



The Price Is Right

Retirement industry pricing attracts (unwarranted?) attention

In the roaring bull market of the late 1990s, discussion of retirement plan fees took a backseat to talk of stellar returns. But in the bear market of the early 2000s, fees became a focus. In 2006 the regulators became involved.

Fee pressure is an undeniable fact of the industry, but how are today's plan fees really affecting profitability? And, in a few years when increased fee transparency is improved, will a plan's expenses really make a difference or will plan sponsors and participants be focused on the services provided by the plan?

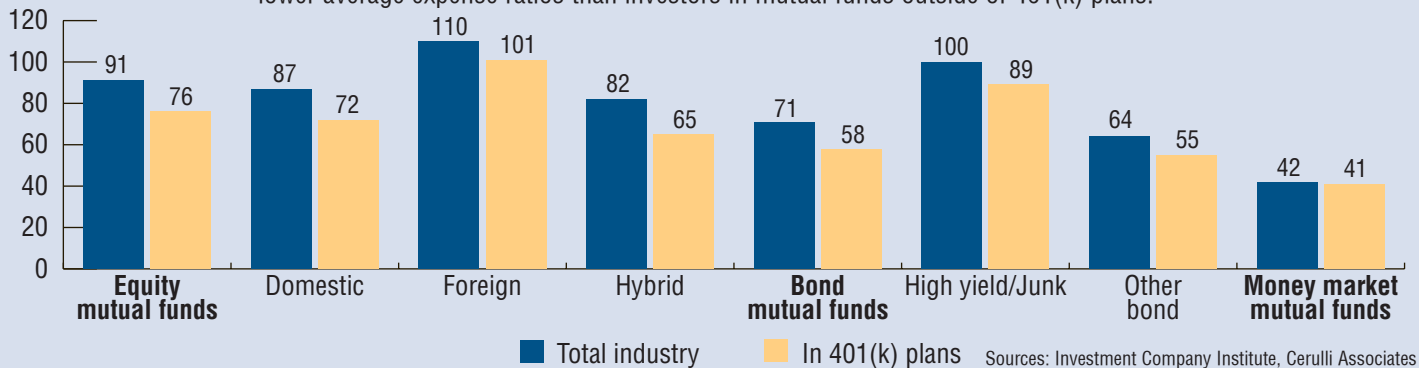
Cerulli analysts believe that the concerns surrounding fees in the retirement industry are somewhat overstated. A closer look at mutual funds in 401(k) plans, for example, reveals that investors in these funds experience lower average expense ratios than investors in mutual funds outside of 401(k) plans. This is due to a number of factors,

including that some plan sponsors choose to cover a portion of 401(k) plan costs; many 401(k) plans have large average account balances that allow for economies of scale; and performance- and cost-conscious plan sponsors regularly evaluate fund performance (which reflects fees).

In this issue of the *Retirement Edition* we examine fees and best practices in the 401(k) and 403(b) industries. We also look at the impact of hefty (and inconsistent) pricing of guaranteed minimum withdrawal benefits (GMWBs) in the annuities industry. Our quantitative section, containing the most current data from our proprietary research engine, provides insights into defined contribution (DC) and defined benefit (DB) providers and sponsors; the impact of the Pension Protection Act (PPA); retirement income trends; annuity options in 401(k)s and insurance products; and IRAs (including assets reported by leading firms). ♦

KEY MARKET TREND: TOTAL MUTUAL FUND FEES BY INVESTMENT STYLE VS. FUND FEES IN 401(k) PLANS, 2005 (bps)

A close look at mutual funds in 401(k) plans reveals that investors in these funds experience lower average expense ratios than investors in mutual funds outside of 401(k) plans.



DEFINED CONTRIBUTION

The (k)! True Hollywood Story

Preventing tragedy via a path to 401(k) fee best practices

At the risk of taking a leap on the 401(k)'s higher influence on popular culture, could we soon see an "E! True Hollywood Story" on 401(k) and fees? The drama has begun in earnest but there's still time to prevent fee-related stories from spiraling out of control.

The drama

The drama has been high lately for 401(k) plans. Last year, a very popular PBS "Frontline" segment was a retirement savings inadequacy story ("Can You Afford to Retire?" May 2006), which still grips viewers today. Many sad-looking participants were portrayed as destitute and financially unprepared for retirement. A snippet from one claimed "the percent of net growth in 401(k)s that is going to fees

is awesome—the financial system put up zero capital and took 0% of the risk and got 80% of the return—the system is fixed." *Forbes* magazine recently ran a cover story called the "Retirement Rip-Off" based loosely on the same ideas. Finally, as if there could not be any more drama, Eliot Spitzer has been hot on the trail of the 401(k) providers, and the SEC recently indicated it would be reviewing the practice of using 12b-1 fees.

In the wake of this, Congress passed, and the president signed into law, the Pension Protection Act (PPA) of 2006, which drew a storm of media attention regarding its impact on the 401(k) landscape. This renewed focus on retirement plans lit the fire on fee topics that had been simmering on the burner for some time. A

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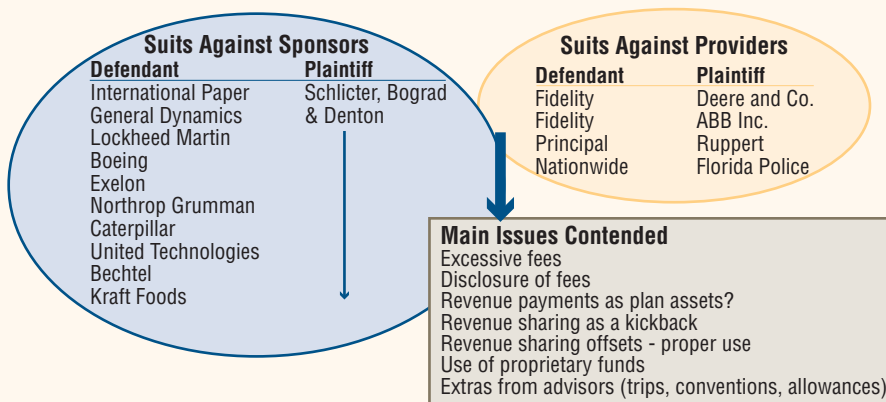
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The Cerulli Edge™—Retirement Edition is a quarterly periodical designed to update the firm's clients about the most recent Cerulli research initiatives regarding the retirement industry. The annual subscription fee is US\$5,000 per client firm. The publication is available in hard copy and electronic format and includes copies sent to as many as 15 key executives. Each additional recipient beyond 15 is \$500. We suggest including heads of business units, CEOs, and directors of marketing, strategy, product development, and sales. Your subscription also gives you access to all archived issues via our web-based client access service. Please contact CAmarketing@cerulli.com for details.

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FEE-RELATED 401(k) LAWSUITS

The lack of fee transparency in 401(k) plans has spurred a great deal of courtroom drama.



Source: Cerulli Associates

recent Government Accountability Office (GAO) report stated that 401(k) plan investment fees are generally borne by participants, but few disclosures are made to them. Soon thereafter, waves of class-action lawsuits were filed against some large plan sponsors. The focus of these suits is the fees in the 401(k) plans.

The Department of Labor (DOL) has been struggling to catch up with guidance needs regarding fees. The DOL's most recent effort is the requirement of new, more in-depth fee disclosures on Form 5500 files (the annual filing of statistics on a retirement plan). But the complexity of plan arrangements has meant that tackling this is a Herculean task. The DOL is working to manage this through its disclosure form 408(b)(2), which contains fee definitions—but the form has nearly 40 definitions of fee terms.

Most recently (on March 6, 2007), a congressional fact-finding session on retirement plans had pundits pounding away on the fees in 401(k) plans, their fairness, the confusion they cause, and, ultimately, their negative impact on unsuspecting participant accounts.

Despite all the congressional and media frenzy, Cerulli analysts believe that the industry is doing a better job of instituting best practices, offering better overall cost and revenue clarity, and, most importantly,

taking the reins of the fee story before a sad 401(k) legacy chronicle can ever begin.

Discovering the (k)! True Story

One cannot peruse a defined contribution (DC) industry conference agenda without at least several sessions dedicated to “fees and transparency” on DC plans. The fact that the word fee is coupled with transparency suggests that something beyond normal view has been going on in the industry.

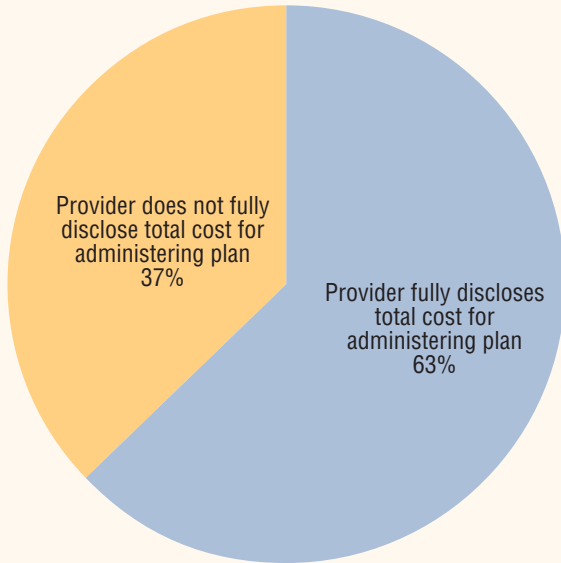
Cerulli analysts believe this is an unfair portrayal. A better pairing of words could be “fees and best practices.” In general, the industry has not been deft at defining and establishing these desperately needed marks.

The Statement on Auditing Standards No. 70 (SAS 70) comes close on the recordkeeping and administration side of the 401(k) package. But this audit approach to service delivery tends to highlight egregious gaffes from a provider while offering little in terms of a database for benchmarking what is above or below the line on service. Ultimately, the industry could be served well by better measurements not only of service levels but also of the fees charged for them.

The advent of the internet's ubiquitous access to information facilitated the “no dicker sticker” idea from the automobile

PROVIDER FEE DISCLOSURE IN 401(k) PLANS

More than one-third of plan sponsors are unaware of the administrative costs involved in their plan.



Sources: Hewitt Associates, Cerulli Associates

industry. This approach has made the car-buying process less scary and more fair for buyers. The financial services industry has been slowly catching up to this changing balance of power—information available for comparison and benchmarking. No one can argue that the time has come to disclose all the fees that are included in a 401(k) sale. And more importantly, there needs to be a sharing of cost data more akin to invoice pricing.

In 401(k)s, the many moving parts and “magic box” pricing make it difficult to compare providers and asset managers. It is hard to create and understand best practices in fee pricing or revenue sharing when there is nothing against which to consis-

tently benchmark. This holds true for both the variable and fixed cost for plans, and most importantly on provider revenue sharing with outside funds on their bundled platforms.

A recent study by consulting and actuarial service provider Milliman, Inc. examined the conundrum of determining actual costs in a bundled 401(k) plan. It concluded that although bundled programs are designed and sold as simple and complete solutions to providing and managing retirement benefits, the same cannot be said of the programs’ fees. Two participants with similar characteristics (*e.g.*, age, account balance, and salary) investing in the same mutual fund in different 401(k) plans are often charged very different fees. The confluence of three key factors—plan sponsors’ ability to understand or even be aware of institutional share classes; the way revenue sharing offsets cost in each class; and how the plan subsidizes costs—plays a role. In the end, however, the cost spread between an institutional and an A-share class to an average participant balance of \$50,000 can differ to the tune of \$375 (see table below).

Herein the fee issues lie. In the current environment, these fee structures are not always understood by sponsors and are rarely communicated to participants, thus exposing a basic fiduciary obligation —reasonableness of fees.

Ultimately, the Milliman study argues, and Cerulli agrees, a thoughtful service

TYPICAL CHARGES TO PARTICIPANTS THAT ARE NEITHER ALWAYS DISCLOSED NOR UNDERSTOOD

The cost of a plan with A-share funds at NAV can be more than double that of a plan with institutional share class funds.

Share Class	12b-1 Fee	Service Fee	Typical Fund Expense Ratio	Cost to a Participant with \$50,000 Balance
Institutional	0.00%	0.00%	0.50%	\$250
Investor	0.00%	0.10%	0.60%	\$300
Trust	0.25%	0.25%	1.00%	\$500
Class A	0.25%	0.50%	1.25%	\$625

Sources: Milliman, Cerulli Associates

plan would bring together the essential parties that deliver support to a 401(k) plan (*e.g.*, recordkeeper, trustees, fund companies, and advisors) in a “bundled unbundled” situation whereby top-notch separate service options are housed on a common platform that fosters competitive pricing in a more broadly encompassing, complete open-architecture environment.

This may combine the service ease of a bundled offering with the competitive pricing dynamic of a true unbundled offering. The approach sounds interesting and bears watching as some firms, such as Milliman, have employed technological innovation to bring the four key “unbundled” 401(k) service providers together on a platform.

Too often it is difficult to determine what is excessive and what is a fair deal. The industry is at an important crossroads on this. Data shows that clarity is often lacking on fee arrangements, particularly the impact that revenue sharing plays in the entire costs/fees equation.

Cerulli analysts envision a place where providers not only produce actionable analysis on the characteristics and behaviors of plan sponsors and participants on their books of business, but also create and share relevant benchmarking on the average fees charged and revenue received from platform funds (proprietary and non-proprietary) on their books. The latter part is lacking and a haze remains about its inner workings.

Preventing a tragic tale

Cerulli analysts believe that movement to “fees and transparency” alone is a shorter panacea to broader fee issues plaguing the marketplace. Many providers are taking large steps toward creating “window sticker” listings of every service and the fee associated. This is good, and Cerulli analysts believe that it needs to continue.

Simply handing a client or participant a listing of costs, however, could be more

useful if accompanied by appropriate benchmarks—then there could be a true value equation that best complements sponsor fiduciary obligations, bodes well for fee fairness to participants, and still leaves room to price in a value margin regarding intangibles such as personnel and services quality.

Pricing to a benchmark can be scary—no one will ever want to pay more than invoice price. However, it will benefit industry leaders who have the scale to price efficiently and never stray far from benchmarks. Some buyers will want BMW-like services and may be willing to pay for that when benchmarks (such as Cerulli is working to develop in the quantitative section of this publication; see page 13) are more evident and additional costs can be justified.

Finding a way to communicate value-add for the sponsor and participants will be imperative in maintaining a strong business. Cerulli analysts believe that fees will inevitably become more visible, and therefore the key is not to fight this occurrence but rather respond with attributes that differentiate product and service offerings.

The Pension Protection Act (PPA) will spur increased net flows from auto-enrollment and auto-escalation. New service models, responding to a market increasingly driven by managed account programs and lifecycle funds, will enable providers to separate themselves from the pack, because a consultative, total retirement picture will be valued by the plan sponsor client and participant.

Meeting the service and educational needs of participants and sponsors is difficult and will enable providers that succeed to do so at a premium. Economies of scale are crucial—but so are service, effective advice, clear education, and strong enrollment capabilities. Finding a way to marry all of these capabilities will lead to profit opportunities in a mature market. ♦

The Real World

Fees are becoming a factor for 403(b) providers

For the most part, prices and fees have not been an issue in the 403(b) market. Unlike 401(k) and 457 plans, in which the employer selects one provider and the underlying investments, 403(b) plans can have an almost unlimited number of providers per plan. Many 403(b) plan sponsors leave the final decision of selecting a provider to their employees. With such a wide diversity of providers from which to choose, 403(b) participants base their decisions largely on relationships with the provider's agent or representative, additional financial planning services offered, or the provider's reputation.

The reality is, however, that 403(b) fees are now becoming an issue. The media attention surrounding fee disparity between individual annuities and mutual funds (granted without an accompanying article

on the different service levels and benefits provided with these fees) has raised the awareness of key decision makers in not-for-profit (NFP) organizations about the impact of fees on retirement savings. At the same time, 403(b) plan sponsors are taking on more responsibilities such as tracking contributions, distributions, and loans. As they assume these responsibilities, plan sponsors are shifting away from favoring individual contracts (usually individual annuities) between the employee and the provider to group products (group annuities and mutual funds) that are intermediated through the employer.

As the model moves away from the individual sale and the employer takes on a more active role in the plan, there will be more focus on fees. Plan sponsors will have the power to demand lower fees for their

403(b) Contracts—A Primer

There are three types of investment contracts that can be offered in a 403(b) plan—individual annuities, group annuities, and mutual fund platforms. This is largely a result of the history of the 403(b).

Keep in mind that the 403(b) was around (1958) even before 457 (1978) or 401(k) plans (1981). When the 403(b) was first introduced, the only eligible investment vehicles were variable and fixed annuities. It wasn't until 1974, with the passage of ERISA, that participants were also allowed to invest in mutual funds. Thus, the original 403(b) contract was an individual annuity between the participant and the provider, and group annuities/mutual funds (which are contracts between the employer and the provider) didn't become commonplace until the passage of 401(k), almost 20 years later.

Individual annuities are still common in school districts and small not-for-profits that want to offer employees an opportunity to set aside more money for retirement, but don't have the administrative personnel or capital to manage the extensive employer responsibilities (*e.g.*, tracking loans, making distributions, and notifying the provider when someone is eligible or has left the company) that are necessitated in group products. Since the fees are not spread among multiple participants, and because they are usually sold individually, these individual annuities are typically priced at retail (not institutionally) and have higher costs than a group annuity.

Another justification for the cost of these plans is that there usually is not an employer match on the contributions (in public school districts, for example, the employer is already contributing to a DB plan). Therefore, the employees generally need to be driven to participate by an advisor or salaried employee of the provider, raising the expense (and value) of the program.

Group annuities and mutual fund-based platforms are more commonplace in the healthcare and higher education segments where the employer often selects the provider(s), but may want a live body to help employees enroll in a plan. Thus, the plan sponsor wants the benefits of both worlds (low-priced investment options with high-quality advisory services). To help plan sponsors balance cost with service, many providers that focus on the healthcare and higher education market offer both group annuities and mutual funds.

Cerulli analysts believe that in light of the changing 403(b) environment, providers across all segments will need to offer flexible and customizable products and platforms that can accommodate the administrative and educational needs of plan sponsors and participants.

CASE STUDY
**L.A. SCHOOL
DISTRICT**

Confronting Fee-Disclosure and Employee Education

While there has been a significant buzz in the corporate defined contribution (DC) industry about fee disclosure and revenue sharing, it is only now hitting public and not-for-profit DC plans. The behavior of the Los Angeles (L.A.) school district (the second largest school district in the nation with more than 710,000 students and 74,000 employees) is a strong example of fee disclosure being met head-on by the plan sponsor.

The L.A. school district, like many others, offers its educators the opportunity to invest in a 403(b) plan. However, California laws stipulate that any willing vendor is allowed to compete in the system. This results in so many choices and fee structures that many participants are confused. Because it is a voluntary government DC plan, however, the school district does not have fiduciary responsibility or a plan document so it cannot take any action to clarify the plan for its employees.

In fall 2006, when the school district launched a 457 plan, it applied some of the lessons learned from its 403(b) plan offering. In the 457 plan, each specific revenue-sharing agreement between fund manager and provider is fully disclosed. The district realized, however, that although the transparency is definitive, it is still likely that employees will not fully comprehend the information with which they are presented.

Therefore, the school district is making a concerted effort to educate employees on the fees. The 457 provider dedicated 20 marketing reps to the L.A. school district account to educate employees individually. Additionally, the district is offering workshops and has online tools on its website.

It is too early to know if this comprehensive education plan will yield increased participation. The school district launched the 457 program just after the 403(b) open enrollment period, so participation thus far is relatively low. Furthermore, there is a low 403(b) participation rate, so even next year's open-enrollment period may not be productive. Finally, this is the third plan now available to L.A. school district employees (they are offered a DB plan, 403(b), and now the 457), so confusion about which plan to choose will likely be high. Nevertheless, it is a worthwhile concept and a solid first step toward encouraging participation in public DC plans.

products because the assets will become aggregated under group plans, rather than scattered among numerous individually-sold products. They will likely begin to look for providers who understand the current and future culture of the 403(b) market, provide a high level of services, but also have lower prices and fees (see L.A. School District case study above).

Providers' response

403(b) providers are adjusting their platforms and services to compete in this lower fee environment. Since 401(k) providers have already dealt with this issue, 403(b) providers can glean insight from their best practices. For example, most of the largest corporate DC plans already utilize mutual fund-based platforms while the small 403(b) plans typically offer individual annuities that are sold through advisors or agents. The most common method for corporate DC providers to reduce fees is to implement flexible pricing

models as assets grow, such as switching from group variable annuities (VAs) to a mutual fund-based platform.

Small 403(b) plan sponsors that currently allow participants to select their own contract directly with the provider will likely use a two-step approach as they transition from individual annuities to mutual funds. The first step will be to gradually gather assets under a group annuity. This will take time, as the plan sponsor has no control over the individual contract, and will have to wait for the participants to actively elect to roll over current assets to the group plan. Once collective 403(b) assets achieve a reasonable size (\$5 million to \$10 million), providers will help the plan sponsors transition to mutual funds.

Providers who already have programs that seamlessly move plans to lower priced products and platforms when assets hit critical mass reiterate that these programs not only build good rapport with the plan sponsors, but also help providers retain

For more on 403(b) plans, see *The Cerulli Report: State of the 403(b) and 457 Marketplace: Challenges and Opportunities*

assets. To ensure the assets remain with the provider, Cerulli analysts believe that the provider should disclose—from the onset of the relationship—that fees will automatically reduce at predetermined thresholds and educate agents/advisors about the benefits of a flexible platform.

Small plans (regardless of DC type) are usually sold through an agent or advisor, and it is important not to alienate these partners as providers seek to retain assets. By reinforcing to agents or advisors that this flexible platform gives them more tools, both the advisor and the provider will, in the end, stand out among their competition.

Cerulli believes that the shift toward group VA- and mutual fund-based platforms will accelerate in the next 5 to 10 years as the 403(b) market begins to emulate the corporate 401(k) marketplace, providers offer more recordkeeping and administrative services, and plan sponsors consider fees as they trim down their provider listings. Switching to a group VA or mutual fund platform will also help large DC providers decrease their internal costs while still providing more services.

Profitability implications

Providers indicate that the 403(b) market is just as profitable as—if not more profitable than—other DC markets. Of providers surveyed by Cerulli, 43% report that their profit margins on the 403(b) side were greater than the profit margins of other DC businesses, and an additional 43% indicate that the profit margins were relatively similar across all DC business lines.

Providers indicating that 403(b) profit margins are greater than other DC segments have larger DC practices. Consequently, they offer recordkeeping and unbundled services, compete on pricing, and offer multiple platform and pricing structures. For these providers, the 403(b) is more profitable because they can derive extra revenue from the advisory services they offer the participants (either through managed account programs or agents and advisors).

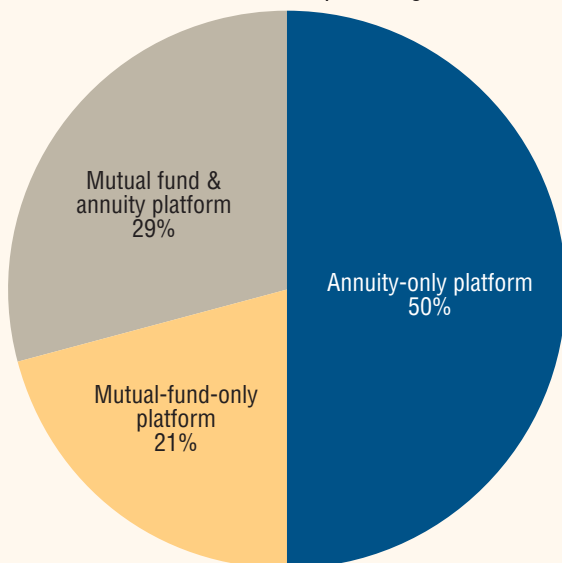
Providers stating that 403(b) profit margins were roughly equivalent to DC profit margins had smaller DC practices, and the 403(b) comprised, on average, 73% of their DC assets. These providers are more likely to offer bundled DC services and their products are predominantly annuity-based. Because they do not offer the degree of customization that could be found with other DC providers, and they offer annuities to both 403(b) and non-403(b) plan sponsors, revenues would be similar across DC segments.

Small providers will need to offer more administrative, compliance, recordkeeping, and advisory services if they want to continue to compete in this market. This will further drive down their profit margins. And, the double whammy is that as they offer more services, they will also receive less revenue.

Plan sponsors will use the collective assets of 403(b) accounts to negotiate lower fees, and will move from a retail-based

PLATFORM CONFIGURATION

403(b) providers need to offer more flexible, customizable platforms to reduce costs while providing more services.



Sources: NTSAA, Cerulli Associates

LARGEST 403(b) PROVIDERS BY ASSETS AND PRIMARY FOCUS, 2005

Many of the largest 403(b) providers are key players in other DC markets.

Firm	403(b) Assets (\$ billions)	403(b) Assets as % of All DC Assets
TIAA-CREF	\$337.0	98%
Fidelity	55.7	8
AIG VALIC	42.6	74
MetLife ¹	30.0	41
The Vanguard Group	30.0	11
ING	25.4	32
Lincoln	19.2	63
Diversified Investment Advisors ²	10.0	41
AXA/Equitable	9.5	62
Prudential	8.6	12

¹The acquisition of MetLife's 401(k) business by Great West is not reflected in these numbers; ²Estimates
 Sources: Pensions & Investments, Investment Advisor, NTSAA, Cerulli Associates

annuity to group platforms and products in order to track participant activity.

Therefore, providers will need scale to defray the cost of offering increased services without raising prices, and to offset the loss of revenue from the higher priced individual annuities. Cerulli believes that this need for scale will accelerate consolidation, merger, and acquisition activity in the 403(b) industry.

Welcome to the real world

Even though 403(b) providers are entering a world where fees are an increasingly important factor in a plan sponsor's selection process, Cerulli analysts believe

that fees will still take a backseat to the level of service that providers offer participants and plan sponsors (the exception being the few index-based mutual funds that have the scale and brand recognition to compete on price). Participants in the 403(b) market are accustomed to receiving a high level of individual advice, and providers will need to price this service into their products. Will providers concentrate on providing a low-cost, low-service model or provide higher level of services at a slightly higher price? Cerulli analysts believe that each of these models can succeed as long as it is properly planned and executed. ♦

ANNUITIES

Deal or No Deal?

Popular retirement income feature comes at a price

Guaranteed withdrawal benefits have taken the insurance industry by storm, and their popularity shows no signs of ebbing. According to Cerulli Associates' proprietary research, 41% of advisors frequently recommend guaranteed lifetime income benefits to provide retirement income for

their variable annuity clients.

Additionally, 24% frequently recommend traditional, fixed-period guaranteed minimum withdrawal benefits, and another 37% occasionally recommend them.

Yet these benefits come at a steep cost, which can significantly impact the account

value over time.

In the simplest terms, a guaranteed minimum withdrawal benefit (GMWB) may be thought of as a withdrawal plan with downside protection (see definition box on page 11). Yet, in the real world, the benefit is composed of myriad moving parts—including step-ups, bonuses, spousal coverage, and guaranteed bases—as illustrated in the table below. Such innovations in product design have also affected pricing—which can range from as little as 20 basis points (bps) per year for a basic fixed-term benefit to more than 80bps for a comprehensive lifetime benefit that covers two lives (see grid below).

By the numbers

To illustrate the impact of the GMWB on the value of an annuity contract, Cerulli analysts computed several scenarios that compare accumulated value both with and without this benefit. One of these scenarios

is illustrated in the line graph on page 12. Investment performance was determined by a random number generator using annual return parameters between -10% and 25% (the average annual return in the illustrated scenario was 8%). To further mimic the real world, payouts were assumed to begin after the contract had been in force for five years.

Under the systematic withdrawal plan (SWP), withdrawals were assumed to equal 5% of the accumulated value of the contract. Both the standard and lifetime withdrawal benefits assumed an automatic five-year reset and 5% annual bonus on the guaranteed amount for deferring payments.

The standard GMWB allowed for a maximum of 7% of the guaranteed withdrawal amount, yet to provide a more balanced comparison, we limited this to the greater of 5% of the benefit base or the amount withdrawn under the systematic withdrawal option. The lifetime withdraw-

GUARANTEED WITHDRAWAL BENEFITS OFFERED BY SELECT VA PROVIDERS, 2007

Insurer	Guaranteed Withdrawal Amount or Base	Guaranteed Minimum Withdrawal Benefit
		Description
Hartford Financial	For GMWB: Initial premium (or contract value, for post-issue election) plus subsequent premiums; For GLWB: Initial premium (rider available at issue only).	Choice of the following: (1) 7% of guaranteed withdrawal amount; optional 5-year step-up (2) 5% of guaranteed withdrawal amount
Lincoln National Life	Initial premium (or contract value, for post-issue election) plus subsequent premiums.	Choice of the following: (1) 7% of guaranteed amount; optional 5-year step-up (2) 5% of guaranteed amount, automatic annual step-up for 10 years
MetLife	For GMWB: Initial premium plus subsequent premiums, both increased at 5% per year; For GLWB: Initial premium increased by 5% annually for earlier of 5 years or first withdrawal.	One of the following, depending on state availability: (1) 7% of guaranteed withdrawal amount, 5-year optional reset (2) 7% of guaranteed withdrawal amount; 3-year reset
Pacific Life	Initial premium (or contract value, for post-issue election) plus subsequent premiums.	7% of guaranteed withdrawal amount; annual or optional step-up (subject to state availability)
Prudential Financial	(1) Greatest of (a) initial premium (or contract value, for post-issue election) plus subsequent premiums, both increased at 5% per year for earlier of 10 years or 1st withdrawal; (b) contract value on date of first withdrawal; (c) highest anniversary value plus subsequent premiums until earlier of 10 years or 1st withdrawal (2) Initial premium (or contract value, for post issue election) plus subsequent premiums, both increased at 5% per year for earlier of 10 years or 1st withdrawal. This amount is stepped up daily. Further enhancements available after 10 years if no withdrawals made.	(1) 7% of guaranteed withdrawal amount; annual or optional step-up

Guaranteed Minimum Withdrawal Benefit Defined

An optional rider on a deferred variable annuity that guarantees the return of principal through periodic withdrawals, even if investment performance erodes the value of the account. Available in two types—*standard* and *lifetime*:

Standard GMWB: A GMWB that guarantees payments for a predetermined term, even if the account value is exhausted

Lifetime GMWB, or guaranteed lifetime withdrawal benefit (GLWB): A GMWB that guarantees payments for life, even if both principal and the account value are exhausted.

al benefit allowed for a 5% withdrawal of the guaranteed amount.

The contract had a base mortality and expense risk fee of 140 basis points, increased by 45 basis points for the GMWB and 65 basis points for the GLWB. In all cases, a single premium deposit of \$100,000 was assumed.

At the end of a 20-year period, the SWP resulted in an account balance that was, in this case, approximately 30% higher than that of both types of withdrawal benefits (see line graph on page 12). Much of this difference was due to the absence of rider

fees on the SWP example. It is important to note that the 5% deferral bonus on the withdrawal benefits apply to the guaranteed amount rather than the accumulated value of the contract.

As account value is also dependent upon the amounts withdrawn, we also examined the annual payouts from each scenario (see bar chart on page 12).

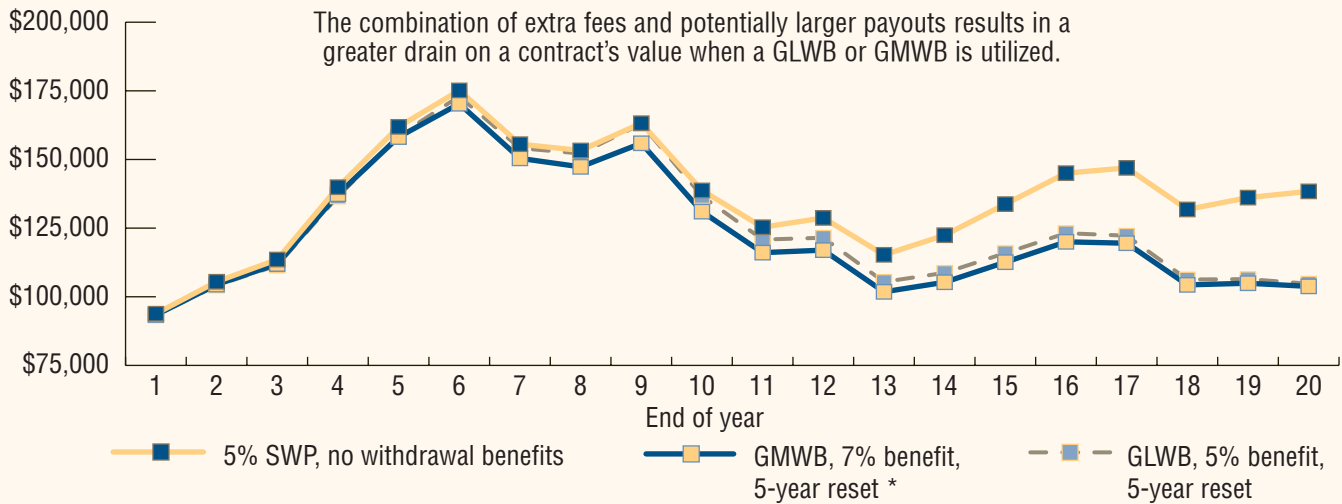
Under the systematic withdrawal plan, the investor has received a total of \$119,000 in payouts, yet is left with an account balance of nearly \$140,000. The GMWB returns a greater level of payouts

Guaranteed Lifetime Withdrawal Benefit		
Cost	Description	Cost
(1) 0.50% of the contract's accumulated value (2) 0.20% of the contract's accumulated value	Choice of (1) 5-7% (single life), 4.5%-6.5% (joint life) of guaranteed withdrawal base, based on age at first withdrawal; plus return-of-principal death benefit (2) same as above, plus automatic annual increases	(1) 0.30% of benefit base (2) 0.40% of benefit base
(1) 0.45% of the remaining guaranteed amount (2) 0.65% of the remaining guaranteed amount	5% of guaranteed amount; automatic annual step-up for 10 years	0.80% of the remaining guaranteed amount
(1) 0.50% of the guaranteed withdrawal amount (2) 0.50% of the guaranteed withdrawal amount, charge ceases if benefit base falls to 0	5% of guaranteed withdrawal amount; automatic annual resets	0.50% (single life) or 0.70% (joint life) of the guaranteed withdrawal amount
0.45% of the contract's accumulated value	(1) 5% of guaranteed withdrawal base; annual or optional step-up; 6% bonus for first 10 years if no withdrawals taken (2) 5% of guaranteed withdrawal base, annual or optional step-up; 6% bonus for first 5 years if no withdrawals taken	(1) 0.65% (single life) or 0.85% (joint life) of the benefit base amount (2) 0.60% of accumulated value
(1) 0.60% of the contract's variable account value	(1) 5% of guaranteed withdrawal amount; annual or optional step-up (2) 5% of guaranteed withdrawal amount; automatic quarterly step-up	(1) 0.60% (single life) or 0.75% (joint life) of the contract's variable account value (2) 0.60% of the contract's variable account value

Source: Cerulli Associates

VA CONTRACT VALUE EXAMPLE, WITHDRAWALS DEFERRED FIVE YEARS

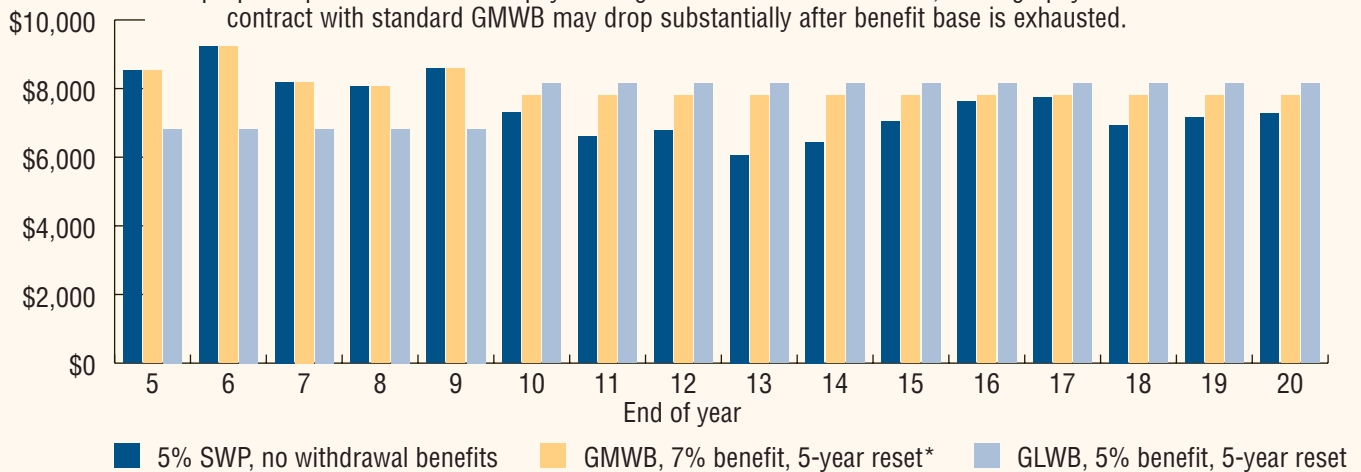
The combination of extra fees and potentially larger payouts results in a greater drain on a contract's value when a GLWB or GMWB is utilized.



*To keep the calculations comparable, the 7% GMWB scenario in this example will pay out the greater of 5% of the benefit base or the amount under the 5% SWP. Source: Cerulli Associates

ANNUAL PAYOUT EXAMPLE, WITHDRAWALS DEFERRED FIVE YEARS

Step-ups keep GMWB and GLWB payouts higher than those from a SWP, although payouts from contract with standard GMWB may drop substantially after benefit base is exhausted.



*To keep the calculations comparable, the 7% GMWB scenario in this example will pay out the greater of 5% of the benefit base or the amount under the 5% SWP until the benefit base is exhausted; 5% of contract value thereafter. Source: Cerulli Associates

(\$128,000, with an additional \$27,000 guaranteed), yet the combination of higher payouts and higher fees reduce the account value to \$104,000. It is a somewhat similar situation for the GLWB—\$124,000 of payments after 20 years with a corresponding account value of \$105,000.

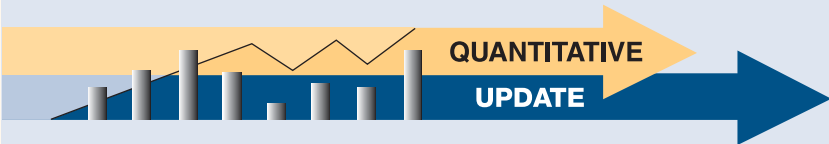
What's the deal?

While the above illustrates just one of an infinite number of potential scenarios, it represents the need to balance the impact of GMWB/GLWB fees with the benefits received.

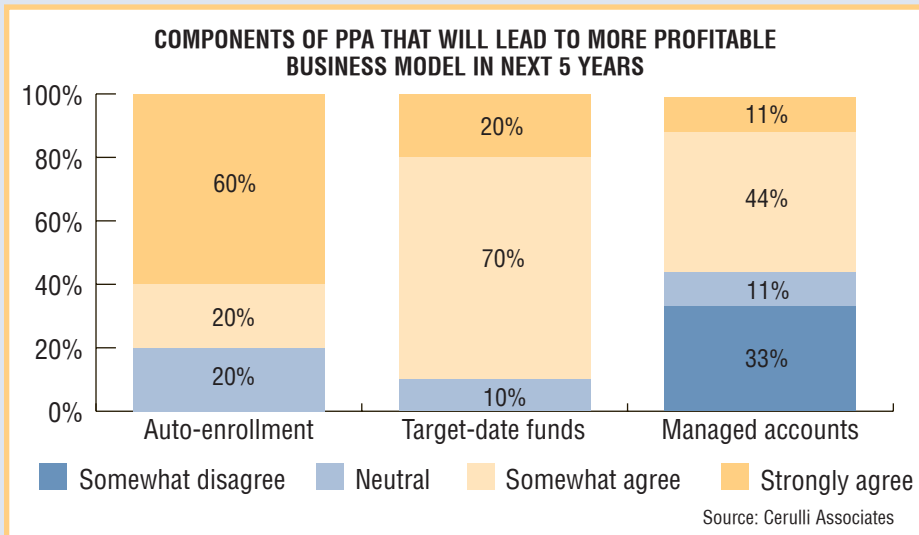
The value of these benefits is evident in

a down market, when the accumulated value of the contract falls to zero, yet payouts are still guaranteed—whereas payouts would cease under a systematic withdrawal plan. Yet, these scenarios are rare.

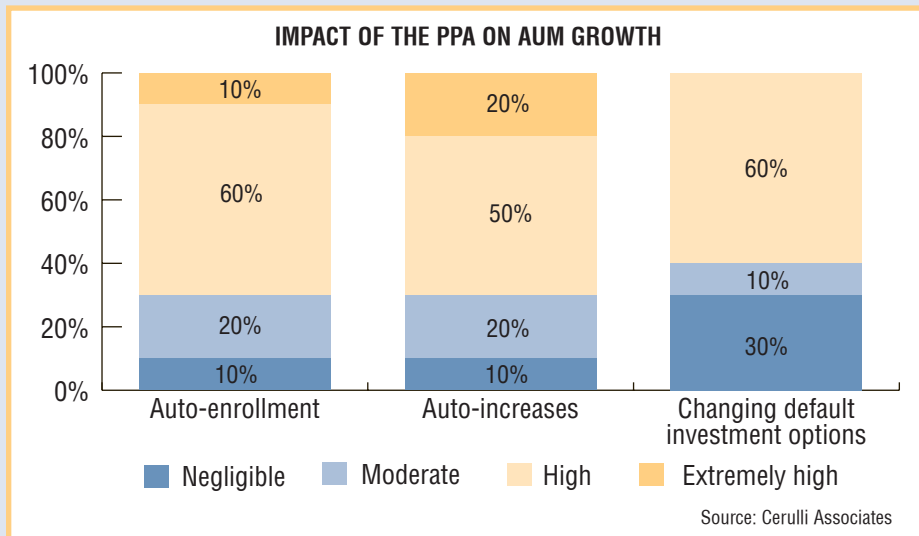
A separate and unresolved issue is whether the level of these fees is sufficient to cover the risks incurred by the insurance companies that offer them, a discussion sparked by recent research by renowned professor Moshe Milevsky. Several firms with which Cerulli analysts spoke are using this research to justify the costs they presently charge, although it is too soon to tell if even higher costs are in the future. ♦



DC PROVIDER PERSPECTIVE



A strong majority of DC providers surveyed by Cerulli agree that auto-enrollment's blessing by the PPA will lead to a more profitable business model. The PPA paving the way for target-date funds to be a widely acceptable qualified default investment alternative certainly has providers with strong internal target-date offerings giddy about the opportunity. That 70% of survey respondents only "somewhat agree" may reflect the concentrated market-share among leading asset managers in target-date offerings. Managed accounts in 401(k) plans seem to be exploding in growth, but the outlook on provider profitability is more neutral. More profits will be reaped by the actual managed account sponsors than DC providers strictly on the recordkeeping side.



Since auto-enrollment and auto-increases are encouraged by the PPA through safe harbor provisions, plans will be more apt to adopt these programs. Providers are ready to help meet that need, anticipating high or extremely high impact on AUM growth from the PPA due to these new provisions. 70% of DC providers anticipate high or extremely high impact from auto-enrollment as well as auto-increases. A majority of providers (60%) also anticipate high growth from new default investment options. Growth in AUM due to target-date funds and managed accounts as default investment options may primarily be driven by the equity markets, as prior default investment options used to be dominated by money market funds with limited growth potential.

FIRMS CONSIDERED SUCCESSFUL COMPETITORS

Firm	Mentioned
Fidelity Investments	25%
Principal Financial	25%
American Funds	17%
John Hancock	8%
Great West	8%
T. Rowe Price	8%
Newport	8%

Source: Cerulli Associates

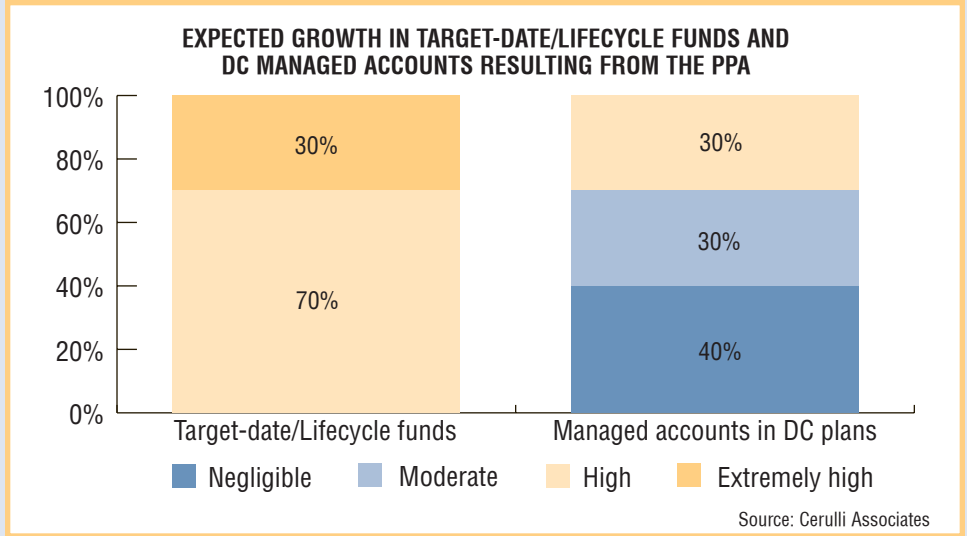
Fidelity Investments and Principal Financial were chosen most frequently by competing DC providers when asked "Who is your most successful competitor?" American Funds followed closely behind. This is no surprise, as Fidelity's forward-looking technology and proprietary lifecycle fund lineup (Freedom Funds) will position the firm well in the upcoming years. Principal Financial has been extremely strong, placing in the top 10 in terms of plans serviced in the small (<100 participants), middle (100-999 participants), and large (1,000-4,999 participants) segments of the 401(k) market.

(For more on this topic, see **Cerulli Quantitative Update: Retirement Markets 2006.**)

MANAGED ACCOUNTS IN DC PLANS

DC providers were more enthusiastic about growth in lifecycle funds than in managed accounts, according to our latest Quarterly Retirement Markets survey. 70% thought growth opportunities for target-date funds were high, while 30% rated their growth opportunity as extremely high. Not one provider thought growth in target-date funds would be moderate or negligible. Managed accounts were seen as a high growth opportunity by 30% of DC providers. But despite the recent explosive growth of managed accounts, 40% of DC providers state that, for them, the future growth opportunity of these programs is “negligible.” Cerulli analysts are more optimistic about managed account growth in DC plans, as customization of a participant’s retirement plan to individual risk tolerance and external sources of wealth appear superior in terms of optimal portfolio management.

Managed account sponsors reported strong growth in their assets under management through the end of 2006. The Morningstar/Ibbotson combination continues to thrive, and Guided Choice has established itself at the top of this market. According to Cerulli’s proprietary surveys, DC providers have also reported astounding growth in managed account assets.

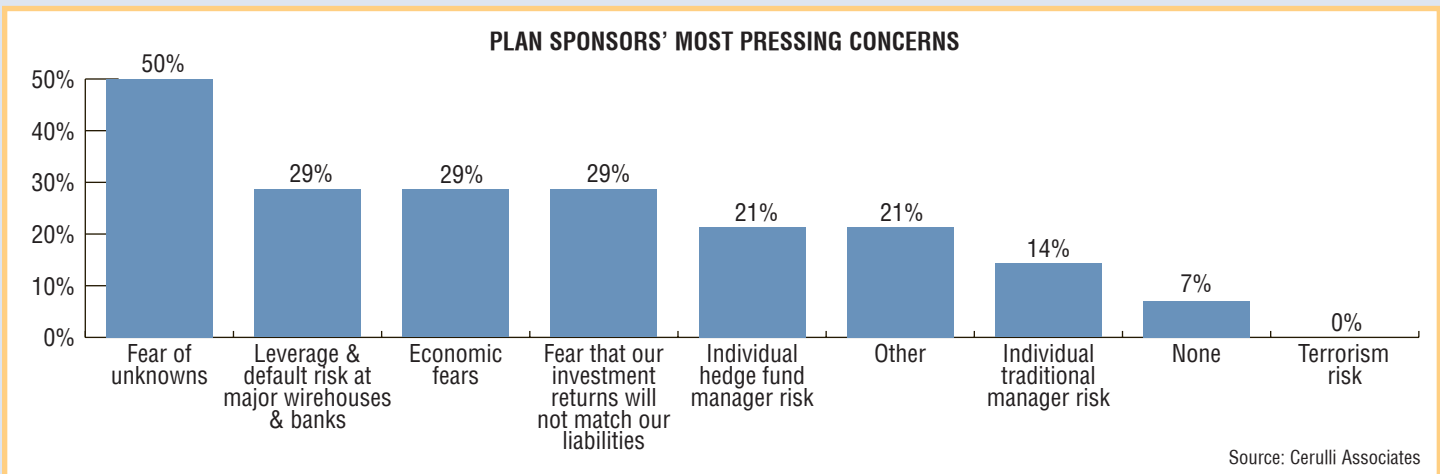


TOP DC MANAGED ACCOUNT SPONSORS, 4Q 2006 (\$ millions)

	3Q 2006	4Q 2006	Growth Since 3Q	Annualized 4Q Growth
Financial Engines	\$7,000	\$8,000	14.3%	70.6%
Ibbotson ¹	6,713	8,000	19.2	101.7
ProManage	6,194	6,537	5.5	24.1
Guided Choice	N/A	10,000	N/A	N/A
Smith Barney (“401(k) Advisor”)	1,321	1,394	5.5	24.0
Merrill Lynch (“Retirement Plus Advisor”)	1,100	1,094	-0.5	-2.2
Morningstar ¹	513	647	26.1	153.0
Standard (“Advice Path”) ²	412	480	16.5	84.2
PMFM	800	872	9.0	41.2

¹Morningstar completed its acquisition of Ibbotson in 2006; 2005 Morningstar and Ibbotson assets are as of 2005
²Formerly Invesmart
 Sources: Company reports, Cerulli Associates

DEFINED BENEFIT PLAN SPONSORS



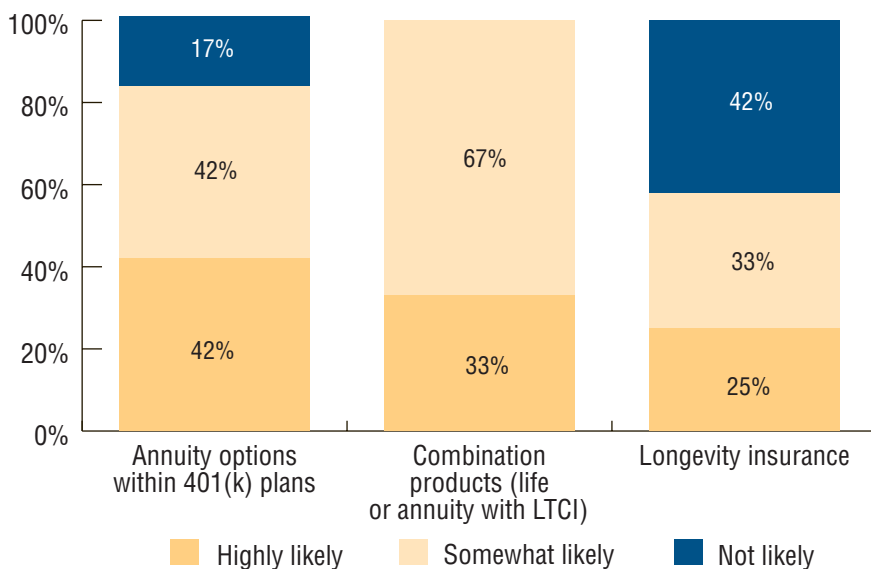
RETIREMENT INCOME

FREQUENCY OF RETIREMENT INCOME OR WEALTH TRANSFER PRODUCT USAGE BY CHANNEL, 2006

Product	Frequency	Bank B/D	IBD	Insurance B/D	NFS B/D	Regional B/D	RIA	All Advisors
Long-term care insurance	Always	4.8%	28.0%	37.5%	13.3%	9.5%	3.9%	15.8%
	Sometimes	33.3	56.0	54.2	45.5	52.4	43.1	47.3
Deferred variable annuities	Always	23.8	36.0	12.5	10.3	19.0	0.0	15.3
	Sometimes	38.1	41.3	75.0	43.2	33.3	25.5	39.8
Variable universal life insurance	Always	0.0	28.4	4.2	9.2	14.3	3.9	12.1
	Sometimes	42.9	31.1	50.0	34.0	38.1	7.8	30.9
Whole life insurance	Always	0.0	8.1	20.8	7.2	5.0	2.0	7.6
	Sometimes	19.0	24.3	41.7	35.3	55.0	6.0	28.9
Deferred fixed annuities	Always	9.5	8.1	16.7	2.8	5.0	0.0	4.9
	Sometimes	23.8	44.6	54.2	25.2	10.0	7.8	26.8
Immediate fixed annuities	Always	14.3	2.7	4.2	0.7	0.0	0.0	2.0
	Sometimes	4.8	21.6	50.0	17.1	45.0	16.0	20.4
Immediate variable annuities	Always	4.8	1.4	4.2	2.1	0.0	0.0	1.7
	Sometimes	19.0	28.4	37.5	16.4	15.0	9.8	18.9
Fixed-indexed annuities	Always	0.0	8.0	4.3	0.7	5.0	0.0	2.6
	Sometimes	14.3	22.7	21.7	11.3	10.0	6.1	13.4
Reverse mortgages	Always	0.0	2.7	4.5	0.7	0.0	0.0	1.5
	Sometimes	9.5	15.1	0.0	8.1	15.0	14.3	10.2
Private annuities	Always	0.0	1.4	4.8	0.0	0.0	0.0	0.6
	Sometimes	4.8	6.9	4.8	3.7	0.0	9.8	5.1

Source: Cerulli Associates

INSURERS' LIKELIHOOD OF DEVELOPING ANNUITY OPTIONS FOR 401(k) PLANS, LONG-TERM CARE COMBINATION PRODUCTS, AND LONGEVITY INSURANCE, 2006

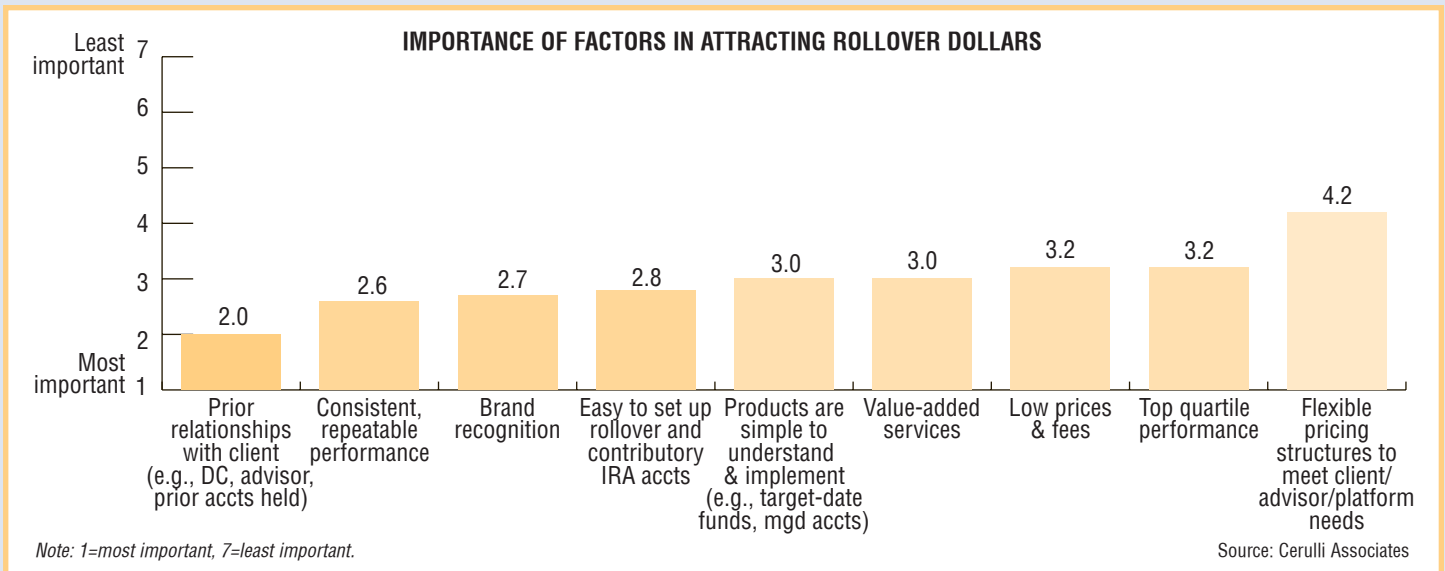


Source: Cerulli Associates

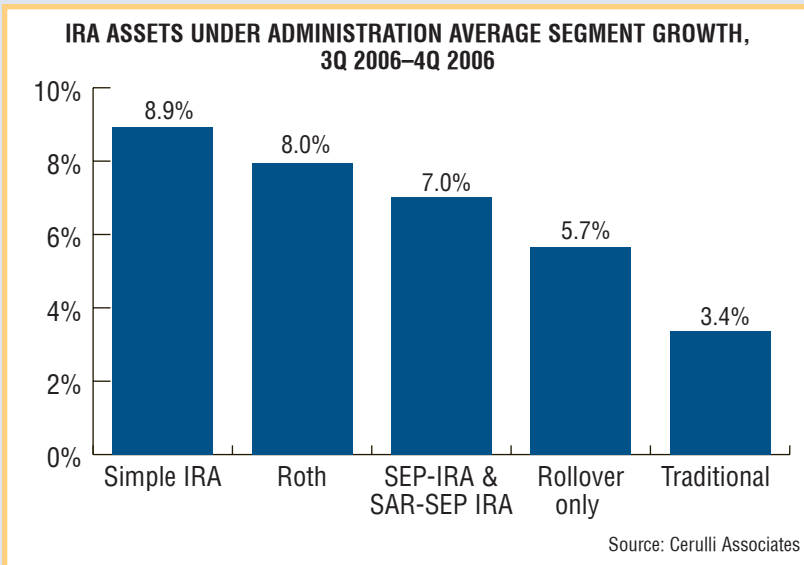
The chart above shows that advisors have different preferences in vehicle usage and process in generating retirement income for their clients. RIAs' usage of variable and fixed annuities is historically weak. In contrast, bank B/Ds and independent B/Ds frequently use deferred variable annuities to generate retirement income for their clients.

As illustrated in the chart at left, of the three high-profile applications of annuities, developing annuity options within 401(k) plans is the most promising, with 42% of insurers surveyed stating that they are highly likely to pursue this opportunity. Annuitization rates have historically been low, so this will not be an overnight development.

INDIVIDUAL RETIREMENT ACCOUNTS



Prior relationships with clients was rated as the most important aspect of attaining the coveted rollover dollars. Consistent performance and brand recognition were close behind, followed by the ease of setting up the rollover. Making the product known through prior relationships and branding seem to be the most imperative, but enabling an easy, pain-free transaction is also important. Interestingly, flexible pricing structures and performance took a backseat to marketing and communication drivers.



As seen in the chart at left, total IRA assets among survey respondents grew at a strong rate for the quarter, driven by the rollover-only segment. The traditional segment had the weakest growth.

LEADING FIRMS REPORTING ASSETS UNDER ADMINISTRATION (\$ billions)

1. Fidelity Investments	\$539.2
2. Charles Schwab	292.7
3. Wachovia	159.8
Leaders' total IRA assets	991.7
Respondents' avg. IRA assets	189.8
Total estimated IRA market	\$4,049.0

Source: Cerulli Associates



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For more information about this event and others, please contact Lindsey Warfel at 617.437.1098 x106 or lwarfel@cerulli.com.