assets.

MetLife conducted two Retirement Income IQ Studies (in 2003 and again in 2008) to test the knowledge of basic retirement income concepts for individuals within five years of retirement. The results are very troubling as significant knowledge gaps exist regarding average life expectancy and other retirement income issues:

- Among the most disturbing findings of the 2008 study was that six in ten Americans (60%) underestimated their average life expectancy.
- Almost half (49%) underestimated the amount of pre-retirement income they will need once they retire.
- Almost seven in ten (69%) pre-retirees overestimated how much they can draw down from their savings – with an alarming 43% believing they could withdraw 10% or more each year while still preserving their principal – even though most retirement experts suggest a withdrawal rate of no more than 4% annually.

This lack of understanding is particularly alarming because it results in poor retirement planning assumptions, which are compounded after retirement by much longer life expectancies. These findings point to the underpinnings for the "perfect storm" of retirees running out of assets.

Obstacles To Overcome To Encourage Annuitization

Aside from a lack of understanding about longevity risk, what are the reasons for not selecting lifetime income and what are the steps that can be taken to change this situation?

When it comes to retirement planning, most people, even those close to retirement, have not planned at all. As the recently released EBRI/Mathew Greenwald & Associates 2010 Retirement Confidence Study highlights, despite the recent economic downturn, 54% of individuals still have not made a financial plan for retirement. Among those who have planned, most of them have not been given the proper framework to evaluate how an income annuity can be an important component of a retirement portfolio. In fact, many financial advisors also need to be educated on the inherent benefits of providing some minimum level of guaranteed lifetime income as a necessary component of a financial plan.

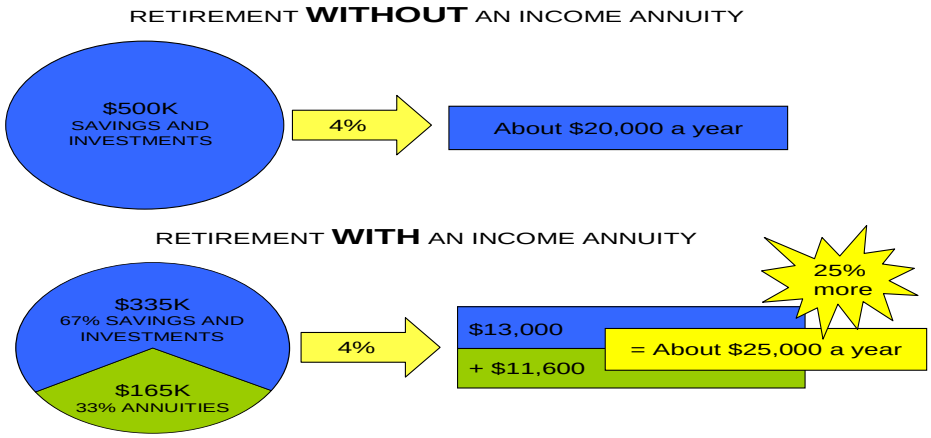
It has been well documented in various market and behavioral research surveys that individuals overvalue a lump sum of money: this is often referred to as the "wealth illusion". At the point of retirement, individuals see their 401(k) balance and it is often more money than they have ever saved in one place. In conjunction with overvaluing this lump sum, individuals often undervalue a future income stream. This is primarily because they overestimate the risk of dying too young to realize the value of a guaranteed lifetime income.

Individuals are also concerned about liquidity and the desire to stay in control of their assets. With average account balances at retirement of $137,337,[10] some may argue that income annuities do not make sense for everyone. However, to the extent that a small account balance still represents a significant share of the individual's net worth, it is certainly possible to argue that it is even more important for this person to annuitize at least a portion of their balance in order to maximize the income from this limited savings.[11] At a time when many aspects of retirement are uncertain – everything from inflation and lifespan to the solvency of Social Security and corporate pensions – Americans are under the impression they need to "invest away" the risks they face in retirement.

Furthermore, inertia is a powerful force, making it easier for participants to simply take a lump sum or roll their balance into an IRA, rather than making an active decision to annuitize a portion of their asset pool. After all, studies have shown that inertia is prevalent throughout a participant's savings years – many individuals rarely make changes to their 401(k) investment allocations – so they are not likely to overcome that inertia without encouragement.

Lifetime income, specifically in the form of income annuities, has low market penetration both in the retail and workplace settings. While the election rate by participants of in-plan distribution annuity options is generally low (decreasing from 3% in 2007 to 1% in 2009 across the 14% of plans that offer annuities),[12] MetLife has seen higher take-up rates for those plans that offer strong education. Employees do listen to their employers and when the sponsor provides educational information, participants act accordingly.

The following is an example of an illustration that demonstrates the powerful benefit of income annuities as a component of a retirement plan.



[10] EBRI Tabulations from EBRI/ICI 401(k) Database.
[11] *Automatic Lifetime Income As A Path to Retirement Security*, Jeffrey R. Brown, PH.D., University of Illinois, June 2009.
[12] *Hewitt Trends and Experience in 401(k) Plans* (2009).

As a result of the shift from defined benefit to defined contribution plans, employer and employee attitudes are also changing with regard to their receptivity to lifetime income options. MetLife's 8th Annual Employee Benefits Trend Study ("EBTS") found that 40% of the 1,300 employees surveyed were interested in learning more about how they could use an annuity as part of their 401(k) plan. While only 10% of employers say they are interested in offering an annuity option as part of their defined contribution plan, 44% of employees would like their employer to offer an annuity as part of their retirement plan.

Potential Solutions To Encourage Annuitization As A Distribution Option

The most important point is that in-plan distribution annuity options should be a component of every retirement plan. As discussed in *Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance*[13] by the leading authorities on asset allocation (Roger Ibbotson, Moshe Milevsky, Peng Chen, Kevin Zhu), in a paper released in 2007, fixed annuities can be a crucial part of a well-diversified retirement income portfolio. Income annuities should be viewed as a way to cover fixed expenses, in addition to the income received from Social Security and, in some cases, a defined benefit pension plan. Individuals are more likely to favor annuitizing part of their savings to address a specific purpose (e.g., covering vacations, grandchildren's education, mortgages, etc.). This helps frame the decision by creating financial context and also helps to address both the liquidity and control issues. Furthermore, the industry should help individuals understand that using income annuities is a way to maximize and protect income with benefit forms that can be customized to fit their individual needs. Overall, the focus needs to incorporate generating income rather than a continued singular focus on investment return.

Over the past decade, research in the field of behavioral economics has explored the areas of choice and framing. This research provides further insight into how and why individual decisions are made and, among other things, the way in which a particular decision is "framed" (the way in which it is explained or presented), rather than the facts or attributes of a particular choice, is an overriding determinant of the decision. When consumers think in terms of consumption, annuities are viewed as valuable insurance, whereas when consumers think in terms of investment risk and return, the annuity is a risky asset because payoff depends on an uncertain date of death. People react negatively to the possibility that they could lose money and often think of annuities as a "gamble" rather than as insurance. When individuals were presented with a "frame" of consumption versus investment, 72% selected the life income annuity compared to 21% selecting the investment approach. Note that the financial amount was identical in these situations but that it was *framed* differently.[14]

401(k) Plan Account Balances Should Be Communicated As Lifetime Income In Addition To The Total Account Balance On Annual Benefit Statements

Educational tools are a critical component in realigning participants' attitudes, knowledge and approaches to their retirement assets. Participants have little understanding of how much to save or how to invest those savings to achieve an adequate retirement income. They also have little to no understanding of how to ensure that their 401(k) savings will last throughout their retirement years. Educational tools, which seek to shift the paradigm from assets to income, can help individuals begin to understand how to turn that lump sum into an income to last 20, 30 or even 40 years.

ERISA section 105 currently requires defined contribution plans to furnish to each participant an

[13] Research Foundation of CFA Institute, 2007.
[14] *Why Don't People Choose Annuities? A Framing Explanation*. The Retirement Security Project, March 2008. Brown, Kling, Mullainathan and Wrobel.

individual benefit statement, at least annually, that includes the participant's "accrued and vested benefits." **The DOL should require that annual benefit statements for 401(k) plans show an equivalent monthly lifetime stream of income, in addition to the total account balance.**

This income amount should be based on conversion factors published by the DOL unless the plan includes an annuity, in which case the annuity factors in the plan may be used to convert the account balance.

The Pension Benefit Guaranty Corporation annually surveys commercial annuity providers and aggregates those rates to determine an average rate that is then used to calculate the annuity values that they use to pay plan participants under their control. Those rates are an accurate reflection of current annuity rates in the market. MetLife recommends that the DOL use those rates (or a similar market survey) in developing their conversion tables.

The annuity amount should be shown as both a single life and a QJSA; QJSA disclosures would need to be based on one or more assumptions regarding the age of the spouse. The DOL should also issue model notices that plan sponsors could use to communicate this information to plan participants.

Plan sponsors that rely on the DOL's tables and notices should be relieved of fiduciary liability for the income amounts displayed on the benefit statements. Finally, to the extent that recordkeepers currently provide modeling tools that go further than what the DOL may require or provide, plan sponsors should be exempt from the conversion requirement. For example, some recordkeepers/service providers provide participants with on-line tools that enable them to make personalized projections regarding the income they can expect during retirement based on certain variables. Where such tools are available, it would only serve to confuse participants to have a different projection set forth on their benefit statements.

MetLife does not recommend that projections be made regarding future contributions in this calculation. Since these conversions are educational in nature and not intended to imply any guarantees of future employment, a static number at a point in time should be sufficient to meet the educational intent. The calculation should be made based on projecting the current account balance to age sixty-five (or whatever the normal retirement age is under the plan), so that participants are able to see what their current account balance would translate into on a monthly income basis.

Please note in this regard that on December 3, 2009, Senators Jeff Bingaman (D-NM), Johnny Isakson (R-GA) and Herb Kohl (D-WI) introduced the Lifetime Income Disclosure Act of 2009. The bill incorporates substantially all of the enhancements to the benefit statement described above. It strikes an appropriate balance between providing this much needed education for plan participants with plan sponsor fiduciary protections.

Finally, MetLife believes that this conversion will serve a twofold educational purpose, as Senators Bingaman, Isakson and Kohl noted in their press release introducing the bill: not only will it show what income amounts are possible from the current account balance (thereby reorienting participants' views of their 401(k) plans as a retirement plan), it could prompt them to increase their savings level within the plan in order to achieve greater income levels at retirement. MetLife believes that this conversion amount will ultimately educate participants of all ages to increase their savings to more appropriate levels. A T. Rowe Price study in 2007 found that when participants are shown their account balances as a monthly annuity amount, individuals were motivated to increase their savings levels.[15]

[15] Retire With Confidence Series, November 2007.

The DOL And The Treasury Department Should Provide Education On The Distribution Phase Of Retirement Plans

The DOL and the Treasury Department have done an excellent job since the enactment of ERISA in issuing not only regulatory guidance interpreting ERISA and the retirement laws that have been enacted since, but numerous educational materials that explain, in lay terms, some of the retirement savings issues facing individuals. Many of these materials have focused on critical issues of saving and investing and on reaching "at-risk" populations. In the last decade the DOL also issued a brochure to help individuals in assessing the risks they face in retirement. MetLife strongly urges the DOL to reissue that brochure, updated to reflect some of the important risks and decisions that individuals will face when approaching retirement and to address some of the distribution options available to them. Wherever possible, quantitative examples should be used. Since the government is an objective source of information, plan sponsors could use these materials to educate their employees about retirement distribution options without increasing their fiduciary liability.

In addition, since plan sponsors can also benefit from education in this area, MetLife encourages the Agencies to publish educational material specifically directed to plan sponsors regarding lifetime income options. Income annuities are an important tool in helping retirees meet their income needs. It is imperative to educate all parties that retirees must not only invest for retirement but also insure for retirement.

The DOL Should Expand The Participant Education And Advice Guidance To Include The Distribution Phase Of Defined Contribution Plans

The DOL has done excellent work in providing guidance on how plan sponsors can effectively provide participants with education and advice regarding the savings phase of defined contribution plans. Interpretive Bulletin 96-1 ("IB 96-1") sets forth guidelines regarding how employers can provide participant education with respect to the allocation of retirement savings among classes of investments. IB 96-1 has been used extensively by employers that want to help their employees without taking on fiduciary liability for the provision of investment advice.

The DOL has also issued critical guidance with respect to the provision of investment advice. The SunAmerica Advisory Opinion has led to a great expansion of advice based on computer models using generally accepted investment theories. Moreover, much of this advice is provided through managed accounts, where the advice is implemented automatically and thus is more effective than advice that participants must implement on their own. The DOL has an opportunity to build on the important success that it has achieved in the savings phase by applying the same framework to the distribution phase.

MetLife recommends four additional steps that can be taken with respect to participant education and advice. The first two relate to IB 96-1 and the second two relate to guidance with respect to advice provided through computer models.

1. As stated in the 2007 report of the ERISA Advisory Council's Working Group on Financial Literacy of Plan Participants and the Role of the Employer, "96-1 needs to address information, education and advice in the decumulation stage as well as the savings phase." **MetLife recommends expanding IB 96-1 to clarify what education may be provided to participants about the distribution phase without that guidance being treated as fiduciary advice.** Such guidance should be as detailed as IB 96-1. For example, the guidance should clarify that computer models that generate generic distribution approaches should be treated as education, not advice. Under the IB 96-1 expansion that MetLife is recommending, a participant could provide his/her own

information, such as other assets, other sources of income (such as Social Security or a pension or spousal pension), age, risk tolerance and annual living expenses. The computer model could then generate a generic distribution model regarding the portion of the participant's account that should be annuitized, the portion that should be rolled over, the portion that should be taken in the form of installment payments, etc. This type of modeling should be permissible for providing distribution education. Finally, as with the DOL's investment guidance, the DOL's distribution phase guidance should permit such guidance to be paid for with plan assets.

2. **MetLife recommends the current investment elements of IB 96-1 should be expanded to clarify that education regarding investment into in-plan accumulation annuities is within the reach of IB 96-1's** existing framework and would not be treated as fiduciary advice.

3. **MetLife recommends that DOL issue "SunAmerica-like" guidance with respect to the distribution phase. In other words, a financial institution would be allowed to contract with an independent expert that would develop and apply a computer model for providing distribution advice based on generally accepted decumulation principles.** The computer model would receive the same type of participant data described above regarding assets, expenses, etc. It would generate specific recommendations based on the plan's distribution options. For example, the computer model might recommend receiving a specific portion of the account in the form of a particular annuity available under the plan, and receiving another portion in the form of a specific installment option. The computer model would also make recommendations regarding how undistributed assets should be applied.

4. **MetLife recommends that the DOL incorporate in-plan accumulation annuities and guaranteed insurance products into the SunAmerica and PPA computer models.** In-plan accumulation annuities provide the distribution analogue to dollar-cost averaging into the market by permitting participants to buy guaranteed pieces of future income at then prevailing interest rates with each contribution. This avoids the risk that interest rates will potentially be low at the point of retirement when a large annuity purchase is made. In-plan accumulation annuity education material would also help participants by framing retirement needs in terms of future income, rather than asset accumulation. Finally, in-plan accumulation annuities allow participants to buy annuities in small increments, thereby avoiding the intimidating "big purchase" at retirement. Guaranteed insurance products such as GLWBs and GMWBs assist participants in meeting their retirement needs in a similar manner.

   If defined contribution plans are to be successful as the primary retirement income plan for today's workforce, it is essential that in-plan accumulation annuities and guaranteed insurance products become a prominent feature. DOL can help achieve this by providing that neither a SunAmerica computer model nor a PPA computer model will be treated as valid unless it takes into account any in-plan accumulation annuity and/or guaranteed insurance product available under the plan. To allow computer models to disregard these types of products is to relegate them to second-tier status and effectively ensure that these products will not be utilized by participants.

Employers Should Offer Partial Annuitization

Offering partial annuitization is critical to the success of creating guaranteed income in retirement. People will need liquid assets for unexpected expenses as well as guaranteed income and, as a result, the insurance industry does not generally recommend that a participant annuitize all of their savings at retirement. MetLife experience indicates that, if participants do not have the ability to partially annuitize their balances, there will be very little annuitization.

MetLife has been the exclusive annuity provider for the Federal Thrift Savings Plan ("TSP") since the plan's inception more than 20 years ago. When the plan first began, the annuity was an "all or nothing" offer – the participant had to either annuitize their entire TSP balance at retirement or none of it. In 2004, the TSP amended the plan to include partial annuitization. As a result, the TSP saw an immediate and dramatic result – a 60% increase in the number of participants annuitizing some of their balances. In addition, there was a significant increase in the average purchase amount of the annuities. MetLife believes this is due to the fact that participants with larger balances, who also need guaranteed income in retirement, felt more comfortable annuitizing their TSP balance because they were not restricted to the entire amount.

From the individual's perspective, purchasing an annuity with a portion of their assets to cover a specific need is more palatable and helps to minimize the negative aspects of a large one-time purchase. Partial annuitization directly addresses the "all-or-nothing" concern. Although only 14% of defined contribution plans[16] offer annuities at distribution, many of those companies offer income annuities on an "all-or-nothing" basis.

MetLife recommends that the DOL provide enhanced education to plan sponsors about their ability to offer partial annuitization to participants. Many plan sponsors have never thought about partial annuitization. Plans have traditionally offered distribution options that apply to participants' entire account balance and the concept of partial annuitization has likely been considered by only a small percentage of plan sponsors.

MetLife also recommends that Congress consider requiring plans that offer in-plan distribution annuities to specifically offer partial annuitization. For example, a plan could be required to offer participants a choice to annuitize 100%, 75%, 50%, 25%, or none of the account balance. As proposed, this would be a mandate but one with minimal cost or burden.

Default Annuitization

MetLife suggests that policymakers consider additional steps if these proposals do not increase annuitization rates significantly in the coming years, because just as individuals purchase life insurance to provide financial security in the event of an early death, they should purchase income annuities to provide financial security in anticipation of a long life.

The statutory and regulatory support for automatic enrollment and automatic escalation has ensured that many more individuals will have some retirement savings. The issuance of the Qualified Default Investment Alternatives ("QDIA") regulations encouraged plan sponsors to include professionally managed investments, such as target date funds, in their plans. These have been positive developments for employees.

Through this RFI, the government recognizes that, just as with enrolling in these plans, individuals may also need help in making their savings last throughout retirement. As with auto enrollment and QDIAs, there is a need to bring other positive attributes of the defined benefit plan system into the defined contribution plan system. Much like defined benefit plans make an annuity payment the "normal" form of payout from a defined benefit plan, defined contribution plans should also make an annuity payment the "normal" form of payout. This would point participants in the right direction without forcing them into an annuity. In other words, the participant would always have the right to opt out of this default (since that may not be the best distribution option for all participants, such as those in poor health or with outside resources). It will be incumbent upon all providers and sponsors in the industry to provide

[16] *Hewitt Trends and Experience in 401(k) Plans* (2009).

appropriate education – as previously discussed – so that the participant understands the powerful and positive impact of converting a portion of their account balance into a retirement paycheck.

If annuitization rates do not increase significantly in the next three to five years, from today's 1% annuitization election rate to 20%, MetLife recommends that the DOL and Treasury Department consider mandatory default annuitization, which would require that at least a portion of a participant's defined contribution plan balance be defaulted into an income annuity at the point of retirement.

A guaranteed lifetime income option could be required for all defined contribution plans, as it is for defined benefit plans. However, as discussed earlier, MetLife does not generally believe that all of a retiree's plan assets should be annuitized. Therefore, under this approach, the option would be structured so that 50% of the individual's account balance is defaulted into the lifetime income option. The employee would be given the same notice and opt-out rights as defined benefit plan participants receive. This requirement should not apply to employers with fewer than 100 employees or to employers offering an active defined benefit plan with only lifetime income benefits (and no lump sum options).

The default mechanism would require employers to include an in-plan distribution annuity option in their 401(k) plan as the default form of distribution with respect to individuals who have attained a specified age, such as 55 or a later age. Finally, the default would not apply unless the amount defaulted was at least $25,000 to prevent the defaulting of small amounts.

With regard to having annuities provided as a default option in the plan, more than four in ten employers surveyed in the 8th Annual Employee Benefit Trends Study ("EBTS") (43%) expressed an interest in a default option for converting a percentage of 401(k) balances into a guaranteed stream of income. Also, the EBTS found that those employers that sponsored both a defined benefit plan and a defined contribution plan had a greater interest in the default option, perhaps because they already offer a lifetime income option in their defined benefit plan and as a result are more familiar with the concept. Interestingly, MetLife's client experiences have demonstrated that participants who have a defined benefit plan are more likely to annuitize a component of their defined contribution plan because they understand the value of the retirement income paycheck.

Finally, if annuities become the default form of distribution in defined contribution plans, MetLife does not believe this will negatively affect contribution rates. Since participants would be permitted to opt out of the default form of distribution, there is no reason for the default to affect contribution rates.

Trial Annuitization

The general idea of trial annuitization is to allocate a portion of a retiring employee's defined contribution plan assets automatically into a lifetime income annuity at the point of retirement, thereby giving retirees an opportunity to "test drive" the benefits of receiving a retirement income "paycheck." This concept is predicated upon the belief that Americans depend on their paychecks to meet their financial obligation. Furthermore, retirees with income from a pension and an annuity were three times as likely to say that retirement is much better than they expected.[17]

A paper released in 2008 by The Retirement Security Project entitled "Increasing Annuitization in 401(k) Plans with Automatic Trial Income," set forth a proposal that would increase the role of lifetime income products in an effort to help retirees enjoy a secure retirement. The authors explained that

[17] The Silent Generation Speaks, MetLife Mature Market Institute, Mathew Greenwald & Associates, 2005

automatic features in 401(k) plans have shown that the power of inertia can be used to significantly improve outcomes without restricting retirees' choices.

Specifically, the paper proposes the following:

- A substantial portion of assets in 401(k)-type accounts (generally considered to be no more than 50% of the account balance) would be automatically directed into an income program for a two-year trial period (the default trial arrangement), unless workers affirmatively elect a different form of payout permitted under the retirement plan.
- There would be trial income of 24 consecutive monthly payments.
- After the trial period, participants would again have the ability to opt for alternative forms of payment.
- Those who made no affirmative choice within a specified period would continue to receive income payments because the program converts automatically from trial-period income to permanent income.

A similar proposal by Professor Jeffrey Brown of the University of Illinois, entitled "Automatic Lifetime Income as a Path to Retirement Income Security," suggests that employers be encouraged to adopt an automatic annuitization plan under which, when an employee makes an initial request for a non-hardship withdrawal from a defined contribution plan, the employee would be notified that he/she is being automatically enrolled into a partial annuitization program. The program would convert half of the participant's total 401(k) account balance into a joint-and-100%-survivor annuity for married couples, or a single life annuity for unmarried individuals. These automatic annuities could be immediate annuities subject to a trial period, a series of laddered annuities with payouts that commence over a several-year period after the initial distribution decisions, or various integrated, in-plan accumulation annuity options that allow participants to invest in deferred annuity contracts during the accumulation phase.

MetLife believes that the use of trial annuities would be a compelling method that could prove helpful in encouraging annuitization. Accordingly, MetLife **recommends that the DOL and Treasury Department issue (1) guidance clarifying how the law applies to trial annuitization (see, e.g., Section 6 above), and (2) educational information for employers highlighting trial annuitization.**

Revisiting Lump Sums Under Defined Benefit Plans

MetLife supports protecting individuals from longevity risk. This support includes proposals that do not involve commercial annuities (e.g., defined benefit income payments), as long as income is guaranteed for life. In this regard, MetLife is quite concerned about the trend toward lump sum distributions in defined benefit plans. Defined benefit plans were intended to provide guaranteed income throughout retirement, not to provide lump sum distributions that can be fully consumed before the end of one's retirement. Lump sum payout options were widely introduced relatively recently when the economics of prevailing interest rates made lump sum forms of payout significantly less expensive for employers than standard lifetime income forms. This development coincided with the waves of early retirement programs that occurred in the same time frame, with the result that lump sum payouts financed not lifetime security but transition to early retirement.

Accordingly, MetLife **would encourage Congress to consider permitting defined benefit plan sponsors to eliminate lump sum distribution options and that this change would not violate the anti-cutback rules**. Of course, any such legislation would need to have a delayed effective date to avoid affecting employees near retirement. Such a proposal might also need to be slowly phased in to avoid encouraging a rush to retire before the effective date. But in the long term, such a rule would significantly improve the retirement security provided by the defined benefit plans that are still in

existence. Participants would receive guaranteed income for life. Also, defined benefit plans themselves would be strengthened since lump sums can undermine a plan's funded status.

Section 8: What tax law changes would facilitate annuitization?
[This addresses questions 25 and 28 in the RFI]

Educational initiatives will improve individuals' appreciation of longevity risk and improve financial literacy generally regarding the distribution phase of retirement. However, as stated earlier in this submission, inertia is a strong force, and individuals will need additional public policy guidance to ensure that they do in fact act in their economic interests. One possible approach to achieving this desired behavior is through the Internal Revenue Code, specifically through helpful tax law changes.

Required Minimum Distribution ("RMD") Rules for Longevity Insurance

The advanced age when longevity insurance payments commence generally exceeds the age 70½ required beginning date for the RMD rules. Therefore, to comply with RMD requirements, longevity insurance offered under a retirement plan or IRA must currently address the possibility of being required to distribute RMD amounts prematurely. In the event that the RMD amounts deplete non-longevity insurance assets, either the RMD rules would be violated or the longevity insurance contract will have to permit distributions (which would have an adverse impact on future income payments). Because neither of these results is workable, longevity insurance generally is not offered to plans and IRAs today. **The offering and use of longevity insurance would increase significantly by changing the RMD rules to exempt longevity insurance acquired within qualified retirement plans or IRAs from the RMD requirement until distributions from the longevity insurance product begin (which could be required by a certain age, such as 85).** This proposal, which could be adopted either legislatively or administratively, has been introduced in several legislative bills, including the Retirement Security Needs Lifetime Pay Act of 2009 (H.R. 2748) originally introduced by Representatives Earl Pomeroy and Ginny Brown-Waite.

403(b) Plans And 457(b) Governmental Plans

Any lifetime income payment guidance issued with respect to 401(k) and other qualified retirement plans should encompass rules regarding 403(b) and 457(b) governmental plans. This is because 403(b) and 457(b) governmental plans are similar to 401(k) plans and the participants in 403(b) and 457(b) governmental plans would benefit from enhanced opportunities to annuitize.

Targeted Tax Incentives For The Purchase Of Annuities Should Be Enacted

In order to further advance the education process for participants, a targeted tax incentive should be provided for the election of annuity distributions. Over the past few years, several bills have been introduced that would provide a limited tax exclusion for individuals who purchase an annuity with pre-tax (qualified) money from a defined contribution plan. The Pomeroy/Brown-Waite bill referenced above would provide such an exclusion. MetLife believes this legislation provides an appropriate incentive for individuals to ensure that they receive lifetime income with respect to at least a portion of their retirement assets.

The point of any such tax incentive is not to change the basic economics of an employee's choice. On the contrary, the objective is to create a small tax incentive that will cause participants to pause and consider annuitization. The concern is that many participants will not read educational material, will not think about the longevity risk and will simply opt out of any annuity that is offered. This is one way to encourage individuals to slow down and focus on the choice that they are making. A small tax incentive is another tool that could result in large numbers of participants considering the substantive merits of annuitization.

Nondiscrimination Testing

It is expensive and ineffective to annuitize small amounts (such as a purchase price of $25,000 or less). Accordingly, if employers decide to offer in-plan distribution annuity options or IRA rollover annuity options, they will likely establish minimum amounts on such distributions (expressed as either a minimum purchase amount or a minimum monthly annuity). Such minimums could raise concerns under the section 401(a)(4) nondiscrimination regulations regarding plan benefits, rights and features. This is because a plan that limits annuity distributions to participants with large accounts may run afoul of the nondiscrimination rules since participants with large accounts are more likely to be classified as highly compensated employees and, therefore, may cause the plan to fail nondiscrimination requirements. Such concerns could discourage employers from offering in-plan distribution annuity options or IRA rollover annuity options. Accordingly, MetLife recommends that the section 401(a)(4) regulations be amended to deem certain minimums required for annuity distributions to be nondiscriminatory. See Treasury Regulation § 1.401(a)(4)-4(b)(2)(ii)(E) for a similar rule regarding plan loans.

Section 9: Why are in-plan accumulation annuities good from a policy perspective and how can their use be facilitated?
[This addresses questions 33 and 34 in the RFI]

In recent years, new products have been developed that permit plan participants to purchase guaranteed future income in the form of deferred income annuities. One key advantage of such products is that they enable participants to allocate a portion of their contributions to a future income stream, allowing them to make smaller contributions over time, rather than one large lump sum purchase at retirement when interest rates could be low. Furthermore, such products help educate the participant over the course of their working career that the defined contribution plan is likely to be their only form of retirement income from their employer. In essence, the focus is on helping to "change the conversation" and thus the mindset of the participant. Finally, these in-plan accumulation annuities are purchased incrementally, thus avoiding the intimidating "big" purchase at retirement.

Since there are so many advantages to these products, MetLife believes that the law should support inclusion of such products in plans; one way to do so relates to the qualified default investment alternative rules. ERISA section 404(c)(5) provides that, for purposes of ERISA section 404(c)(1), a participant in a defined contribution plan will be treated as exercising control over the assets in his/her account with respect to the amount of contributions and earnings if, in the absence of an investment election by the participant, such assets are invested by the plan in accordance with DOL regulations. The DOL's regulation 29 CFR § 2550.404c-5 describes the types of investment products that are Qualified Default Investment Alternatives ("QDIAs") under ERISA section 404(c)(5).

As has been well documented in a variety of studies, the overwhelming response to the initial DOL QDIA regulations has been the selection of target date funds as the default option for individuals who do not affirmatively elect to participate in the plan on their own. The vast majority of these funds do not contain any type of guaranteed income feature.

The DOL could help stimulate this market by addressing the fiduciary issues related to in-plan accumulation annuities in the manner discussed in Section 6 above. The DOL could also revise the QDIA regulations to require that QDIAs contain an in-plan accumulation annuity component. The theory underlying target date funds and managed accounts is that they are aimed at preparing an individual for retirement. The deficiency is that most target date funds focus exclusively on the accumulation phase and do not prepare individuals for the equally challenging distribution phase. The DOL has an opportunity to remedy this deficiency. This change alone would have a dramatic effect on participants' readiness for the distribution phase of retirement.

In-plan accumulation annuities would also benefit from the clarification discussed in Section 6 regarding when and how the QJSA rules apply to such products.

Section 10: Policy recommendations for the IRA market

Unfortunately, despite whatever policymakers, employers and financial services providers are able to do within the context of defined contribution plans to help ensure that individuals are prepared to manage those assets effectively, the reality is that most employees do not remain at one job for their entire career. The pattern over the past few decades has been that many workers will have numerous jobs during their career. In fact, according to the Bureau of Labor Statistics between the ages of 18 and 42 an individual will hold, on average, 11 jobs. While no one knows what future workforce patterns will be, it is reasonable to expect that many workers approaching retirement age will have access to more than one defined contribution plan in their working lives. Many of those workers will choose to take the money from their former employer's plan. A 2009 Hewitt Associates report titled *Survey Findings: The Erosion of Retirement Security from Cash-outs: Analysis and Recommendations* states in part: "…Among all workers who terminated from employment in 2008, 46% took a cash distribution, 29% left their assets in the plan, and 25% rolled assets over to another qualified plan or IRA." According to a new report, *2010 Investor Assets in Motion: IRA & Retirement Marketplace Opportunities* by Cogent Research, Americans now hold more assets in IRAs than workplace-based retirement accounts. Total defined contribution assets are $3.9 trillion whereas IRAs are $4.1 trillion, this outpacing is expected to continue into the future.

With IRA assets becoming such a large portion of an individual's retirement asset base, the stakeholders need to develop solutions that address these sources of retirement income in addition to the assets held in defined contribution plans. Among the proposals that policymakers should consider in this area are the following:

1. Require IRA providers to annually disclose the annuity equivalent amount on the IRA statement, similar to the annuity illustration recommendation made for 401(k) plans in Section 7.
2. Facilitate IRA rollover annuity options by clarifying and simplifying the fiduciary duties involved, as discussed in Section 6.
3. Facilitate the purchase of longevity insurance through the RMD reforms discussed in Section 8.
4. Encourage distribution-phase education and advice in the manner addressed in Section 7.
5. Adopt tax incentives for annuitization, as discussed in Section 8.

MetLife®

RETIREMENT INCOME

The Role of Product Allocation in Sustaining Retirement Income

By: Moshe A. Milevsky, Ph.D. and Anna Abaimova
For: MetLife

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The Role of Product Allocation in Sustaining Retirement Income

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THE ROLE OF PRODUCT ALLOCATION IN SUSTAINING RETIREMENT INCOME

While the Baby Boomers have been accumulating wealth during the last 30 years, financial advisors have been preaching the benefits and importance of a diversified portfolio using the principles of asset allocation. This established philosophy is largely attributed to the well-cited studies and scholars who have documented that asset allocation is the single most important investment decision that a long-term "retirement saver" makes, outweighing the importance of individual security selection. At its essence the message has been that if investors own a diversified asset allocation portfolio as part of their retirement plan, then their financial futures are secure. More importantly, under this mantra, individual investors have been actively discouraged from trying to time the market or picking so-called hot sectors and flashy industries. The strategy preached has continuously been to buy, using an asset allocation strategy, then hold for the long run.

But once it comes time to retire and start withdrawing income from their accumulated assets, the famed role of asset allocation is diminished in importance and a new concept emerges as the core ingredient of a healthy retirement portfolio; that is product allocation.

During retirement, product allocation surpasses asset allocation in importance, when success is properly measured in terms of lifetime income sustainability.

While a diversified portfolio of stocks and bonds will forever be important regardless of age and lifecycle stage, the product allocation — or combination of actual products and instruments in which you keep your asset allocation — will have an even greater impact on the amount of retirement income you receive and the sustainability of that income throughout your lifetime. Utilizing only one product or category may not allow you to maximize your periodic income payments, maintain liquidity for emergencies, satisfy your legacy needs AND sustain payments for a lifetime. Rather, we believe that a mix or portfolio of product types can help accomplish retirement income goals, just like a mix of asset types can help accomplish asset accumulation goals. With the availability of traditional pension plans diminishing and the responsibility of retirement income financing shifting from corporations to individuals, the proper practice of product allocation becomes even more important.

In this report we will explain exactly what is meant by product allocation and how to apply this new approach to 21st century retirement income thinking.

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THE CHALLENGES

Most readers will understand that as individuals transition into retirement they face unique and different challenges, or risks that simply do not arise in the earlier wealth accumulation stage of the lifecycle. These risks can have a dramatic effect on retirement income sustainability. We will now briefly review these risks before we introduce our main thesis regarding product allocation.

Longevity Risk

The National Center of Heath Statistics reports that American life expectancy at birth has increased by about 15 years in the last 50 years alone. Life expectancy is now estimated to be 75.2 years for males and 80.4 years for females. Of course, averages alone don't tell the entire story since once we reach our retirement years, the chances of surviving for another 20 to 30 years are substantial. In fact, as we survive each stage of life and the associated risks, the odds of us surviving to higher ages increase. For example, a 50 year-old female has a 49% chance of surviving to age 85; however, once she makes it to age 70, her chances increase to 56%.[1] That is 7 more percentage points. Indeed, we increase life expectancy as we age.

Exhibit #1 provides some additional values. From our perspective, the most compelling and relevant of longevity statistics is the probability of survival for at least one member of a couple. The chance that at least one member of a couple survives to age 85 is 76%; the probability that one spouse or even both are alive at age 90 is one in two.

While individual lifestyle factors, behavioral habits and family history will further impact any survival estimates, our main point is to remind the reader that the human lifespan is random and a retirement strategy must — more so than ever before — account for this longevity risk.

EXHIBIT #1

Probability of Survival at Age 65

To Age	Female	Male	At Least One Member of a Male-Female Couple
70	93.9%	92.2%	99.5%
75	85.0%	81.3%	97.2%
80	72.3%	65.9%	90.6%
85	55.8%	45.5%	75.9%
90	34.8%	23.7%	50.3%
95	15.6%	7.7%	22.1%
100	5.0%	1.4%	6.3%

Sources: *Are You a Stock or a Bond?: Create Your Own Pension Plan for a Secure Financial Future*, (Pearson/FT Press, 2008); Society of Actuaries RP-2000 Table with full projection.

1 Source: Society of Actuaries RP-2000 table (Healthy Annuitant).

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Inflation Risk

Part of the U.S. Federal Reserve mandate is to ensure that macro-economic inflation is kept at acceptable levels. They do this by fine tuning monetary policy so that the change in the Consumer Price Index (CPI) stays within a certain range. However, they don't target and will never accept a zero percent inflation rate. Thus, what many retirees fail to realize is that a small inflation rate is an economic given and that even a very low inflation rate can have a detrimental effect on their purchasing power several years into retirement.

Exhibit #2 illustrates how even an inflation rate as low as 2% can reduce the purchasing power of $1,000 by more than a third after 20 years of erosion. After 25 years, the initial $1,000 is only worth about 60% of its original value in real terms under the same 2% inflation rate. Here is another way to think about it. Recall there is a 50% chance that at least one member of a newly retired couple (at age 65) will live to age 90. Thus, if a retiree starts receiving a pension check of $1,000 per month, for example, and this payment is never adjusted for price inflation, then at age 90 the same $1,000 will only buy less than $380 worth of goods and services, under a 4% inflation rate.

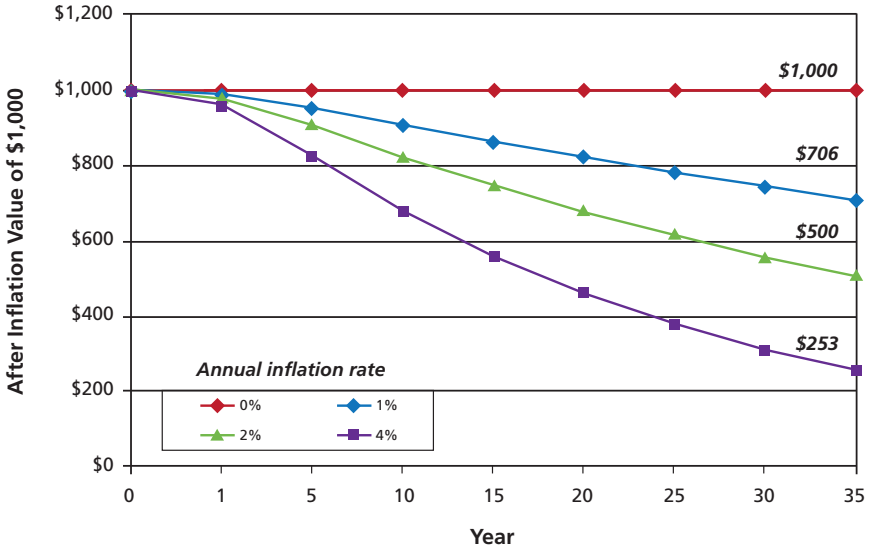
More importantly, the mathematics of purchasing power erosion is even more pronounced for retirees. Aside from the Consumer Price Index (CPI) mentioned above, the U.S. Bureau of Labor Statistics recently inaugurated a new unique (experimental) inflation index for the elderly, which they call CPI-E. The impetus for this new index arises because as we age, our spending habits change. Any inflation index, after all, is a reflection of a given basket of goods and the CPI-E aims to capture retirees' spending patterns.

For example, as we age, we tend to buy less clothing and more medicine. Over the past 25 years, the average CPI-E inflation rate has been 3.33%, whereas the average broad population inflation, measured by the CPI-U has been 3.12%. The average inflation for wage earners for the same period, measured by the CPI-W was 3.02%. Now, these differences might seem small, but over time they compound the effect, as you can see from Exhibit #2.

Either way, the data certainly implies that inflation is different and is higher for retirees. Also, it is important to note that even in periods of deflation, retirees can still experience inflation. Whether this will continue in the future is unclear at this point, but we certainly must consider it a risk-factor.

EXHIBIT #2

Inflation: What Does a $1,000 Payment Really Buy You?



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Sequence of Returns Risk

In a recent white paper commissioned by MetLife entitled Retirement Income and the Sensitive Sequence of Returns, we (the same authors) demonstrated how in the years just before and just after retirement — a.k.a. a region we coined the fragile risk zone — a retiree's accumulated assets are most sensitive to losses from poor market returns. This is primarily because the greatest amount of money is at stake. Thus, if portfolio investment returns are sequenced so that negative or poor returns are experienced early on in retirement, the sustainability of the income strategy will be threatened.[2] This is illustrated in the example below.

EXHIBIT #3

Negative Returns Early On Can Reduce the Retirement Sustainability Quotient

Hypothetical example

Two clients. Same average investment return. Very different retirement outcomes.

- Both clients start out with a $1 million investment
- Upon retiring, they begin to withdraw $50,000 per year (in inflation-adjusted terms)
- The average compounded 10-year return for both accounts is 3.7%

CLIENT 1: Negative Returns Early On				CLIENT 2: Negative Returns Later On			
End of Year	Rate of Return	Withdrawal	Account value at end of year	End of Year	Rate of Return	Withdrawal	Account value at end of year
			$1,000,000				$1,000,000
1	-20%	$50,000	$760,000	1	24%	$50,000	$1,178,000
2	-10%	$50,000	$639,000	2	20%	$50,000	$1,353,600
3	-8%	$50,000	$541,880	3	16%	$50,000	$1,512,176
4	0%	$50,000	$491,880	4	12%	$50,000	$1,637,637
5	4%	$50,000	$459,555	5	8%	$50,000	$1,714,648
6	8%	$50,000	$442,320	6	4%	$50,000	$1,731,234
7	12%	$50,000	$439,398	7	0%	$50,000	$1,681,234
8	16%	$50,000	$451,702	8	-8%	$50,000	$1,500,735
9	20%	$50,000	$482,042	9	-10%	$50,000	$1,305,652
10	24%	$50,000	**$535,732**	10	-20%	$50,000	**$1,004,529**
Average annual rate of return			3.7%	**Average annual rate of return**			3.7%

Both clients average a 3.7% rate of return. But at the end of year 10, Client 2 has over $468,000 more than Client 1.

These examples are hypothetical and are for illustrative purposes only. It is not meant to represent performance of any particular investment. These examples are meant to demonstrate the impact of the sequence of returns, assuming annual withdrawals of $50,000 (initially 5% of the account value). Withdrawal charges would apply if withdrawals exceed the contract's annual free withdrawal amount. If the taxpayer has not attained age 59½ at the time of the distribution, the portion of the withdrawals that is subject to income tax may also be subject to a 10% Federal income tax penalty. These hypothetical illustrations do not take into account premium taxes. These examples do not take into account any fees or charges that may be associated with a particular product.

2 For more information on the sequence of returns effect, see Chapter 6 of Are You a Stock or a Bond?: Create Your Own Pension Plan for a Secure Financial Future (Milevsky, 2008).

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INSURE AGAINST THE RISKS

One cannot control the timing of an inevitable bear market, just as we have no control over the precise length and cost of our golden years or the rate of inflation throughout our retirement. Thus — and this is one of our main points that motivate the need for a product allocation strategy — rather than trying to predict the outcome of any of these random events, we believe one should *insure against adverse outcomes* using a product allocation strategy. In a sense the objective is to hedge against these retirement risks in the context of one's retirement income goals.

The Products to Help Manage Retirement Income Risks

Given the growing importance of managing retirement income risks, it is not surprising that the financial services industry is continuously expanding its repertoire of insurance and investment products. The resulting challenge from these ever expanding innovations is determining which should be recommended for allocating a client's wealth, as well as in what proportions.

As a starting point, we assert that there are three major financial and insurance categories that should be considered in some combination within a comprehensive retirement income product allocation strategy. These categories are:

(1) systematic withdrawals from traditional investments,
(2) variable annuities with guaranteed living benefits and
(3) income annuities with pure longevity insurance.

EXHIBIT #4

Which Products Are Available?

Systematic Withdrawals From Traditional Investments
- Mutual Funds
- Stocks, Bonds, Cash Within Separately Managed Accounts

VAs with Guaranteed Living Benefits
- Guaranteed Minimum Withdrawal Benefit for life rider
- Guaranteed Minimum Income Benefit rider

Income Annuities
- Single Premium Immediate Annuity,
- Deferred Income Annuity

Systematic Withdrawals from Traditional Investments

The systematic withdrawal plan, or SWP, is a category/strategy in which money is systematically withdrawn from an account (such as a separately managed account or mutual fund) in order to generate a stream of retirement income. The assets within the account are allocated among various traditional asset classes, including mutual funds, stocks, bonds and cash. Conceptually these withdrawals from the SWP account continue until the account value hits zero, or until the end of the retiree's lifecycle.

Variable Annuities With Guaranteed Living Benefits

The latest generation of variable annuities (VAs) offers the option to elect a number of riders or features with embedded guarantees that address retirement income risks. The two most popular are the GMWB for life (guaranteed minimum withdrawal benefit in which withdrawals are available for life) and the GMIB (guaranteed minimum income benefit). An analysis and understanding of the role and mechanics of these optional riders is critical for proper retirement income planning, and going forward we will refer to them as VAs with Guaranteed Living Benefits.

Fixed and Variable Income Annuities

Income Annuities can be either immediate or deferred, depending on when the income begins (immediately or at some point in the future), and either fixed or variable, depending on whether the income amount is the same for each payment or varies with market conditions. Once income begins, it is guaranteed to last as long as the annuitant lives, regardless of how long that is. Thus, the primary risk-management benefit of these products is that they provide the buyer with longevity insurance. The embedded longevity insurance protects the annuitant against the risk of outliving their planning horizon.

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The Effectiveness of Retirement Income Products

Since each product category has certain benefits, combining all three product types within one product allocation strategy may help clients to better accomplish their retirement income goals. Before determining how much of each product type would be appropriate for a particular client, it is important to gauge their relative strengths.

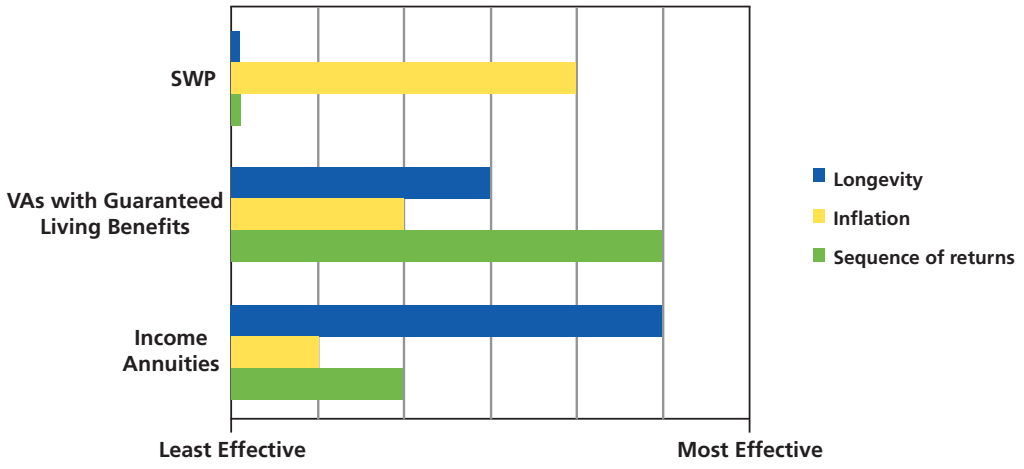
We will compare products based on these criteria:

- How well they help manage the three primary risks of longevity, inflation and sequence of returns.
- How well they help clients achieve certain retirement income goals. The three goals we'll compare are liquidity, staying the course and legacy planning.
- How the insurance and guarantee fees for the products compare, relative to their features and benefits.

The product features are stated in general terms and categories and do not necessarily reflect a particular company's design.

EXHIBIT #5

Effectiveness in Managing Risks



Systematic Withdrawals From Traditional Investments

Focusing first at the top of the chart, we start by evaluating the systematic withdrawal plan (SWP) category which is typically funded by stocks, bonds and cash within a Separately Managed Account or similar investment account.

For its effectiveness as a longevity hedging tool, the SWP account receives a low score in comparison to the other products. There are no associated guarantees and the investor is solely responsible for monitoring and adjusting the spending and investment policy in order to make the account last for the duration of retirement.

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On the other hand, the SWP receives the highest grade for the inflation hedging attribute. That's because the investment choices within a basic investment account are virtually endless and the underlying asset allocation is under the control of the investor and/or the advisor. This allows the investor to select a variety of investments including equities, which tend to outperform other investments and outpace the rate of inflation over the long run. More importantly, one can purchase inflation-linked bonds, such as TIPS or iBonds which can help hedge and protect against inflation risk. The flexibility of this account and the virtually unlimited number of options available within a SWP imply that an investor that is primarily concerned about inflation is best served with a substantial allocation to this category.

The SWP scores low for the sequence of returns risk attribute. It offers no protection against potential market drops in the fragile risk zone if the asset allocation involves a substantial exposure to stock investments. This shortfall may result in a damaging and lasting financial effect on retirement income sustainability. And while a SWP allocation heavily weighted in fixed income investments may overcome market volatility, it may also result in low growth. As a result, allocations in fixed investments may not keep up with the rate of inflation which can cause retirees to "outlive" their funds. The bottom line is that SWP accounts don't provide any insurance, guarantees or protection.

SWPs OFFER FLEXIBILITY AND GROWTH BUT NO GUARANTEES

- Total investment choice.
- Ability to select investments that outpace inflation in the short and long run.
- Potential for income volatility due to market fluctuations.
- No guarantee that money will last a lifetime.
- Generally less costly than other products.

VAs With Guaranteed Living Benefits[3]

Unlike SWPs, VAs with Guaranteed Living Benefits offer the option or ability to guarantee an income stream for life. They therefore score well on managing longevity risk. However, they do not provide the pure form of longevity insurance offered by Income Annuities, which we'll discuss later.

VAs with Guaranteed Living Benefits also score higher than income annuities with regard to inflation risk because many offer systematic payment step-ups or minimum percentage increases that could in certain cases potentially offset the impact of inflation in the long run. They also offer investors access to a diversified variety of investment options that include stocks and bonds and let investors stay in the market, even while taking withdrawals, which can give them the

KEY ATTRIBUTES OF GMIBs AND GMWBs FOR LIFE*

- The ability to take immediate withdrawals and also guarantee lifetime income later, regardless of market conditions.
- Income for life (or for the lives of the investors and their spouses).
- Larger withdrawals if the market performs well or if the investor doesn't need withdrawals immediately.
- Ability to stay invested in the market even while taking withdrawals.

* There are important differences between GMIBs and GMWBs for life. Please see the applicable product prospectus for specific information about the features, costs and restrictions associated with each type of rider. Fees and costs are generally higher than a SWP.

3 Guaranteed living benefit riders are optional and available for an additional fee. The fee also has the potential to increase upon step-up (locking in account value gains). Withdrawals will impact the ability to take a step up. Also, there are usually investment allocation restrictions associated with these types of riders.

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confidence to "ride out" any market declines. They can even offer protection from market declines by locking in account value gains and guaranteeing continued growth from high points for the purposes of calculating income under the benefit.

VAs with Guaranteed Living Benefits are ideal instruments for helping to hedge a retirement against the so-called sequence of returns risk. As we mentioned earlier, implicit guarantees and promises are the core of these products. They promise at least the return of the initial investment, despite the performance of the market in the fragile risk zone. VAs with Guaranteed Living Benefits are analogous to long-term equity put options that can be purchased in the open market to provide downside protection on a portfolio. To sum up, their embedded guarantees earn them high scores for this attribute.

It is because of the fused combination of insurance against a collection of financial risks that we consider VAs with Guaranteed Living Benefits to be a unique risk management category product worthy of its own allocation.

When certain guaranteed living benefits are elected, policyholders are inclined to allocate more wealth to riskier asset classes such as equities.

This is according to a recent empirical study of asset allocations within variable annuity policies, published in the Financial Analysts Journal in the Spring of 2008. This behavior is observed at all ages and with variable annuity policies from a wide swath of issuers.[4] We interpret these results as evidence that long-term guarantees provide policyholders with a comfort level that allows them to accept greater short-term financial risk. This is the behavioral impact of guaranteed living benefits.

Fixed and Variable Income Annuities

The strength of an Income Annuity lies in its promise to pay out a steady, fixed (and in the case of an immediate variable annuity — market-contingent) payment for as long as the policyholder lives. The retiree cannot outlive the guaranteed income that the Income Annuity provides and hence the longevity risk concern is directly addressed and hedged. This product category should be viewed as a close substitute for the (disappearing) traditional defined benefit pension, which has been prized by previous generations of retirees.

Insurance companies are able to provide this guaranteed income by pooling the mortality risk of their policyholders. The idea is that some individuals will live longer than the normal life expectancy and some will not. Those who live longer are, in effect, subsidized by those who don't.

The longevity insurance provided by these products is even more valuable when the Income Annuity is purchased early in life (e.g. prior to age 50) in small increments with payments that commence late in life (e.g. after age 80) — such as with a deferred income annuity. In fact, the greater the gap between the purchase date and the commencement date, the larger the payout. This is because of mortality pooling as well as something we refer to as "extreme risk pooling" which is essentially insurance on a less likely event, such as living beyond age 85. Because of these benefits the Income Annuity receives high marks for the longevity risk attribute.

4 Source: Are You a Stock or a Bond?: Create Your Own Pension Plan for a Secure Financial Future (Milevsky, 2008).

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Conversely, the most common design of this product — the fixed income annuity — scores low on its ability to tackle inflation. So the most widely purchased version of the product does not avoid the erosion of purchasing power effect illustrated in Exhibit #2. Now, while some versions of this product do offer payments that vary with market performance (like the immediate variable annuity) and others offer income payments that are adjusted for changes in the CPI index or by a fixed annual cost of living adjustment (COLA) rate, this protection comes at a price. As a result, initial payments would be significantly lower, and would be expected to rise gradually over time. Moreover, since the retiree would no longer be benefiting to the same extent from the mortality credits and "extreme risk pooling" associated with pure longevity insurance, a rise in the inflation attribute score might be accompanied by a fall in the longevity attribute score.

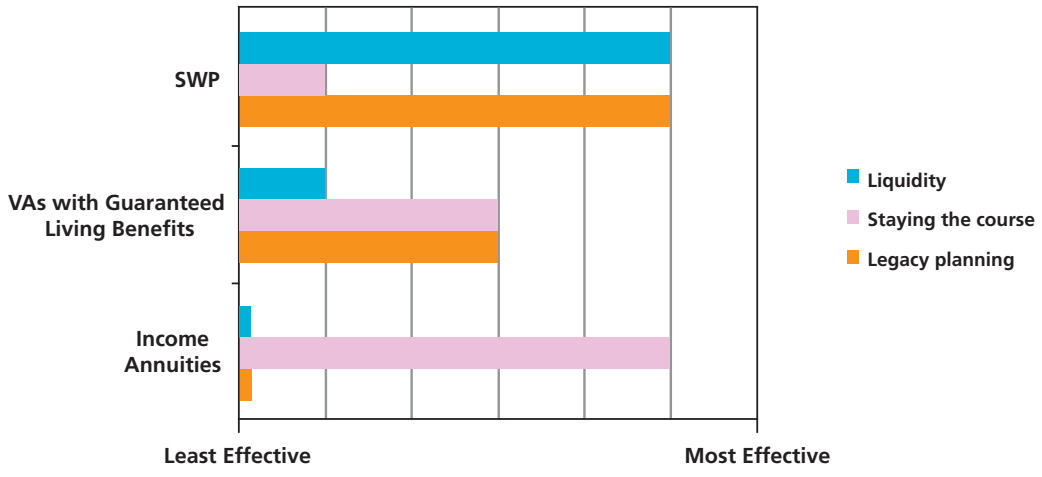
Finally, we assign a somewhat neutral score to the Income Annuity for its ability to hedge against the sequence of returns. While the product does not explicitly provide insurance against an early bear market, it indirectly overcomes the risk, since payments are fixed and guaranteed regardless of market fluctuations. There certainly are downside or "bear market" guarantees.

KEY ATTRIBUTES OF THE INCOME ANNUITY:

- Provides a guaranteed fixed income stream for life.
- Provides a high level of income for the investment.
- Possible deferral period establishes a lifetime income start date which allows you to better manage other assets.

EXHIBIT #6

Effectiveness In Achieving Goals



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Retirement Income Goals

- Liquidity: Refers to investors' desire to have easy access to money that is not tied up in an investment.
- Staying the Course: Refers to the product's ability to keep investors on the right track or correct their innate urge to try and time the market.
- Legacy Planning: Refers to investors' desire to leave money behind for loved ones once they die.

Systematic Withdrawals From Traditional Investments

With a SWP, the investor can meet liquidity needs and legacy planning goals with the greatest ease since he or she retains control over their asset allocation and withdrawal rate. But it is this exact same reason that leads to a low ranking for the SWP's effectiveness in helping the investor stay on course and avoid behavioral mistakes.

VAs With Guaranteed Living Benefits[5]

VAs with Guaranteed Living Benefits are effective in addressing behavioral weaknesses, hence their solid ranking for Staying the Course. When purchasing this product, investors know they are protected against poor market performance in the fragile risk zone. As a result, they need not make any (possibly detrimental) moves to try and adjust their retirement investment and income strategy.

This product's legacy planning goal is somewhat interconnected with the goal of staying the course; hence it receives a similar ranking. As mentioned, analysis of extensive industry data suggests that since the investor is protected against a market downturn during sensitive years, they are more likely to opt for a riskier asset allocation within the variable annuity. This allocation could potentially result in higher growth over the long-term which could be passed on to loved ones at death.

The liquidity of a VA with a Guaranteed Living Benefit is somewhat restricted because of withdrawal limits imposed by the riders and surrender charges that remain in effect for a number of years after the initial purchase. However, with many riders, the policyholder is allowed a minimum level of income with the possibility of additional income if the market performs well. The percentage allowed each year is similar to the percentage an advisor would typically recommend, so taking more than what is allowable under the product each year many not be in the investors' best interest anyway.

5 Guaranteed living benefit riders are optional and available for an additional fee. The fee also has the potential to increase upon step-up (locking in account value gains). Withdrawals will impact the ability to take a step-up. Also, there are usually investment allocation restrictions associated with these types of riders.

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Income Annuities

We assigned a very high ranking for the product's ability to help clients stay the course. In the absence of product-imposed restrictions, many investors are susceptible to making irrational decisions and errors with their investments which can decrease the chances of meeting their income goals in retirement. When the initial irreversible payment is made to the insurance company issuing the Income Annuity, the control over the investment management decisions is also transferred away from the investor. This leaves virtually no room for behavioral biases and blunders.

A total allocation to an Income Annuity would be inappropriate if the retiree's retirement goal was to leave a relatively large legacy as opposed to meeting personal consumption and spending needs. Likewise, the product's inherent design does not allow for a fluctuating spending rate or large lump sum withdrawals for unexpected cash needs. After all, the reason these products are able to offer such effective longevity insurance is the irreversibility (for the most part) of the initial lump sum payment. Thus, for the Income Annuity's ability to address liquidity and legacy planning goals, the product receives a low ranking.

Fees May Be Worth It

In comparing costs, the basic Income Annuity tends to be the least expensive product option from the perspective of fees because it is the simplest product and offers basic longevity insurance and nothing more. On the other hand, VAs with Guaranteed Living Benefits will have higher fees relative to the other products because they offer the most benefits and guarantees. Note, however, that the market cost of stand-alone products that help protect and insure against market declines, called put options, are often much higher.

The account owner maintains some control over the fees charged by a SWP since these vary with the selection of the underlying investments. As a result, its fees and expenses would fall somewhere between that of the other two income products.

WHICH PRODUCT IS BEST? ALL THREE.

When we look at all three products side-by-side, comparing all of their relative attributes, we find that they are economically equivalent. Each product offers a valuable benefit that is "paid for" via a tradeoff in another risk management or goal achievement attribute. That is, one product may hedge against longevity risk but at the expense of a legacy planning or liquidity goal; another product may offer more guarantees for a higher product fee, etc.

Therefore — and this is our main thesis — we suggest a combination of all three products, namely a product allocation mix.

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DECIDING ON A PRODUCT ALLOCATION FOR YOUR CLIENTS

How much your clients should allocate to each product type will obviously depend on their personal and financial goals and situation. You can start by assessing the degree to which each of the factors we've used applies to your particular client. Asking questions like those shown below will allow you to determine how important the goal of liquidity, legacy planning or being able to stay the course is to your clients, and how concerned they are about longevity, inflation or the sequence of returns risk.

SAMPLE QUESTIONS: Ranking Retirement Risks And Priorities

Instructions: Develop a list of questions or statements similar to those shown below. Ask your clients how strongly they agree or disagree with each statement and score their response on a scale from zero to five points. The catch: the total number of points for the entire questionnaire must add up to exactly 10. This restriction will highlight the clients' top priorities and the tradeoff they must face when selecting a product allocation strategy.

1) Inflation Risk

I am worried and concerned that during my retirement years the rate of increase for my desired goods and services — i.e. my personal inflation rate — will be even higher than the officially reported Consumer Price Index (CPI) rates and the historical 3% figure.

Disagree ← (0 1 2 3 4 5) → Agree

2) Longevity Risk

For a typical 65 year-old retiree, life expectancy is approximately age 82 according to insurance actuaries and demographic experts. I actually feel much healthier than my peer group and am blessed with very good genes in my family history. In fact, I have some direct relatives who lived well-into their nineties. So, I personally believe there is a better than 50% chance I will survive to 82 and beyond, and I think I stand a good chance of living to age 90.

Disagree ← (0 1 2 3 4 5) → Agree

3) Sequence of Returns Risk

If financial markets follow a prolonged downward and bearish trend — especially during the early years of my retirement — I'm afraid I'll have to reduce withdrawals from my investment portfolio and standard of living. After all, I don't have much of a guaranteed pension and am relying primarily on my accumulated assets to generate the necessary cash flows which will replace my paycheck.

Disagree ← (0 1 2 3 4 5) → Agree

4) Liquidity and Flexibility

Some investors don't anticipate any sudden expenses in retirement and are thus willing to restrict access to their funds in order to obtain long-term guarantees and benefits. However, I prefer to keep my financial assets fully liquid and accessible for emergencies and unplanned expenses since I don't have many other sources of regular cash flow in retirement. I certainly don't want to invest or buy into anything that is irreversible.

Disagree ← (0 1 2 3 4 5) → Agree

5) Behavioral and Psychological

In retirement, I don't see myself taking a very active role in my ongoing asset allocation, especially at an advance age. I'm also worried about the impact of medical conditions that might impact my financial judgment as I age. Personally, I would rather place my investments and retirement income on autopilot and let somebody else worry about things.

Disagree ← (0 1 2 3 4 5) → Agree

6) Legacy Planning

I would like to leave a substantial and meaningful financial bequest to my loved ones and favorite charities. In fact, I stand ready to reduce my standard of living in retirement in order to achieve this goal. I don't have much in the way of life insurance and I am therefore hoping that part of my accumulated assets will be available toward this objective.

Disagree ← (0 1 2 3 4 5) → Agree

SAMPLE

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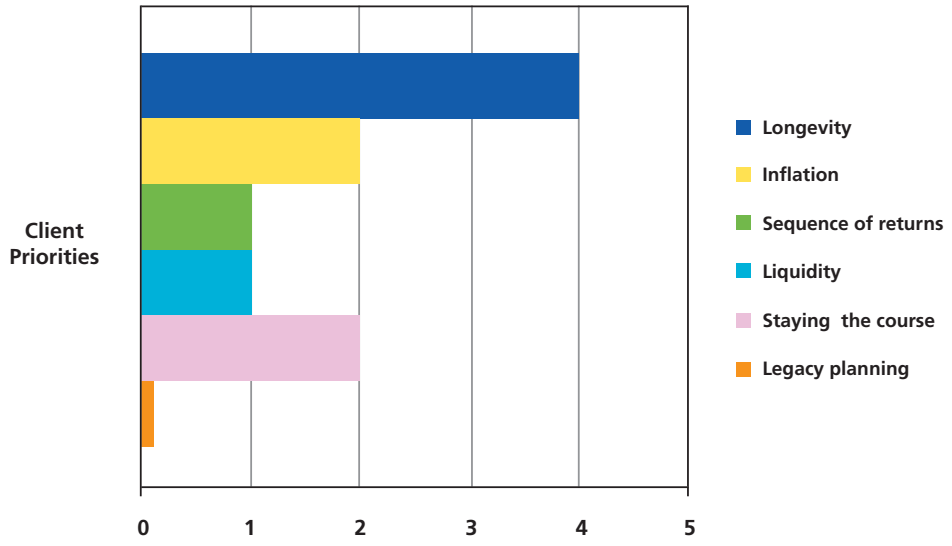
Exhibit #7 is an example of scores for a client that lacks a legacy planning goal but is particularly concerned with inflation and outliving his retirement accumulated assets.

EXHIBIT #7

Establishing Client Priorities



Next, you'll need to consider what percentage of your clients' assets they'll need to withdraw each year and balance that with how much they'd like to leave for a legacy, if any. There is an economic tradeoff, shown in Exhibit #8 on the next page. For example, your client may decide they need to take income at a rate of 5.2% of their assets per year. The larger the amount of their legacy, the lower the probability their income will last a lifetime. The last step in the process is a product allocation recommendation that addresses the client's unique ranking of retirement priorities.

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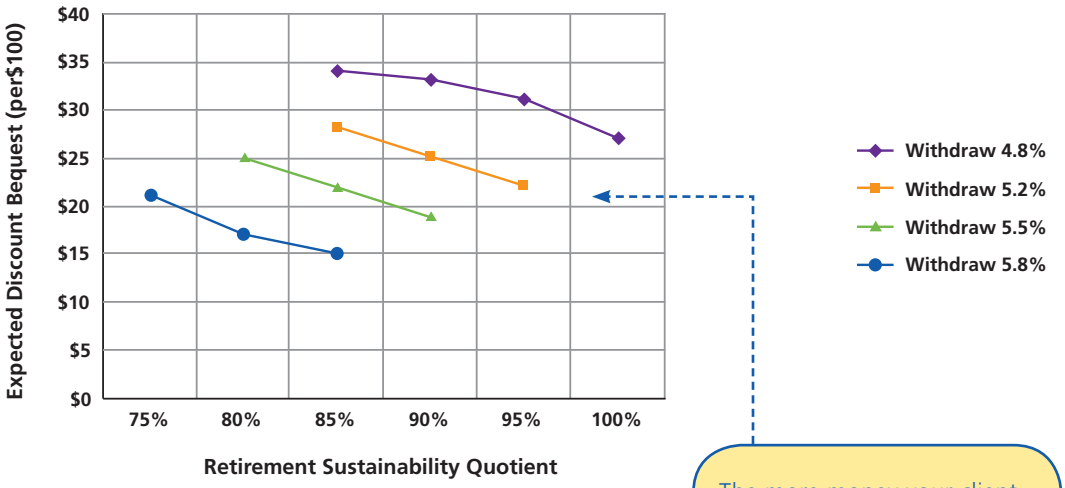
EXHIBIT #8

Economic Tradeoffs at Retirement



The more money your client desires to leave as a legacy, the lower their Retirement Sustainability Quotient.

The expected legacy and RSQ values in Exhibit #8 were determined using a novel and proprietary methodology developed by the QWeMA Group Inc.[6] The algorithm is called PrARI®, an acronym for Product Allocation for Retirement Income[7] and it considers several individual and economic variables such as retiree age, gender, health and the uncertain remaining lifetime; wealth, spending rate, pension and capital market projections.[8] The program then analytically determines a unique optimal product allocation to the three retirement income products that maximizes retirement income sustainability (measured by the RSQ) while leaving a minimum specified legacy. Each point along the four tradeoff frontiers in Exhibit #8 is associated with a PrARI-generated optimal product mix.

The Retirement Sustainability Quotient (RSQ) measures the ability to receive periodic and stable income consistently throughout a lifetime, despite fluctuating market conditions or the effects of other risks such as inflation or longevity. In these illustrations, the RSQ is measured on a scale of 0% to 100%.

6 The QWeMA Group is not providing any investment or other financial advice of any kind or nature and results produced by its analytic software program are merely provided to be used in the support of the marketing, sale and promotion of products and services. In no event shall QWeMA Group, or any officer, director, principle, employee, agent or other representative of QWeMA Group, be liable for any damages, liabilities, expenses or losses in any connection with the provision of any investment advice or recommendations made by the user of this analytic software program or its representatives whether in reliance on or use of the program or any ancillary materials or otherwise.

7 PrARI is a registered trademark of the QWeMA Group Inc.

8 The precise statistical parameter assumptions used for the calculations are as follows: retirement age = 62, excellent health, inflation adjusted risk-free rate = 3%; inflation adjusted expected equity returns = 7%, market volatility = 18%; annual GLB insurance fee = 1.3%, inflation adjusted guaranteed GLB payout rate = 4.5%.

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PRODUCT ALLOCATION: CASE STUDIES

Meet two hypothetical clients named Denise and Ava both of whom are seeking retirement product allocation advice. Let's briefly examine their retirement income priorities and see how those priorities can translate into a product allocation mix. We will also look at their anticipated income percentage and bequest amount. These hypothetical case studies do not take into account any fees or charges that may be associated with a particular product.

MEET DENISE:

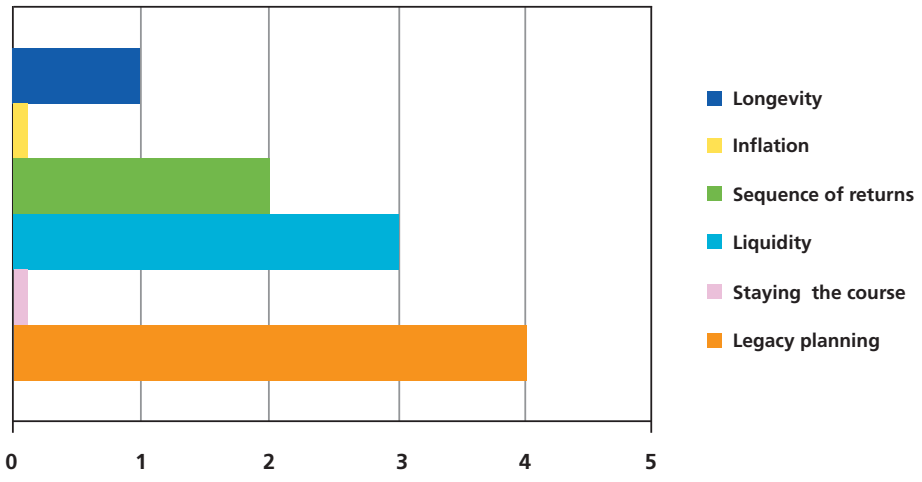
- 62 years old.
- Ready to retire from her job.
- Plans to travel with her husband, who is already retired.
- Will receive inflation-adjusted defined benefit pension.
- Additional $1 million to invest.
- Needs an annual income of $55,000 (5.5%) and wants to leave a portion to her beneficiaries.

The tradeoff that Denise faces is represented in the Exhibit #8 by the green line. She is presented with a choice of several strategies that would result in an expected discounted bequest ranging from $19 per initial $100 (or $190,000) to $25 per initial $100 (or $250,000). The corresponding retirement sustainability ranges from 89% to 79%.

To determine which strategy is appropriate for Denise, she completes the Ranking Retirement Risks and Priorities Questionnaire and her scores are summarized in Exhibit #9.

EXHIBIT #9

Denise's Retirement Priorities



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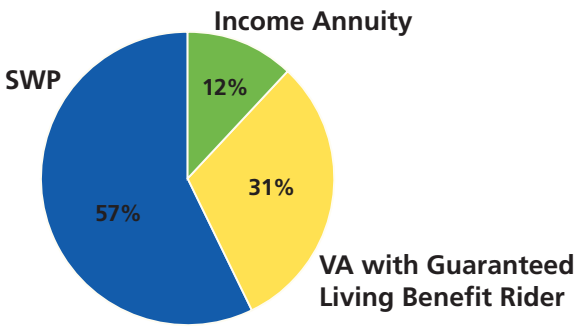
Denise feels that both goals — achieving a steady and sustainable spending rate of $55,000 per year, as well as leaving a bequest are equally important. She is less concerned about the other retirement risks. Generally, she feels that she can risk falling somewhat short of her target income since the couple can also rely on her pension and the husband's retirement income to meet their spending needs. As a result, she decides to compromise between her two goals and selects the allocation summarized in Exhibit #10. This allocation takes into account 1) Denise's ranked priorities and 2) each product's effectiveness at addressing retirement risks and goals, which we assessed in a previous section. The largest proportion is to be allocated to a SWP account to address Denise's liquidity and legacy planning goals, while the lesser allocations to the Income Annuity and VAs with Guaranteed Living Benefit rider categories will help address longevity and sequence of returns risk to achieve a reasonable Retirement Sustainability Quotient.

EXHIBIT #10

Denise's Product Allocation



Desired income of $55,000 per year (5.5%)

Legacy Planning goal of $22 per $100

Probability of retirement income sustained throughout lifetime: 84%

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MEET AVA:

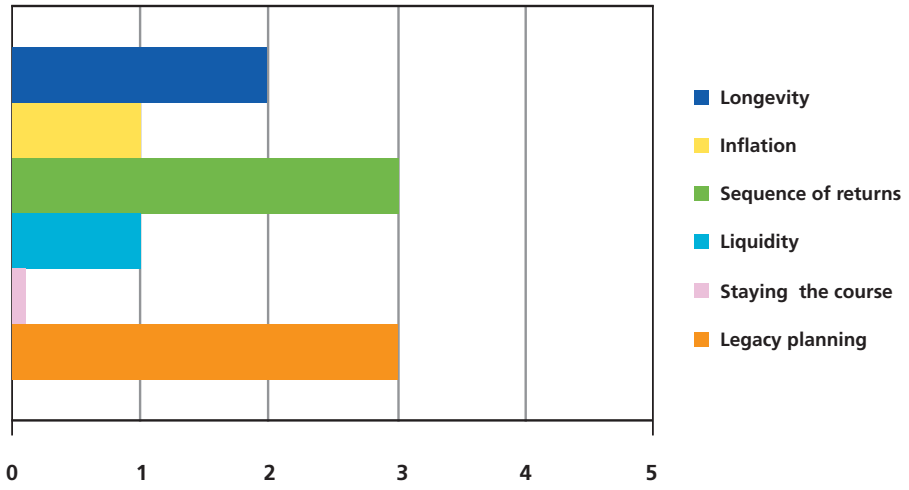
- 62 years old.
- Has an IRA account of $750,000 plus modest Social Security payments.
- Would like an inflation-adjusted income of $39,000 per year upon retirement.
- Hopes to leave a portion of her assets to her son.

The tradeoff frontier for Ava, who plans on spending 5.2% of her accumulated retirement assets, is represented by the orange line in Exhibit #8. With her advisor she assesses the two ends of the sustainability spectrum. While on one hand she could leave as much as $210,000 (or $28 per initial $100 investment) to her son as a bequest, she would have to settle for a lower probability of spending sustainability.

Ava completes the Ranking Retirement Risks and Priorities Questionnaire, and based her scores on the six questions, the ranking of her priorities is illustrated in Exhibit #11.

EXHIBIT #11

Ava's Retirement Priorities



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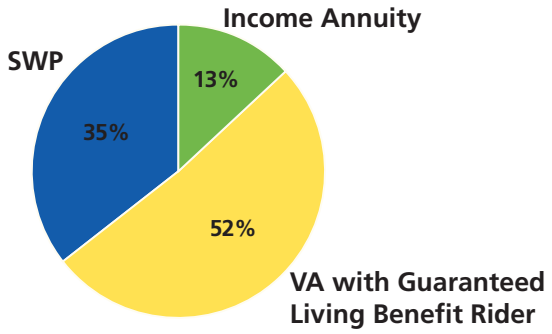
Given the low guaranteed income that she will receive from Social Security, she is quite concerned that an early bear market, inflation or a longer than expected life span may jeopardize her ability to finance a comfortable retirement. At the same time, she assigns a high score to her legacy planning goal. Upon consideration of her goals and the tradeoff she faces, Ava selects the strategy summarized in Exhibit #12, which allocates 35% to the SWP, 52% to the VA with Guaranteed Living Benefit rider and 13% to the Income Annuity. This product allocation will allow her to manage her retirement risks so that she can achieve her annual spending goal of $39,000 with a probability of 90%. At the same time, her bequest sum, in present value terms, is expected to be a quarter of her accumulated assets or $187,500.

You can see that a small portion of her accumulated assets is allocated to an Income Annuity to help manage her longevity risk and improve her odds of success, while a significant portion of her accumulated assets — 35% — is allocated to the SWP category to help Ava meet her estate goal. The largest percentage of the account is allotted to the VA with Guaranteed Living Benefit rider, which is the most effective at protecting investments against the adverse effects of the sequence of returns risk (one of Ava's top concerns), while also contributing to her longevity and legacy planning goals.

EXHIBIT #12

Ava's Product Allocation



Desired income of $39,000 per year (5.2%)

Legacy planning goal of $25 per $100

Probability of sustaining retirement income throughout lifetime: 90%

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CONCLUSION

The hypothetical case studies we have just illustrated, obviously should not be taken literarily as actual investment and/or insurance recommendations for real live people regardless of how 'close' the reader feels to Denise or Ava. Rather, the above mentioned case studies should be viewed as analogies for thinking about the economic tradeoffs in retirement. At the very least they should illustrate how you might translate goals and risk tolerance into a product allocation mix. It is the beginning of a discussion rather than the end of a process.

Indeed, there are a number of other financial and insurance products that may play a role in a client's overall retirement plan. They include life insurance, long-term care insurance and debt instruments such as reverse mortgages and home equity loans.

To sum up, the main practical takeaway from what we have discussed is as follows. We strongly believe that in most cases retirees will not be able to finance a sustainable retirement income with only one or two traditional product classes. Indeed, all three product categories — SWPs from Traditional Investments, Variable Annuities with Guaranteed Living Benefits and Income Annuities — mixed and matched in various combinations are required in order to maximize the sustainability of one's retirement income.

We leave it in the hands of individuals and their advisors to determine the exact product allocation strategy that will balance the clients' retirement risks and legacy planning goals. Working through a retirement needs analysis or retirement priority questionnaire with your clients may be a good place to start, as such tools may make initial conversations productive and easy. Once you know how much your clients will need in retirement and how much they have available from guaranteed sources, you can determine if there is a gap of guaranteed income needed, which will help you design an appropriate product allocation strategy for that individual's retirement income needs.

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Investment Performance Is Not Guaranteed.

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Variable annuities are long-term investments designed for retirement purposes. MetLife variable annuities have limitations, exclusions, charges, termination provisions and terms for keeping them in force. There is no guarantee that any of the variable investment options in this product will ever meet their stated goals or objectives. The account value is subject to market fluctuations so that, when withdrawn or annuitized, it may be worth more or less than its original value. All product guarantees are based on the claims-paying ability and financial strength of the issuing insurance company.

Withdrawals of taxable amounts are subject to ordinary income tax and if made before age 59½ may be subject to a 10% Federal income tax penalty. Withdrawals will reduce the living and death benefits and account value. Withdrawals may be subject to withdrawal charges.

Variable annuities other than Preference Premier℠ are issued by MetLife Investors Insurance Company, MetLife Investors USA Insurance Company and in New York, only by First MetLife Investors Insurance Company. The Preference Premier variable annuity is issued by Metropolitan Life Insurance Company, New York, NY and offered though MetLife Securities, Inc., New York, NY and New England Securities Corporation, Boston, MA. All products are distributed by MetLife Investors Distribution Company, Irvine, CA. All are MetLife companies. March 2009

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Contribution Assets at Retirement

Good morning Madame Chairwoman, Mr. Vice Chair and members of the Working Group. My name is Jody Strakosch. I am National Director for Institutional Income Annuities at MetLife and am here today to testify on behalf of my company. MetLife is the nation's largest life insurance company, a leading provider of employee benefits and a retirement income innovator. MetLife has over 11,000 group annuity contracts in force and guarantees income payments to more than 1 million people. The company has been ranked #1 by the Life Insurance Market Research Association (LIMRA) for the last four years in annuity assets under management, surpassing the #2 provider by approximately $8 billion. In 1921, MetLife was the first insurer to issue a group annuity contract. In the past several years, the company has also introduced a new generation of income annuities aimed at providing guaranteed lifelong income.

MetLife was the first company to introduce a deferred fixed income annuity as an allocation option within a 401(k) plan ("Personal Pension Builder," distributed by the Merrill Lynch Retirement Group), thereby allowing plan participants to create their own personal pension by buying guaranteed pieces of future income. We also introduced a product called "Retirement Income Insurance" or longevity insurance, which is a fixed, deferred income annuity for either qualified or non-qualified assets that is designed to generate guaranteed lifetime income starting at a later age, for example, an individual's 85th birthday (the average life expectancy for Americans who have reached age 65). Earlier this year, MetLife was selected by Barclays Global Investors, N.A. (BGI), one of the world's largest asset managers, as the income annuity provider to retirement plans investing in the firm's innovative SponsorMatch™ program. Introduced last fall, BGI's SponsorMatch is a new investment category for defined contribution (DC) plans that seeks to enhance the employer's matching contribution, in part by providing annuity income to the participant when in retirement.

We commend you for holding this hearing today and thank you for inviting MetLife to testify. We believe the hearing today, and the work of this Working Group generally, is critical to the future retirement security of the Baby Boom generation and the generations of workers to follow.

As we all know, the demographics and shifting retirement landscape present American workers, public policymakers, employers and future generations with significant challenges. We are all aware of the continuing shift from traditional defined benefit pension plans that provided workers with a steady stream of income that could not be outlived to defined contribution plans that typically provide a lump sum payment with no guarantee of lifetime income. This change in benefit structure has placed the burden for funding and investing assets, as well as ensuring that those assets last throughout retirement, squarely on the shoulders of today's workers. This shift, coupled with the increased pressure on the Social Security system, has raised significant policy concerns, many of which Congress and regulatory agencies, including the Department of Labor, have been wrestling with for many years. Chief among these concerns to date has been the issue of retirement savings adequacy. Most individuals who have access to defined contribution plans either do not take advantage of those savings opportunities or do not save enough. We believe that Congress and the regulatory agencies have taken important steps forward to ensure that individuals increase their savings levels, including automatic enrollment and automatic escalation of deferral amounts.

Now policymakers need to shift their focus to the equally important challenge of ensuring that the money that is saved in these plans is managed so that individuals do not outlive those savings. This focus is critical because, as MetLife's Chairman and CEO, C. Robert Henrikson, who has had the pleasure of testifying before Congress on the future of retirement security several times over the last five years, often says, "401(k) plans are extremely popular. But no one knows yet for sure if they are successful, if success is measured in terms of ensuring that those savings last a lifetime." I think we would all agree that we do not want to wait 30 or 40 more years to learn the answer when we have the ability to act now to make significant changes to ensure that these plans will be successful in providing lifelong income.

Education is Critical

Unfortunately, the road to retirement security does not end once one accumulates sufficient assets to retire. Actually, in many ways, the challenges are at least equal, if not greater, once one retires. Although one can make good estimates of asset sufficiency, there are so many unknowns in retirement that it is almost impossible for most people to be fully

comfortable in knowing that they will be able to meet their income and health needs in retirement. Questions regarding how long one will live, the rates of inflation during retirement, how investments will fare due to the impact of market volatility, and what types of unexpected health and long-term care needs one will have are just a few of the many issues that individuals will face once they retire. Education is critical in this area.

MetLife believes that education concerning the ultimate distribution of a worker's retirement assets should begin at the time of enrollment in the company's investment savings plan, if not earlier. While specific details of the distribution options need not be provided at this point, participants should be informed that the very purpose of the plan is to provide for their long-term financial security in retirement. It should be explained that the accumulation of assets is not the end game of the plan, but the basis for helping provide long-term security. Shortly after enrollment and once appropriate contribution and asset allocation education is provided, the process of educating participants on income replacement should begin. As early as possible in their plan tenure, participants should be made aware of the impacts of longevity risk, inflation, and investment performance in retirement, and how they might wish to protect spouses or partners.

Tools, education and periodic reports to help participants determine target levels of income in retirement would be helpful. The impact of such tools would be significant if participants had access to appropriately trained and compensated financial advisors. In this regard, we commend Congress and the Department of Labor on their work in making investment education and advice more accessible to defined contribution plan participants. We appreciate the guidance that the Department issued in 2007 and look forward to seeing the further guidance that the Department will soon be issuing on investment advice.

In addition, we know the Department has taken many steps and provided much guidance over the years to participants and plan sponsors on various retirement security topics. Most recently, the Department released an educational booklet entitled "Taking the Mystery Out of Retirement Planning," which we believe is a helpful tool for individuals to compare their projected income and expenses in retirement and, importantly, start to think about how they can make their retirement savings last throughout their lifetime. However, we believe the Department can go further in this regard. Specifically, we suggest that the Department release educational brochures

on the "decumulation" phase of retirement that focuses on the issues retirees may face (including increasing health care costs, potential long-term care costs, and the impacts of longevity, investment, and inflation risks on their retirement savings). The guidance should also include information on ways to address these issues and risks, including the establishment of a diversified "decumulation" portfolio that would include the use of income annuities.

MetLife Retirement Income IQ Study

To underscore the above-mentioned points and the strong need for education, MetLife conducted a Retirement Income IQ Study in 2003 to test the knowledge of basic retirement income concepts for individuals within 5 years of retirement. The results from that study were very troubling. On average, respondents answered just five of the 15 questions in the Retirement Income IQ Test correctly – an average score of 33 on a grading scale of 100 points – clearly a failing grade. MetLife refielded this study earlier this year and the results were released publicly in late June. Although the scores are somewhat better with pre-retirees scoring an average of 43, which is a ten percentage point increase, it is still a failing grade.

We were very disappointed to learn that in the last five years, we have not seen a dramatic improvement in individuals' literacy around retirement income concepts that are critical to their management of assets in retirement. Among the most disturbing findings, MetLife's 2008 Retirement Income IQ Test reveals that almost seven in ten (69%) pre-retirees overestimate how much they can draw down from their savings – with an alarming 43% saying they believe they can withdraw 10% or more each year while still preserving their principal – even though most retirement experts suggest a withdrawal rate of no more than 4% annually.

MetLife's 2008 Retirement Income IQ Test also reveals that significant gaps exist around average life expectancy and other retirement income issues. Six in ten Americans (60%) underestimate their average life expectancy and almost half (49%) underestimate the amount of pre-retirement income they will need once they retire. This lack of understanding is particularly concerning because poor retirement planning assumptions are compounded after retirement by today's much longer life expectancy. However, in this year's Retirement Income IQ Test findings, more than half (56%) of respondents did note that longevity risk is the greatest risk in retirement, up significantly from 23% in 2003.

In addition to the 15 multiple choice questions, five new attitudinal questions were added to the 2008 study to ascertain which actions pre-retirees are taking to prepare for retirement. These questions also sought to gauge how comfortable pre-retirees are with the outlook for their retirement future. The findings underscore what one would expect: those who take action to ensure that they have adequate retirement income are better informed and more confident that they will have a comfortable retirement.

The findings of MetLife's latest Retirement Income IQ clearly point to the need for more education in this area. Indeed, we believe that education can never be delivered too early or too often. To play our part in communicating this need to the employer community, MetLife will be hosting a web seminar for plan sponsors in partnership with Dallas Salisbury, President and CEO of the Employee Benefits Research Institute. In addition to discussing the implications of the IQ findings, the presenters will underscore why it's incumbent upon employers to offer greater education and guidance as individuals approach retirement, and also to allow their employees to secure guaranteed lifelong income.

Maximizing and Guaranteeing Streams of Income is Critical to Retirement Security

As I mentioned earlier, it is essential that policymakers turn their attention to the "decumulation" phase of retirement savings. And that is why the work of the Advisory Council, and the Department of Labor, is critical. The recommendations you make to the Department, and that hopefully they will implement, can help workers understand and secure a stable retirement income that they cannot outlive. The work of the Council is very important, indeed, especially when you consider that less than one in five (19 percent) of today's workers are on track to meet 100 percent of their estimated needs in retirement, according to a recent study by Hewitt Associates released earlier this month, which examined the projected retirement levels of nearly 2 million employees at 72 large U.S. companies using actual employee balances and behaviors.

In your mission statement for this group, you posed a number of important questions about what types of income streams should be available to plan

participants today, and the barriers and challenges faced by plan sponsors and participants in using those vehicles.

There are a variety of vehicles available today that provides for an income stream, some guaranteed, some not, but unfortunately, most participants continue to take the "lump sum" option thereby eliminating the opportunity to convert a portion of their nest egg into a lifetime income stream, unless they roll their assets into a retail IRA Annuity.

In order to appropriately address needs across the varying demographic and economic profiles of the American workforce**,** MetLife believes that an annuitization feature that makes available income streams would be helpful for today's 401(k) participants, both as accumulation and distribution options. These annuities could be offered singly or in combination in addition to the options that today many plans make available to participants (lump sums and periodic installment payouts):

- Immediate income annuities, both fixed and variable, either as a distribution option from the plan, or through a rollover from the plan. These guaranteed lifetime income annuities could be available in their simplest form without death benefits, or with a death benefit and/or inflation protection
    - This approach is an employee choice

- Fixed and variable deferred annuities within the plan that provide for accumulation of a future guaranteed lifetime income stream on a dollar-cost averaging basis
    - This approach can be an employee choice as a standalone accumulation option, or
    - This may be an employer-directed matching contribution to a standalone option or as an income option embedded in a target date fund

- Longevity insurance, which defers guaranteed lifetime income annuity payments until age 80 or later (the efficient use of longevity insurance within a defined contribution plan requires relief from the Minimum Required Distribution rules since the defined contribution plan must retain other assets to pay the RMD until the longevity policy begins to pay income benefits)

There are other retail programs, for both qualified and non-qualified assets, which have been recently introduced in the market, that include:

- Payout mutual funds, which distribute assets over a selected time period
- Managed payout funds. in which the participant receives an income stream until the expiry date, at which point the original investment is returned
- Systematic Withdrawal Programs [SWIP], in which a stream of payments expressed as a fixed percentage [generally 4%] of the declining portfolio is paid.

These provisions, however, do not guarantee that income streams will be paid throughout the lifetime of the payee.

It is important to offer the participant some flexibility in determining how they would like to create their own income stream, and a combination of these approaches is likely to provide a participant with an optimal strategy to create lifetime income.

MetLife strongly supports the use of income annuities as part of a well-diversified decumulation strategy. A distinct advantage of annuities is that they are the only financial products specifically designed to generate a guaranteed lifelong stream of retirement income and the payment streams can be customized to meet the specific income needs of the individual at his/her point of retirement. Additionally, another key advantage of income annuities is that they generally have the ability to produce the highest level of guaranteed income per dollar of assets, which then provides the participant with the ability to maximize income. Putting these advantages together means that income annuities can perform the double task of maximizing current income <u>now</u> while also avoiding the risk of running out of money <u>later</u>.

These advantages cannot be overemphasized, especially as Americans continue to underestimate how long they will live, underestimate how much they need to save for retirement and overestimate how much they can safely withdraw from their retirement savings in order to make their savings last their lifetime, as our Retirement Income IQ Study underscores.

In terms of the disadvantages of immediate fixed income annuities, from an individual's point of view, there is a perceived loss of control of all or part of the lump sum (people are just now beginning to understand that one should pay for liquidity where it is needed). Income products may be perceived to be complex because of the choices that are offered (cost of living adjustment, inflation protection, what percentage to select for a joint and survivor). Finally, fixed income annuities are typically quoted on a net income basis meaning that the fees are embedded, which may make it difficult to compare to other products.

Although we acknowledge that these are real concerns, we believe that the industry has listened to these concerns and has taken significant steps to address these concerns through product innovation and education. However, we know that more needs to be done and we will continue to improve and simplify our products and our communication about them.

Annuities as Distribution Options

In terms of current practices with respect to plan distribution design, the most commonly offered options are lump sum and periodic installment payments; the most utilized is the lump sum distribution. In order to reach participants, it is important and necessary to work with the plan sponsor. However, to date, few employers offer annuities as a distribution option (and in fact, many plans have eliminated annuity distribution options) for a number of reasons. Chief among those reasons are fiduciary liability concerns and the additional administrative burdens that are attendant to offering annuities.

As we are all aware, we live in an increasingly litigious society. Plan sponsors have been facing an increasing number of lawsuits over the years involving their provision of retirement plans. With the latest rash of lawsuits involving defined contribution plans, employers are becoming increasingly (and understandably) wary of offering benefits to their employees. The end result: far too many workers may be on their own to replicate the retirement security that was previously provided to them. In short, they will -- on their own -- need to ensure that their retirement savings – provided that they have saved enough in the first place – lasts as long as they do.

With specific regard to offering annuities as a distribution option from defined contribution plans, we have heard repeatedly over the years from our customers that the uncertainty of their precise fiduciary duties attendant to offering annuities to their workers is a chief deterrent to them including annuities as a distribution option. We applaud Congress for including a directive to the Department of Labor in the Pension Protection Act to clarify that the DOL guidance included in Interpretive Bulletin 95-1 does not apply to defined contribution plans. And the Department of Labor has taken a step forward with its proposed regulation clarifying what the fiduciary's duty is vis-à-vis the offering of annuities as distribution options within defined contribution plans. However, we believe that the Department can and should go further in clarifying and simplifying the plan sponsor's obligations when offering annuities to provide adequate litigation protection for plan sponsors. In informal discussions with some of our customers, they believe that the Department should simplify its guidance in this area.

In addition to the fiduciary liability concerns, plan sponsors have voiced concerns regarding the administrative burdens associated with offering annuities as a distribution option from defined contribution plans, most notably through the imposition of the joint and survivor annuity requirements that would require a written spousal waiver if another form of distribution were chosen. We believe that there have been significant technological advances (e.g., electronic pins, eye scans) that have been introduced in this area that would lessen the administrative burdens on employers if such practices were to be implemented. We suggest that the Department explore these alternatives and perhaps issue guidance to plan sponsors on the appropriate use of such technologies.

How Plan Sponsors May Help Participants

Plan sponsors have a unique opportunity to help their employees because they are the first line of information. If plan sponsors stress the importance of, and provide the appropriate vehicles for converting a component of the accumulated account balance into a lifetime guaranteed income stream, we believe this is one essential element to having participants take action. It will require a coordinated effort from many parties, including the government, recordkeepers, insurers, and investment advice providers to recognize the importance of guaranteed income. Further product simplification and tax incentives may also be required.

Plan sponsors can also bring their sophisticated knowledge and institutional purchasing power to the table, thereby ensuring that participants receive well-constructed options commensurate with a reasonable fee structure.

We also encourage the plan sponsor community to consider adopting a "Retirement Income Policy Statement" which would outline the retirement income alternatives available to their participants. This could be similar to the now widely used "Investment Policy Statement" which most plan sponsors use as a guideline for their investments.

We further encourage plan sponsors to ask their recordkeepers to provide participants with a simple estimated conversion of their 401(k) balances into a lifetime payment stream so that they are not continually distracted by the "lump sum" balance availability and begin to view their 401(k) plan as a source of reliable monthly retirement income. General guidelines should be established for the recordkeepers so that there is a consistent basis used across the industry.

In addition to continuing their efforts to educate participants about the need to accumulate assets, plan sponsors may want to consider incorporating the importance of ensuring that participants have a guaranteed income stream as a component of a successful lifetime financial plan.

Non-Insurance Vehicles Do Not Maximize or Guarantee Lifetime Income

As previously mentioned, there are a number of other types of income stream vehicles that exist today that can help plan participants ensure that they have a steady stream of income—at least for a period of time. We believe that there are certain advantages to incorporating such vehicles into a diversified "decumulation" strategy. But we strongly caution policymakers not to assume that these non-insurance vehicles can substitute for an annuity—an insurance product that will maximize and provide a guaranteed stream of income for as long as the individual lives. And, as a side note, I would add that the marketing around these products may have created confusion and a false sense of security for individuals purchasing those products, as there may now be a belief that these products will provide flexibility and control over one's assets while guaranteeing that they will have income throughout life.

Having addressed these issues, other stream of income products do provide certain advantages, among which are the following:

- They can be "overridden" by participants; in other words, they can change their mind;
- Participants retain control over the assets;
- They may be easy to understand.

The disadvantages of such income streams are that they are always vulnerable to:

- Poor investment performance, especially in the early years of retirement;
- Greater than anticipated rates of inflation; and
- Their inability to address longevity risk.

While the availability of a variety of income streams is essential, plan sponsors and their consultants, as well as participants and their financial advisors, must be educated on the use of such streams in varying combinations to meet the specific needs of a given retiree.

Structuring Default Income Stream Distributions

Among the questions your working group posed to panelists was how to structure a default periodic distribution option and what barriers exist to offering such a default. Significantly, under such an offering, plan sponsors will still have fiduciary liability concerns. The probability of participants "opting out" of an arrangement that affects what are generally thought to be their life savings may be greater than the probability of their opting out of auto enrollment, which is viewed as affecting only a small percentage of their current paycheck.

Plan sponsor fiduciary concerns regarding the provision of a default annuity distribution option may be alleviated by the safe harbor provided by the final regulation regarding the selection of annuity providers. However, as stated earlier, we urge the Department to simplify the safe harbor significantly so that the requirements are not viewed as overly burdensome, which will be the view particularly for smaller employers. Also, it would be important to simplify the QJSA notice and disclosure rules. And, consideration may be

given to targeted tax incentives that have been included in various bills submitted to Congress.

We know that retirement income planning is daunting for many individuals. One potential way to create a lifetime income would be to establish an income distribution option from a defined contribution plan. If it is decided that a default periodic income distribution option should be included in defined contribution, a relatively simple approach would have the default apply to a minimum percentage of the participant's account balance, or alternatively, purchase a minimum guaranteed lifetime income stream. Of course, following with current auto-enrollment practices, the participant should have the ability to "opt-out" of the guaranteed lifetime income stream.

Objections to such a default option can be addressed through comprehensive education on the significance of longevity risk, the importance of which we know from our research consumers are starting to understand, and the potential negative impacts of inflation and poor investment performance, particularly in the early years of retirement. Also, the impact of such an option can be lessened by making it a trial experience for a pre-determined time period, such as 24 months.

Conclusion

In conclusion, MetLife believes that the Council should recommend the following steps be taken by the Department, employers, and Congress in order to ensure that individuals do not outlive their retirement savings:

- Further education on the issues and potential solutions affecting individuals in retirement. This education should be done by the Department in educational brochures and by employers soon after the employee joins the employer's plan.
- Investment education on both the accumulation and "decumulation" aspects of retirement savings should be facilitated and encouraged by policymakers.
- Employers should develop a Retirement Income Policy Statement that they adhere to in administering their retirement plans.
- Annual 401(k) plan statements should contain a monthly income equivalent to the lump sum amount contained on the statement.

- Employer fiduciary concerns in selecting annuity providers need to be addressed. The Department needs to simplify the annuity selection regulation it released last year.
- Spousal consent rules need to be addressed and modernized.
- There should be preferential tax treatment of annuity income streams so that there is an incentive for individuals to secure lifelong income
- A default annuity model should be considered and possibly implemented so that individuals will be ensured of receiving at least a portion of their money as an annuity.
- The required minimum distribution rules should be revised to exclude longevity insurance from the RMD calculation.

I want to thank the Council for establishing this important Working Group and for inviting me to testify today. I would be happy to answer any questions you may have.

The Longevity Annuity: An Annuity for Everyone?

Jason S. Scott*

June, 2007

*I would like to thank John Watson, Wei Hu, David Ramirez and Andrea Scott for many excellent comments and suggestions. Any remaining errors or omissions are my responsibility alone. The views expressed herein are those of the author and not necessarily those of Financial Engines.

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The Longevity Annuity: An Annuity for Everyone?

Abstract

As of 2005, individuals had an estimated $7.4 trillion invested in IRAs and employer-sponsored retirement accounts. Given these investments, many retirees will face the difficult problem of turning a pool of assets into a stream of retirement income. Purchasing an immediate annuity is a common recommendation for retirees looking to maximize retirement spending. However, the vast majority of retirees are unwilling to annuitize all of their assets. This paper demonstrates that a new type of annuity, a longevity annuity, is optimal for retirees unwilling to fully annuitize. For a typical retiree, allocating 10%-15% of wealth to a longevity annuity creates spending benefits comparable to an immediate annuity allocation of 60% or more.

Keywords: Annuity, annuitization, pensions, longevity risk, insurance, Social Security

JEL Classifications: D11, D91, E21, H55, J14, J26

Electronic copy available at: http://ssrn.com/abstract=992423

The Longevity Annuity: An Annuity for Everyone?

1 Introduction

The aging of the US population and the demise of the defined benefit plan are two major trends reshaping the retirement landscape. As of this writing, the oldest of the Baby Boomers has already turned sixty. The aging of the Baby Boomers will create an unprecedented explosion in the retiree population. The assets available to these new retirees are also undergoing substantial change. The last two decades have seen a substantial shift from defined benefit plans towards a reliance on individual accounts to fund retirement. As of 2005, individuals had approximately $7.4 trillion dollars invested in IRAs and employer-sponsored defined contribution plans compared to $1.9 trillion contained in employer-sponsored defined benefit plans.[1] This shift has raised a critical question for many newly-minted retirees: "How can I convert accumulated assets into retirement income?"

An immediate annuity is a common recommendation from practitioners and academics alike to maximize retirement income from a given pool of assets. In a typical immediate annuity contract, an insurance company promises to make regular monthly or annual payments for the life of the individual in exchange for a one-time premium payment. It has been over four decades since economic theory first concluded that individuals looking to maximize guaranteed spending in retirement should convert all available assets to an immediate annuity.[2] However, in stark contrast to the predictions of economic theory, very few retirees allocate any dollars to an immediate annuity, much less fully annuitize.[3] Given retirees' reluctance to make large annuity purchases, this paper extends the theory by answering the question: "Which annuity should I buy with a minority of my assets?"

[1] Investment Company Institute [2006]
[2] See Yaari [1965]
[3] For example, LIMRA [2006] estimated fixed immediate annuity sales of $5.9 billion for 2006.

The gulf between prediction and behavior is so wide that numerous academic studies have analyzed this "annuity puzzle."[4] Importantly, virtually all of the previous analysis assumes the fundamental annuity contract available is an immediate annuity. Recently, a new type of annuity contract, referred to here as a "longevity annuity," has been introduced.[5] Longevity annuities are essentially immediate annuity contracts without the initial payouts. That is, a longevity annuity involves an upfront premium with payouts that begin in the *future*. For example, an age 85 longevity annuity can be purchased at age 65, but payouts only commence when *and if* the purchaser reaches age 85. As we will see, longevity annuities are an extremely efficient form of longevity insurance. In fact, the spending benefit a retiree could achieve with a ten percent allocation to a longevity annuity typically exceeds the benefit from a fifty percent allocation to an immediate annuity. Enticing a retiree to annuitize half their portfolio could prove very challenging. However, a ten percent longevity annuity allocation which provides a similar benefit level may look much more attractive. Given their large benefits per premium dollar, longevity annuities, especially those that start payouts late in life, likely qualify as an annuity for everyone.

The intuition behind and the arguments for the desirability of longevity annuities are developed over the next four sections of this paper. Section 2 asks "what makes insurance valuable?" and develops a useful metric for evaluating potential insurance purchases. Section 3 examines various strategies retirees can utilize to turn assets into income. Section 4 builds on the analysis in Section 3 to demonstrate that longevity annuities deliver higher levels of spending increases per premium dollar compared to immediate annuities. Section 5 conducts a robustness analysis to confirm that the longevity annuity advantage is robust to various pricing, mortality and interest rate assumptions. Importantly, Section 5 also confirms the longevity annuity advantage using actual bond investments and annuity contracts available in the marketplace.

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[4] See Brown and Warshawsky [2004] for a summary of explanations for the "annuity puzzle" including: a bequest motive, the influence of Social Security, annuity pricing, irreversibility of the annuity purchase, etc. However, the full annuitization prediction is robust to most of these explanations. Hu and Scott [2007] explore behavioral barriers to annuitization.

[5] Longevity annuities are alternatively referred to as "delayed payout" annuities owing to the fact that annuity payments are delayed relative to an immediate annuity.

2 What makes insurance valuable? The Spending Improvement Quotient (Q)

Before diving into the issue of longevity risk and annuities, we start with a basic question: "What makes insurance valuable?" We begin by answering this question in a simplified setting. Consider a driving enthusiast who absolutely must have a car. Further, suppose our driver has no access to insurance to replace the car if an accident occurs. Without insurance, our driver will set aside enough money for a replacement car if an accident were to happen. This is money our driver can not spend. Access to car insurance completely changes the situation. Now our motorist only has to set aside the cost of insurance. Any remaining dollars can now be safely spent on other things. The size of this windfall depends crucially on the insurance cost relative to the replacement cost.

For example, assume the car has a replacement cost of $20,000. Suppose our driver has an excellent driving record, and only has a five percent chance of making an insurance claim. If insurance were sold at cost, then the car insurance price would be only $1,000.[6] In this case, purchasing insurance allows $19,000 in additional spending relative to self-insurance. At this price, car insurance provides nineteen dollars of additional spending per insurance premium dollar.

What happens if our driver has a history of wrecking cars? The chance of totaling the car is now much higher, so the price for car insurance would also be much higher. Suppose the chance of an accident has increased five-fold to twenty-five percent. The cost of insurance would likewise rise five-fold to $5,000. Now purchasing insurance only allows $15,000 in additional spending. The spending improvement per premium dollar has been reduced to just three dollars. While insurance still makes sense, the benefit relative to self-insurance is less compelling. In an extreme case, a reckless driver with a ninety-five percent chance of totaling the car may find insurance costs have risen to a staggering $19,000. The spending benefit per premium dollar has shrunk to a paltry five cents. If insurance prices are cost plus a profit premium, insurance costs could actually exceed replacement costs for this type of driver.

[6] Assuming the insurance company sold a similar policy to numerous drivers with comparable risk profiles, the average cost of a policy would equal $20,000 * 0.05 or $1,000.

Analyzing the spending improvement per premium dollar helps individuals select from competing insurance contracts. Suppose an individual had an additional dollar she was willing to allocate to insurance. What insurance contract should she select? When the alternative is self-insurance, the answer is simple. She should allocate the extra insurance dollar to the insurance contract that frees up the most spending. In other words, she should select the insurance product with the highest spending improvement per premium dollar. To simplify the exposition, this quantity will be referred to as the Spending Improvement Quotient and be abbreviated by Q. More specifically:

Q = Spending Improvement Quotient

= [Self-Insurance Costs – Insurance Costs] / [Insurance Costs]

In the car insurance examples, the insurance cost was simply the car replacement cost reduced to reflect the chance of an insurance payout. If we denote the probability of an insurance payout by P, then the Spending Improvement Quotient simplifies to:

Q = [Self-Insurance Costs – Insurance Costs] / [Insurance Costs]

= [Self-Insurance Costs – P* Self-Insurance Costs] / [P* Self-Insurance Costs]

= [1 – P] / P

This result is intuitive. To evaluate the potential insurance benefit, simply consider the likelihood of a payout. If an insurance payout is very unlikely, generally insurance is cheap relative to self-insurance, and insurance can provide substantial benefits. Alternatively, when insurance payouts are highly likely, insurance cannot be provided at much of a discount to self-insurance. Under these conditions, insurance provides little benefit. These fundamental concepts apply to all insurance contracts including longevity insurance. Focusing on high value, or high Q, insurance will be the key to maximizing the benefit per premium dollar.

3 The New Retirement Problem: Turning IRAs into Income

With the dramatic increases in IRA and 401(k) plan balances, a common problem facing retirees will be turning those assets into income. To illustrate how insurance concepts apply to the retirement income problem, we will analyze the problem faced by a newly-retired individual. Our retiree is 65 years old, and has a sizeable $1 million IRA available to fund retirement spending. Before tackling the full retirement problem, consider a simpler problem of funding spending for a single year 20 years in the future. For our retiree, this would correspond to funding spending at age 85. If our retiree wants a guaranteed payout in 20 years time, an obvious investment choice would be a zero-coupon bond. The price today for $1 in 20 years would depend on the prevailing interest rates. Assuming prevailing interest rates are 2.5% at all maturities[7], spending in 20 years would cost:

B_{20} = Price today of a zero-coupon *bond* which pays out $1 in 20 years.

$= 1 / (1.025)^{20}$

= $0.61

Each dollar our retiree wants to spend at age 85 could be initially secured for a sixty-one cent investment in a 20 year zero-coupon bond.

Securing spending with bonds is analogous to setting aside the full replacement cost of the car. With self insurance, the money is set aside whether or not the insurance event occurs. Similarly, the dollar from the zero-coupon bond is available whether or not our retiree actually lives to spend it. An alternative to bonds is an annuity contract. Suppose there was an annuity contract that could be purchased today that had a one-time payout in twenty years. The annuity contract differs from the bond in that the payout is contingent on survival. Given the similarities in payout structure, we denote this single payment annuity as a *zero-coupon annuity*.

How much does a one dollar payout in twenty years cost using a zero-coupon annuity? Just as in the car insurance example, the price for longevity insurance depends on the probability of a payout. For longevity insurance the payout probability is the

[7] This roughly corresponds to the real rate of interest as of this writing.

chance our retiree survives twenty years to qualify for the payout. If we let S_{20} be this twenty year survival probability, then the zero-coupon annuity price would be:

A_{20} = Price today of a zero-coupon *annuity* which pays out $1 in 20 years, *if alive*.

$= S_{20} * B_{20}$

Assuming our retiree is male, the twenty year survival probability appropriate for annuity pricing would be about fifty-one percent.[8] Even with some insurance market related frictions, a zero-coupon annuity is offering spending in twenty years at nearly a fifty percent discount to self-insurance in the bond market. Just as in the car insurance example, we can calculate a spending improvement quotient for the twenty year zero-coupon annuity. In this case, the improvement would be:

Q_{20} = [Self-Insurance Costs – Insurance Costs] / [Insurance Costs]

$= [B_{20} - A_{20}] / A_{20} = [1 - S_{20}] / S_{20}$

$= 0.94$

The spending that costs $1.94 to secure in the bond market only cost $1.00 in the annuity market. Thus, every annuity dollar allocated to fund spending at age 85 frees up $0.94 cents for additional spending.

The above analysis indicates that annuity-based spending at age 85 can be secured at a substantial discount to bond-based spending. There is nothing particularly special about age 85 spending. In fact, we can repeat the analysis to calculate the potential insurance benefit for each age between 65 and 100. The Q analysis for each year from 65 to 100 is displayed in Figure 1. The range of spending improvements is surprising. The potential insurance benefit for spending at age 66 is a paltry one cent per dollar invested. Given the previous examples, the reason for this result is obvious. People that purchase annuities at age 65 almost always live to collect the payment at age 66. In this situation, potential insurance benefits are extremely limited. In contrast, the age 100 payment has a Q value of 31.79. Funding spending at age 100 costs just pennies on the dollar using the

[8] Social Security population average mortality tables indicate a 40% survival probability. The 51% is based on GAR-94 mortality tables (with generational adjustments). The annuity pricing survival rate is higher for two reasons. First, annuity purchasers are generally healthier than average. Second, insurance companies have to cover the cost of doing business. Given the reserves and adjustments built into the GAR-94 table, it should be a reasonable choice for estimating annuity prices.

annuity market compared to the bond market. For this individual, the insurance benefit of the age 100 zero-coupon annuity is approximately *twenty-five hundred times* the insurance benefit provided by the age 66 zero-coupon annuity.

Abstracting from the details of Figure 1, the message is clear. Longevity insurance provides substantial benefits for late-life spending, but much smaller benefits for near-term spending. This observation explains both the problem with immediate annuities and the potential of longevity annuities. Both immediate and longevity annuities can be thought of as bundles of zero-coupon annuities. An age 85 longevity annuity, for example, bundles together each of the zero-coupon annuities from age 85 onward. Similarly, immediate annuities represent a bundle of all the zero-coupon annuities. While longevity annuities concentrate more dollars on high value insurance, immediate annuities add near-term, low-value annuity payments to the bundle. The resulting blended average Q-value for the immediate annuity is 0.56.[9] In contrast, the Q-value for the age 85 longevity annuity is more than five times higher at 2.93.

4 Longevity Annuities: Optimal Insurance to Maximize Spending

For each dollar our retiree shifts from bonds to immediate annuities, \$0.56 is available for additional spending. If all assets were shifted to an immediate annuity, spending would increase by 56% relative to a bond-based spending program. But what if our retiree is uncomfortable with a 100% allocation to annuities? How should they allocate the dollars they are willing to annuitize? Figure 1 provides the basis for an answer. For the very first dollar annuitized, the best spending improvement can be had by purchasing the age 100 zero-coupon annuity. It is tempting to put all annuity wealth into the age 100 annuity. After all, look at the spending boost! However, our retiree needs spending in every year, not just at age 100. Even though our retiree cannot exclusively focus all spending on age 100 annuities, the first bonds that should be substituted with annuities should be bonds earmarked for age 100 spending. Assuming

[9] The Q value for immediate annuities can be calculated by comparing a bundle of zero-coupon bonds to a bundle of zero-coupon annuities. Purchasing \$1 of spending each year in retirement using bonds costs $B_0 + B_1 + \ldots + B_{35} = \$1 + \$0.976 + \ldots + \$0.421 = \$24.15$. Purchasing \$1 of spending each year in retirement using annuities costs $A_0 + A_1 + \ldots + A_{35} = \$1 + \$0.9636 + \ldots + \$0.0129 = \$15.47$. The spending improvement achieved by shifting bond-based to annuity-based spending is thus 0.56.

our retiree wishes to allocate more dollars to annuities, the next highest surplus producing annuity will be the age 99 annuity followed by the age 98 annuity.

The optimal bundle of zero-coupon annuities to purchase thus depends on the amount of assets our retiree is willing to annuitize. However, since optimal strategies entail sequentially adding earlier and earlier zero-coupon annuities, all optimal bundles are longevity annuities. If our retiree were only willing to annuitize a few dollars, then the longevity annuity that begins payments at age 100 would be optimal. If more dollars are available for annuitization, a longevity annuity that begins payouts at age 99 would be in order. The start date for the longevity annuity would continue to be reduced until the annuity allocation is exhausted. Surprisingly, only retirees interested in fully annuitizing their assets should select an immediate annuity. All other retirees should opt for the longevity annuity that exhausts their willingness to annuitize.[10]

Figure 2 illustrates the difference between allocating dollars to immediate annuities versus longevity annuities. Allocations to immediate annuities result in a constant $0.56 additional spending per dollar annuitized. Thus, the available spending using an immediate annuity increases linearly from a base of $41,416 with a pure bond portfolio to a maximum of $64,645 with a 100% annuity allocation. The curve corresponds to the spending achievable with longevity annuities. The longevity annuity curvature stems from the fact that the initial dollars are spent on high-Q, age-100 payments. Additional dollars are then spent on successively lower-Q payments. Diminishing returns causes the slope of the longevity annuity curve to gradually flatten as the annuity allocation increases.

The longevity annuity spending curve shares both the beginning and ending points with the immediate annuity spending line. The two strategies emanate from the same point, since 0% annuitized corresponds to bond-only income for both. With 100% annuitized, a longevity annuity has a payment start date that is immediate. Thus, the two annuity options share the 100% annuitized point as well. However, at *every point between* 0% and 100% annuitized, the longevity annuity provides higher spending levels per dollar annuitized.

[10] Interested readers can refer to Scott, Watson and Hu [2006] for more details on optimal annuitization.

To illustrate the leverage available from longevity annuities, consider the age 85 longevity annuity (i.e. the longevity annuity that begins to make payments at age 85).[11] Suppose our retiree optimally funds spending prior to age 85 with bonds, and funds spending after age 85 with a longevity annuity. Using the bond and annuity prices derived above, our retiree would find that an 11.5% allocation to an age 85 longevity annuity would generate annual payouts of $55,385 starting at age 85. Allocating the balance of the portfolio to zero-coupon bonds generates $55,385 in annual income prior to age 85. Thus, annual spending throughout retirement has increased 33% relative to a bond-only portfolio. If an immediate annuity was used instead, the same 11.5% annuity allocation would only increase spending by 6.5%. To achieve a comparable spending increase with immediate annuities, our retiree would have to allocate more than 60% of their portfolio to annuity purchases. Convincing a retiree to annuitize 60% of assets could be extremely challenging irrespective of the potential benefit. However, annuitizing 11.5% of assets may prove much more palatable, especially if this modest allocation allows guaranteed spending to increase by over a third. The ability of longevity annuities to deliver a majority of the annuitization benefits for a relatively small portfolio allocation makes them a powerful tool to help retirees effectively turn assets into income.

5 Robustness Analysis: Mortality, Interest Rates and Real World Pricing

The preceding analysis made three key assumptions in order to evaluate the relative efficiency of longevity annuities. Those assumptions were the mortality rates for our retiree, the prevailing interest rates for bond investments, and the formula by which insurance companies turn mortality and interest rates into annuity prices. This section explores the impact of altering these key assumptions.

The robustness analysis consists of analyzing six cases each with a different set of core assumptions. The results for each case are reported in Table 1. Case 1 assumes the retiree is male, prevailing interest rates are 2.5%, and annuity prices are determined using the theoretical model described in the preceding paragraphs. Thus, Case 1 corresponds to the situation previously explored in detail. Given those assumptions, we determined that

[11] This longevity annuity is highlighted since it is the latest starting readily available longevity annuity.

an 11.5% allocation to an age 85 longevity annuity provided more than five times the spending improvement compared to the immediate annuity (33.7% vs. 6.5%). All of this information is reported in first column of Table 1.

Case 1 assumed our retiree was male. However, women have very different mortality rates compared to men. Given mortality plays a critical role in annuity pricing, Case 2 repeats the analysis assuming our retiree is female. Improved mortality has increased the annuity costs in general. However, longevity annuities still provide substantial benefits relative to immediate annuities. For this situation, the spending increase for our retiree is 4.35 times as big with a longevity annuity compared to an immediate annuity.

Case 1 and Case 2 assume an interest rate of 2.50%. As of this writing, this interest rate corresponds to the real rate of interest available from government inflation-indexed bonds. If the dollars our retiree is trying to secure each year in retirement are inflation-indexed dollars, then this real interest rate is appropriate for the calculations. Some retirees may prefer fixed spending that does not increase with inflation. For this situation, nominal interest rates would be appropriate. As of this writing, nominal interest rates are approximately 5.00%. Case 3 and Case 4 repeat the analysis using the nominal rate of interest. While the specific numbers have changed,[12] the relative strength of longevity annuities remains. For these cases, the spending improvement for the longevity annuity relative to the immediate annuity increased by a factor of 6.61 and 5.52, respectively.

The analysis up to this point has been somewhat theoretical to help pinpoint the key reasons why longevity annuities provide substantial advantages. However, it is important to realize that benefits from longevity annuities can be readily achieved by current retirees. As of this writing, there are at least two insurance companies that offer longevity annuities. MetLife introduced longevity annuities in 2004 under the product name Retirement Income Insurance. In March of 2006, The Hartford also introduced a longevity annuity product called The Hartford Income Security.

[12] Fixed nominal payments imply our retiree is spending more during early retirement and less during late retirement. The initial spending level is higher, but is eroded by inflation over time. Since less wealth is used to fund spending after age 85, the amount optimally allocated to an age 85 annuity decreases.

Actual bond and annuity prices can be obtained to assess the validity of the preceding analysis in the real world. In July of 2006, MetLife provided a longevity annuity price quote for a 65 year old wishing to purchase an age 85 longevity annuity.[13] In addition to annuity prices, bond yields are required to perform the analysis. Treasury yield data were obtained on July 13, 2006. At that time, the yield curve for government securities ranged from 5.00% to 5.27%.

Case 5 and Case 6 report the results when using actual bond and annuity prices. For a male retiree, a modest 7.9% longevity annuity allocation allows spending to increase by 21.5%. A comparable allocation to an immediate annuity only increases spending by 3.1%. For this real world case, the spending improvement from longevity annuities was 6.91 times the spending improvement achieved with immediate annuities. The results using actual prices are very comparable to those achieved with theoretical pricing assumptions (Case 3 and Case 4). If anything, actual prices suggest the size of the longevity annuity advantage is slightly underestimated with the theoretical pricing model.[14]

The robustness analysis considered the influence of three critical assumptions: mortality rates, interest rates and annuity pricing formulas. While the particulars of the analysis do indeed depend on these three factors, the advantage of longevity annuities was robust across all of these permutations. In some sense, the robustness is not surprising. The key to longevity annuity benefits is the realization that purchasing income conditional on survival *must* get cheaper as the chance of survival declines. Since cheaper insurance corresponds to more valuable insurance, longevity annuities allow retirees to concentrate their annuity dollars on high-value insurance. This fundamental advantage of longevity annuities should be robust across virtually all scenarios.

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[13] For a male retiree, a $100,000 premium purchased monthly payments of $7,730. Given this price quote, each dollar of annual income starting at age 85 costs approximately $1.10 (assuming no within-year mortality and 5% interest rates). An age 67 longevity annuity price quote implied a per dollar annuity cost of $10.24. The price per dollar spending using an immediate annuity was estimated by taking the age 67 longevity annuity and adding $1 and $0.94 to account for the age 65 and age 66 payments, respectively.

[14] Higher levels of adverse selection with immediate annuities is consistent with the increased longevity annuity benefit multiple.

6 Conclusion

Trillions of dollars have accumulated in IRA and employer-sponsored retirement accounts with trillions more expected over the ensuing decades. Millions of retirees will face the problem of translating their accumulated assets into retirement income. Immediate annuities are a typical recommendation from academics and practitioners alike to increase guaranteed spending from a given pool of assets. Unfortunately, the theoretical foundation for immediate annuities relies on the willingness of retirees to fully annuitize their assets. In practice, virtually no retiree will voluntarily annuitize their entire portfolio. This paper extends the theory by answering the key question: "Which annuity should I buy with a minority of my assets?"

The answer to this question is somewhat surprising. By focusing on the fundamental properties that make insurance valuable, we demonstrate that longevity annuities maximize guaranteed retirement spending per dollar annuitized. Only retirees willing to fully annuitize will find an immediate annuity optimal. All other retirees should prefer some form of longevity annuity. In fact, the first few dollars annuitized with a longevity annuity provide such substantial benefits that the vast majority of retirees should find these annuities desirable. A sample calculation, using actual annuity prices, found that a 65 year old male retiree could increase his guaranteed spending by over twenty-one percent by allocating less than eight percent of his portfolio to an age 85 longevity annuity. This spending improvement was almost *seven times* the spending improvement from a comparable immediate annuity allocation.

This paper's title asks "is the longevity annuity an annuity for everyone?" The answer is a qualified "yes." Many individual-specific considerations are important to the annuitization decision. The desire to leave behind a large estate could motivate some retirees to avoid annuities. Likewise, some retirees may have such uncertain future spending needs that locking in a spending level with an annuity is undesirable. However, at some point the benefit per premium dollar grows so large that this form of insurance makes sense for most people. Since longevity annuities, especially those that start payouts late in life, offer substantial benefits per premium dollar, almost every retiree would likely benefit from at least a modest allocation of assets to a longevity annuity.

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Appendix A: Longevity Annuity Policy Considerations

A straightforward economic analysis demonstrates the desirability of longevity annuities. However, large scale adoption of longevity annuities may depend critically on public policy decisions. This appendix highlights two important policy decisions that could increase longevity annuity utilization rates. First, the current rules regarding required minimum distributions (RMDs) create a barrier to the adoption of longevity annuities. Longevity annuities that began payouts after age 70 currently run afoul of the RMD rules. One example of the issue would be an age 65 retiree that uses their IRA to purchase an age 85 longevity annuity. This retiree cannot make the RMD at age 70 since no annuity payments are scheduled until age 85. Even if only a portion of the IRA was used to make the longevity annuity purchase, future market declines or withdrawals could still result in insufficient funds to make the RMDs. Recognizing this issue, insurance companies do not currently accept qualified dollars to purchase longevity annuities with late life start dates. IRA assets currently must first be withdrawn and taxed prior to a late dated longevity annuity purchase. This is a substantial barrier to adoption of a very valuation annuitization option.

The second policy issue relates to the role inertia currently plays in the utilization of employer sponsored pension plan features. With the recent Pension Protection Act (PPA), Congress signaled a willingness to be more proactive in helping individuals effectively use their employer-sponsored retirement plans. The underlying principle was to encourage employers to create plan defaults that were in the best interest of participants. Assuming inertia causes many employees to retain the defaults, overall retirement outcomes should be improved. Examples of newly defaulted decisions include: automatic enrollment, automatic savings escalations, and automatic investment or management. However, the PPA was silent on ways to automate the income phase of the 401(k). It is not surprising that the PPA was silent given the lack of consensus around an income solution that is appropriate as a default for all participants. Longevity annuities offer an intriguing possibility. Since the benefit per dollar annuitized is dramatic, at least for the later dated longevity annuities, a longevity annuity with a sufficiently late start date may be an ideal default candidate. The cost would only be 5%-15% of assets, but the longevity protection benefit would be substantial.

Figure 1
Spending Improvement Quotient (Q)
Zero-Coupon Annuity Payments

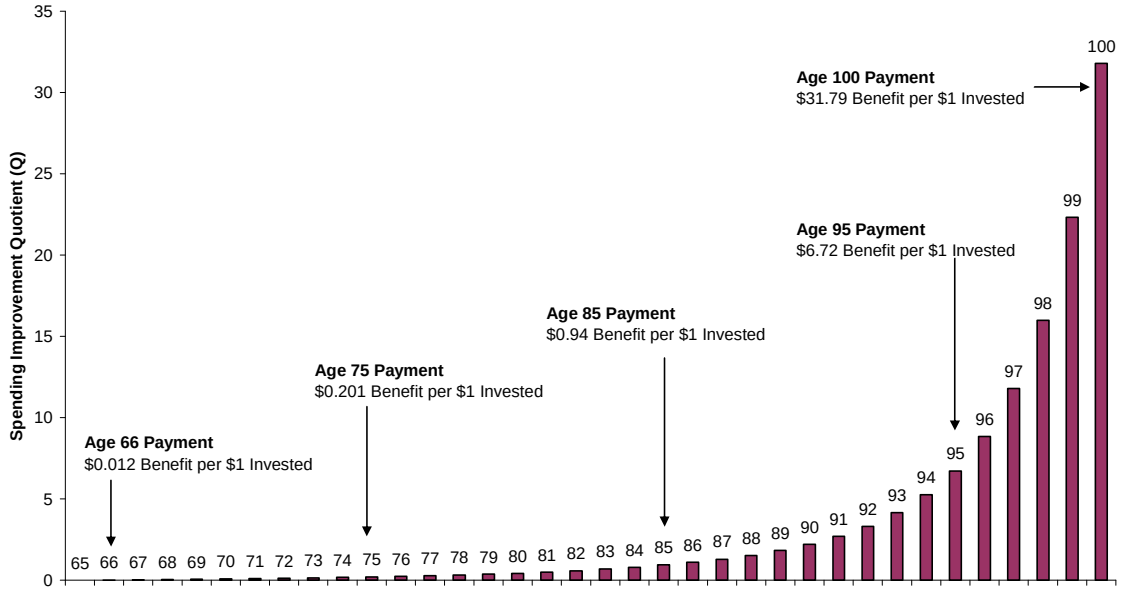

Figure 2
Spending Longevity Annuity vs. Immediate Annuity
$1,000,000 Assets, Age 65, Male

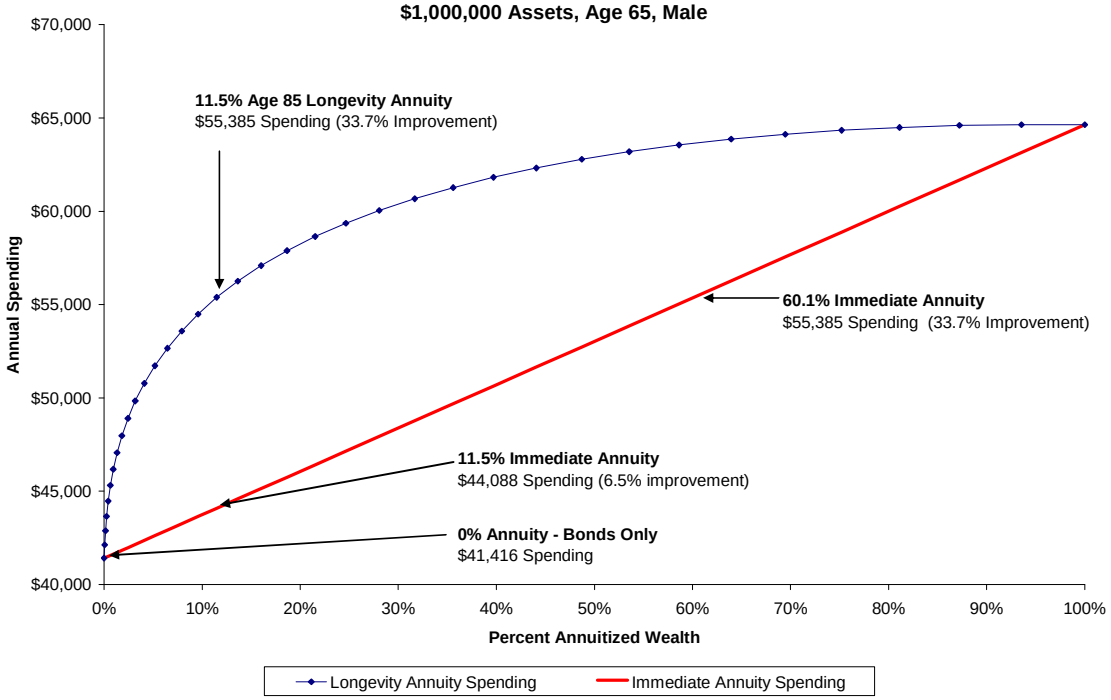

Table 1
Robustness Analysis: Interest Rate, Mortality, and Annuity Pricing Assumptions
Age 85 Longevity Annuity vs. Immediate Annuity

	Theoretical Bond/Annuity Prices				Actual Bond/Annuity Prices	
Assumptions	**Case 1**	**Case 2**	**Case 3**	**Case 4**	**Case 5**	**Case 6**
Mortality: Male(M) vs. Female(F)	M	F	M	F	M	F
Interest Rates: Real (2.5%) vs. Nominal (5.0%)	2.50%	2.50%	5.00%	5.00%	~5.00%[1]	~5.00%[1]
Bond-only Spending from $1 million	$41,416	$41,416	$57,557	$57,557	$58,841	$58,841
Age 85 Longevity Annuity Results						
Optimal[2] Annuity Allocation (%)	11.5%	15.3%	8.2%	10.9%	7.9%	10.4%
Spending Improvement (%)	33.7%	27.9%	21.9%	18.3%	21.5%	18.2%
Immediate Annuity Results[3]						
Annuity Allocation (%)	11.5%	15.3%	8.2%	10.9%	7.9%	10.4%
Spending Improvement (%)	6.5%	6.4%	3.3%	3.3%	3.1%	3.1%
Longevity Annuity Benefit Multiple[4]	**5.23**	**4.35**	**6.61**	**5.52**	**6.91**	**5.84**

[1] *Treasury yield curve on 07/13/06 ranged from 5.00% to 5.27%*
[2] *Annuity allocation required to equalize income across all retirement years. Income from age 65 to 84 is bond-funded. Thereafter annuities fund income.*
[3] *Immediate annuity prices estimated from age 67 longevity annuity prices*
[4] *Ratio of longevity annuity spending improvement to immediate annuity spending improvement*

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To get started, enter information about you and your spouse. Enter how many years you'll need your retirement income to last on Line A. Then, determine your annual income goal. If you have yet to complete a retirement budget, your Financial Representative can help you complete the Retirement Expense Worksheet. Once you determine this number, enter it on line B, *Annual Income Goal Based on Projected Expenses*. Then, enter your *Guaranteed Income Available* on line C. There are additional lines below line C to help you and your spouse make additional calculations. On line D, enter the *Value of Savings to Be Used for Retirement Income*. The lines below line D list some common income sources. On the next line, subtract the Guaranteed Income Available from your Annual Income Goal to determine the *Income Needed from Additional Savings*. Finally, consider if it's important for you to leave a legacy to your heirs.

1.

Client	Spouse
Name: _____	**Name:** _____
Date of Birth: _____ **Age:** _____	**Date of Birth:** _____ **Age:** _____
Retirement Age: _____ ☐ **Already Retired**	**Retirement Age:** _____ ☐ **Already Retired**

A. Years of Retirement Income Needed: _____
(Consider both your ages, and the likelihood of at least one of you living into your 90s.)

B. Annual Income Goal Based on Projected Expenses: **$** _____
(Use enclosed Expense Worksheet to determine amount if unsure.)

C. Guaranteed Income Available: **$** _____
(Use below to list specific amounts) (Total from below)

Client—Annual Amount	**Spouse—Annual Amount**
Social Security: _____	Social Security: _____
Pension Income: _____	Pension Income: _____
Income Annuity (SPIA): _____	Income Annuity (SPIA): _____
Other Fixed Income: _____	Other Fixed Income: _____

D. Value of Savings to Be Used for Retirement Income: **$** _____
(Use below to list specific amounts) (Total from below)

Client—Total Amount	**Spouse—Total Amount**
401(k)/403(b): _____	401(k)/403(b): _____
Investments: _____	Investments: _____
Savings: _____	Savings: _____
Other: _____	Other: _____

E. Income Needed from Additional Savings: **$** _____
(Total from line B minus total from line C.)

In addition to retirement income goals, is it important for you to leave a legacy for heirs or charity? Yes ☐ **No** ☐

Explain: _____

_____

Now it's time to determine your comfort level with the concepts of flexibility and guarantees. **Keeping in mind the savings you have indicated are available for retirement income,** answer the following questions. Write the number that corresponds with your answer in the "My Answer" column, then add the numbers in that column for your Income Selector Score.

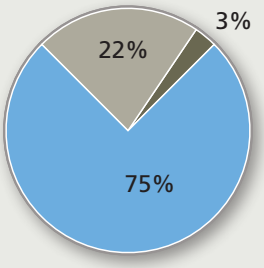
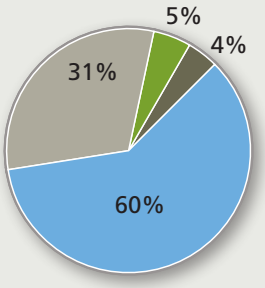
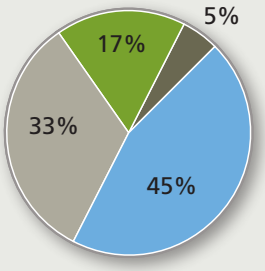
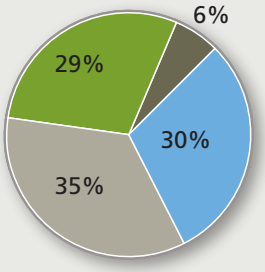
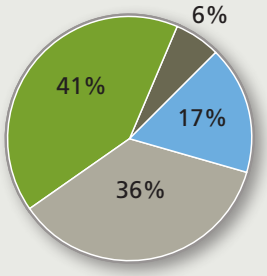
2.

	Agree	Disagree	My Answer
1. I prefer a predictable retirement income check each month, like a regular paycheck, in exchange for giving up some of my ability to take more income when I may need it.	1	0	
2. I don't want to worry about the ups and downs of the market after I retire and the effect on my income, even though I may miss out on opportunities to increase my income level if the market goes up.	1	0	
3. I am much less concerned with how long my retirement funds last and much more concerned with living my desired lifestyle in my earlier retirement years.	0	1	
4. It's important for a large portion of the income generated from this account to last my entire lifetime.	1	0	
5. I would be comfortable giving up access to this money in order to receive the most income possible.	1	0	
6. If income from my retirement funds suddenly dropped by 10%–15%, I would be concerned about how it might impact my lifestyle.	1	0	
7. It's important for me to have a large portion of this account available at all times—for things like unexpected home repairs or family emergencies—even though that may mean less income is available throughout my retirement years.	0	1	
8. I would like to actively manage this investment and the income stream it generates—and I'm confident I will be able to continue to do so as I age.	0	1	
9. Having the flexibility to use my assets to generate the income I want today is important to me, even if it means I risk running out of assets and having no income later.	0	1	
Your Income Selector Questionnaire Score >			

3.

More Income Flexiblity — **More Income Guarantees**

Traditional Investments | Variable Annuity with Guaranteed Income Benefit | Lifetime Income Annuity | Longevity Income Protection Annuity

0-1 Points Flexible Income	2-3 Points Protected Flexible Income	4-5 Points Balanced Income	6-7 Points Stable Lifetime Income	8-9 Points Guaranteed Lifetime Income
				
It appears that you're interested in having access to your money at all times, especially at this point in your life. You're a confident investor who is comfortable weathering market volatility since it will give your income the potential to grow during your retirement. Based on your answers to the questionnaire, you may prefer income solutions that offer the potential for maximum liquidity and flexibility with a relatively small amount of guarantees.	Access to your money is important and you feel you can handle some market volatility, as long as you have a small safety net to fall back on. Placing some money aside to cover lifetime income, while important, may be a second priority. Based on your answers, you may prefer a solution that offers a degree of flexibility with a modest amount of guarantees.	Your answers show that you value both flexibility and guarantees when it comes to your retirement income needs. You are willing to give up some control of your savings in exchange for a more predictable income stream. You'd also like to be somewhat involved in the management of your investments and maintain a degree of flexibility. Based on your answers, you may want to consider a balanced mix of various withdrawal options and lifetime income guarantees.	Guaranteed lifetime income seems to be a high priority for you. However, you may be willing to tolerate slight amounts of market volatility in order to maintain a degree of flexibility for unexpected events. Based on your answers, you are looking for a high level of predictability in your income—knowing when and where it's coming from at all times. You may prefer a solution that offers some guaranteed lifetime income and some withdrawal options.	Having a high level of guaranteed lifetime income may be your top priority. Based on your answers, your number one concern is outliving your income and you don't feel comfortable managing your investments day-to-day to make sure they last. You may prefer solutions that offer a high level of predictable lifetime income with less flexibility.

This is a tool to help you better understand the relative flexibility and guarantees associated with certain types of products, and how these can be used to help you meet your income goals. Below are some of the hypothetical assumptions used to determine the suggested allocation percentages. This is not a recommendation to purchase any particular product. These are only suggestions; the final decision is yours. For details about specific products, features, and limitations based on your age and situation, please speak to your Financial Representative.

1: For Traditional Investments: Assumed historical returns and industry recommended annual withdrawal rates; consideration is not given to taxes, fees, or charges associated with the purchase of any particular product.

2: For Longevity Income Protection Annuity: Guaranteed income payment from a Deferred Income Annuity assumes a life-only income option and a start date at age 85.

3: For Lifetime Income Annuity: An immediate income annuity using a life-only income option.

4: For Variable Annuity with Guaranteed Income Benefit: Optional income benefit rider assuming withdrawals up to the amount permitted in the rider. Fees, charges, and waiting periods associated with the purchase of this rider are not considered.

Variable annuities are offered by prospectus only, which is available from your registered representative. You should carefully consider the product's features, risks, charges and expenses, and the investment objectives, risks and policies of the underlying portfolios, as well other information about the underlying funding choices. The amounts allocated to the variable investment options of your account balance are subject to market fluctuations so that, when withdrawn or annuitized it may be worth more or less than its original value.

The principal value and rate of return in a variable annuity will fluctuate due to market conditions. Therefore, at any point in time, the value of the annuity contract may be worth more or less than the owner's actual investment in the contract. There is no guarantee that any of the variable options in this product will meet their stated goals or objectives. This and other information is available in the prospectus, which you should read carefully before investing. Product availability and features may vary by state.

Annuity product guarantees are based on the claims-paying ability of the issuing insurance company. Most annuity products have terms and exclusions for keeping the policy in force. Your representative can provide additional details.

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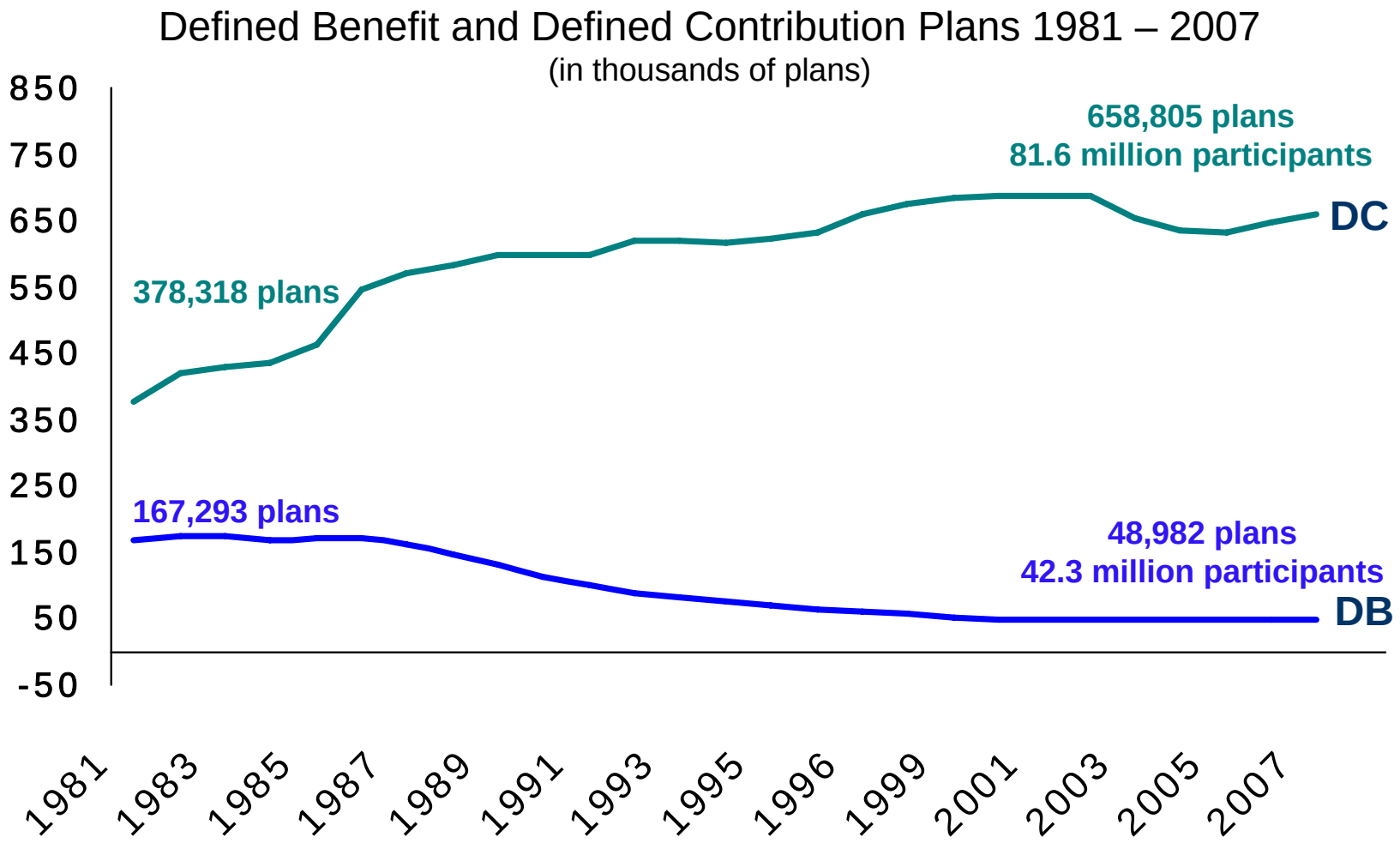
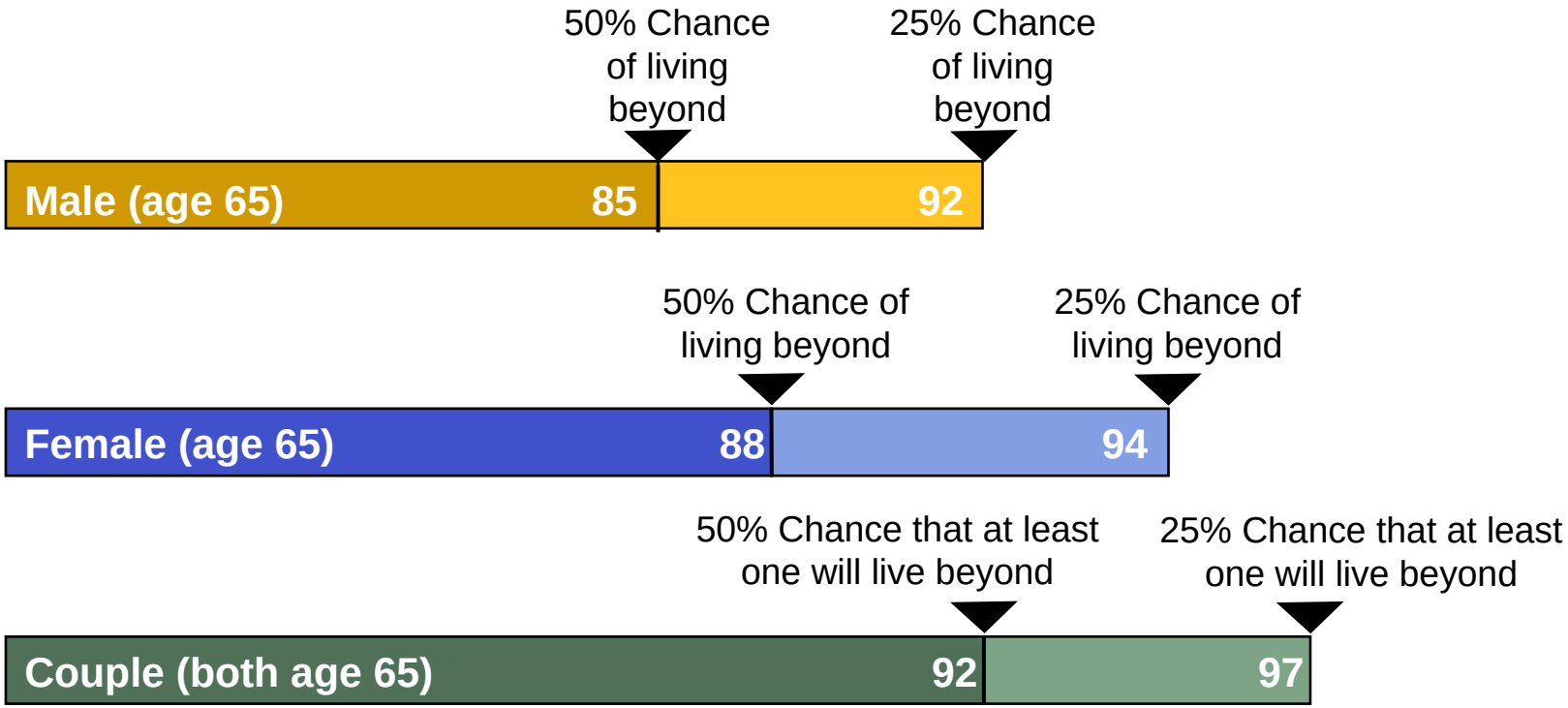
The Rise (of DC) and the Fall (of DB)



Source: Private Pension Plan Bulletin, Abstract of 2007 Form 5500 Annual Reports, U.S. Department Of Labor Employee Benefits Security Administration, January 2010

People Underestimate The Time Spent In Retirement



Source: Annuity 2000 Male and Female Mortality Tables