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Prudential's Four Pillars of Retirement Series

# The Four Pillars of U.S. Retirement

## A Framework to Discuss How Americans Will Prepare for and Live in Retirement

Prudential

Growing and Protecting Your Wealth®

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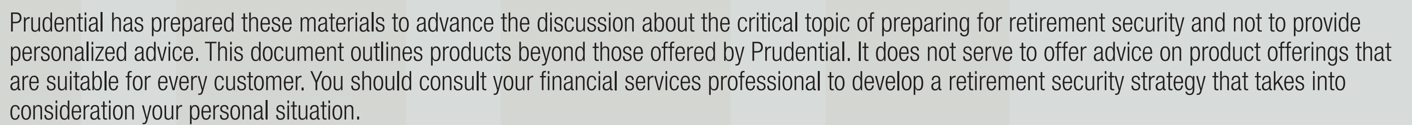

Prudential has prepared these materials to advance the discussion about the critical topic of preparing for retirement security and not to provide personalized advice. This document outlines products beyond those offered by Prudential. It does not serve to offer advice on product offerings that are suitable for every customer. You should consult your financial services professional to develop a retirement security strategy that takes into consideration your personal situation.

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# The Four Pillars of U.S. Retirement

Prudential has developed the "Four Pillars of U.S. Retirement" as a framework to discuss how Americans will prepare for and live in retirement.

The Four Pillars have their origin in the traditional "three-legged stool" of retirement security: Social Security, Employment-Based Plans, and Personal Savings. To this, Prudential has added a fourth Pillar, Retirement Choices, to capture lifestyle and financial choices that are taking on greater significance given the changing nature of retirement in America.

There are many investment and insurance products that can play a part in saving for retirement, generating retirement income, and protecting retirement assets. Several of these products are referenced in the Pillars below. For purposes of this paper, any given product is shown in only one Pillar. In practice, many of these products span multiple Pillars.

For most Americans, no one Pillar is sufficient to meet retirement income needs. To save and plan effectively for a secure retirement, individuals should consider all Four Pillars.

| Social Security | Employment-Based Plans | Personal Savings | Retirement Choices |
|---|---|---|---|
| A social insurance program that provides retirement benefits as well as survivor and disability benefits. | Retirement plans available to individuals through their public, private, or not-for-profit employers, including:<br>• Defined Contribution plans, such as 401(k) and profit-sharing plans<br>• Defined Benefit pension plans<br>• Non-qualified and stock option plans | Products and platforms for the individual investor, which can be used to supplement Social Security or employment-based plans. These include*:<br>• IRAs<br>• Annuities<br>• Bank deposits<br>• Mutual funds<br>• Individually held securities | Lifestyle and financial choices that play a significant role in retirement security.<br>Lifestyle choices including:<br>• When to start retirement<br>• Whether to work in retirement<br>• Where to live<br>Financial choices including how to:<br>• Allocate assets in retirement<br>• Convert assets to income<br>• Protect assets and income |

*With the exception of bank deposits, products listed are not bank guaranteed/not FDIC insured/may lose value.

# The Importance of a Holistic Approach

## SOCIAL SECURITY

Though the nature and reliability of Social Security is a hot topic today, the fact is that, on average, Social Security replaces about 40%[1] of income. On the other hand, the national discussion on Social Security brings into sharp focus the need for Americans to consider those sources of retirement income over which they have more direct control—that is, the other three Pillars.

## EMPLOYMENT-BASED PLANS

Today, among the roughly 50% of private-sector workers who are covered by an employment-based retirement plan, only 37% are covered by a traditional defined benefit pension plan, through which they can expect to receive a guaranteed retirement income. By contrast, an increasing number of workers with retirement plan coverage—nine in 10—are covered by 401(k) or similar defined contribution plans.[2] With the shift from defined benefit (DB) to defined contribution plans (DC), responsibility for saving for and generating a guaranteed retirement income is transferred from institutions to individuals.

Among the most important things individuals covered by defined contribution plans can do today to help guarantee a secure, comfortable retirement are:

- ***Enroll***– at the earliest opportunity (historically, about one-quarter of workers eligible to participate in a defined contribution plan fail to do so).
- ***Contribute***– at least enough to get the full benefit of a company match, if one is offered, and increase contribution levels over time.
- ***Diversify***– among investments suitable to one's age and risk tolerance. Many plans offer programs to assist participants with these important decisions.
- ***Think income***– as retirement approaches, consider how best to convert your retirement accumulation into a stream of retirement income that cannot be outlived.

The Pension Protection Act of 2006 (PPA) strengthened the savings aspect of DC plans by supporting the use of "autopilot" features—including automatic enrollment, contribution escalation, investment defaults, and asset rebalancing. These features encourage more individuals to save and increase the likelihood of accumulating an adequate retirement nest egg. The next step may be for Congress to consider extending the autopilot concept to the retirement income phase, thereby encouraging more individuals to create guaranteed streams of lifetime income.

## PERSONAL SAVINGS

Whether or not Americans have access to an employment-based plan, their personal savings can be a key source of retirement income. Individuals might include assets in annuities and IRAs, as well as portions of other personal savings, in their retirement planning.

## RETIREMENT CHOICES

Because the first three Pillars may not be enough to sustain a long retirement, retirees will increasingly have to make choices such as how to allocate assets, convert savings to retirement income, and protect assets and income for those who depend on them. Hand in hand with these financial considerations are lifestyle choices, such as whether and how to work in retirement and where to live.

While these retirement choices are not new, they take on new significance in the face of the market trends that put increased pressure on the first three Pillars and increased responsibility on individuals' shoulders.

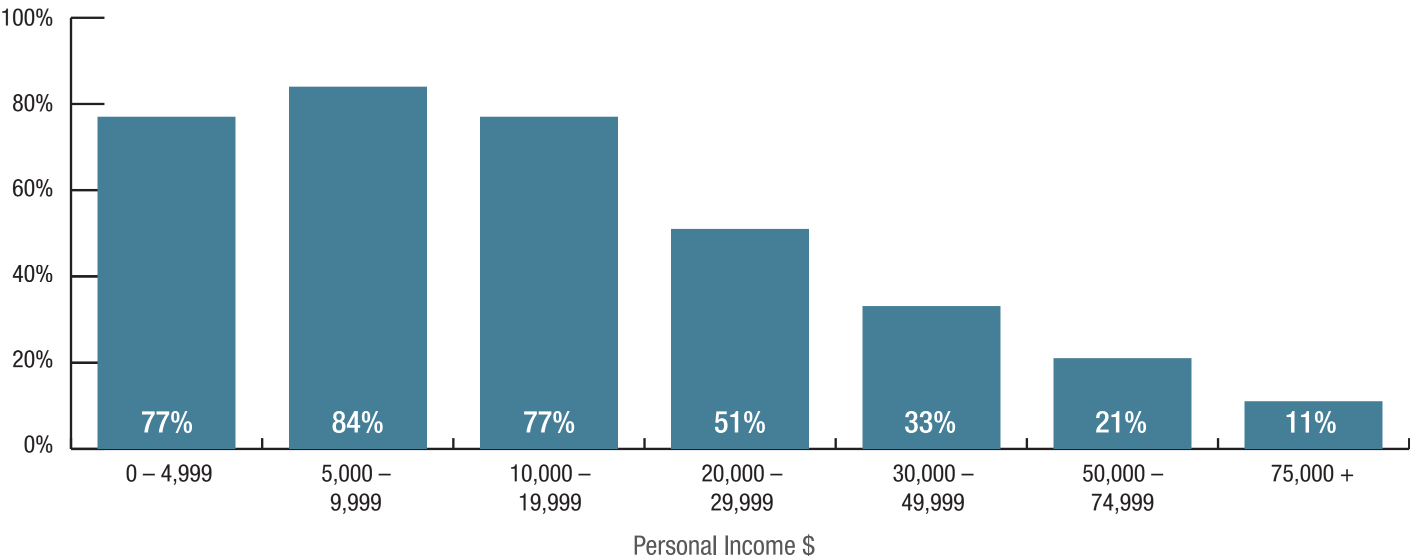
Whether saving through plans offered at their place of work or on their own, Americans should remember the basics: start saving early, save more, and seek financial advice to develop a retirement plan that encompasses each of the Four Pillars.

# Social Security

The Social Security Act of 1935 created, among other provisions, a social insurance program to provide income for retired workers. Over time, this program was extended to dependents of retired workers and surviving dependents of deceased workers, and the scope of the system was broadened with the addition of disability insurance. The entire program is now collectively referred to as Old Age, Survivors, and Disability Insurance, or OASDI. In the context of retirement security, the retirement benefit aspect of OASDI ("Social Security") is perhaps most relevant.

Social Security provides a base level of retirement income. The higher a retiree's income in retirement, generally, the lower the percentage of that income is received from the Social Security benefit.

## Percentage of Personal Income Represented by Social Security for Individuals Age 65+, 2006




Source: U.S. Bureau of the Census, March 2007 Current Population Survey.

The average monthly payment received by today's retirees is $1,050.[3] The maximum monthly Social Security retirement benefit is $2,185 for a worker retiring at age 65 years and 10 months, the age at which full Social Security benefits are paid in 2008.[4] Previous changes to Social Security to address future solvency issues resulted in the gradual raising of the age at which full benefits can be collected, from 65 in 2002 to 67 by the year 2027.[5]

The current debate on Social Security underscores the importance of:

- Maintaining focus on the key underlying issue: the need for Americans to adequately save and plan for generating a reliable stream of retirement income
- Recognizing all Four Pillars of retirement security
- Optimizing retirement income from the Second, Third, and Fourth Pillars

# Employment-Based Plans

Employment-based retirement plans are an important source of retirement "wealth" for U.S. workers. Over the past 20 years, there has been a significant shift in the types of plans offered by employers, away from DB pension plans, and toward DC plans. The growth in popularity of DC plans began in the 1980s, with the introduction of the 401(k) plan.

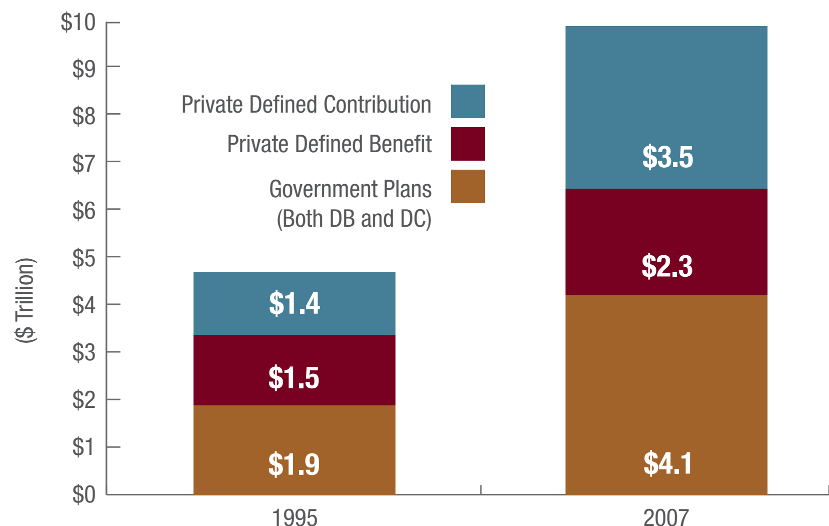
Under the DB model, the employer, through the plan, assumes the responsibility and risk for delivering a "defined" benefit: a guaranteed stream of monthly income, based on a formula typically tied to participants' salary and/or years of service.

With DC plans, however, what is "defined" is not the benefit but the amount of the contribution, which comes from employees and/or the sponsor. The amount accumulated at retirement will be based on investment performance, contribution levels, participant behaviors (trading frequency, loans, withdrawals, etc.), length of participation, and other factors. By their nature, DC plans focus attention on asset *accumulation* rather than the creation of a guaranteed stream of retirement *income*.

The transition from DB to DC plans has significant implications for individuals. While DC plans offer greater flexibility and control, individuals assume the risks associated with saving for and generating retirement income, and must make their own decisions as to contribution amounts, asset allocation, investment choices, and payout options.

### DB TO DC: QUANTIFYING THE SHIFT

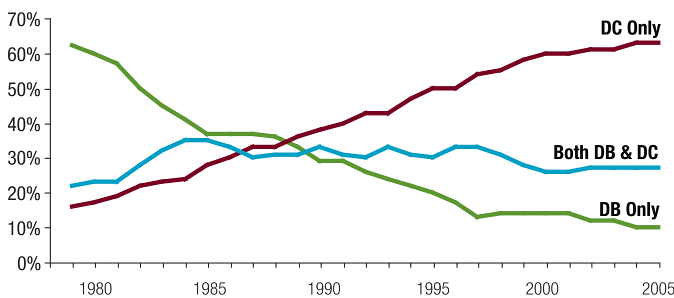
The shift from DB to DC plans is clearly seen in the relative growth of DC vs. DB assets, as well as by statistics showing the percentage of workers covered by DB vs. DC plans over time. As indicated in the chart below, for private sector DC and DB plans, DC assets grew at a faster pace than DB assets for the period 1995-2007, and private DC assets now exceed private DB assets.




Source: *Flow of Funds Accounts of the United States*, June 2008.

This translates to a sharp change in the number of workers covered by DB vs. DC plans. In 1980, 83% of private-sector workers with retirement plan coverage were covered by a DB plan and 40% were covered by a DC plan. By 2005, these coverage ratios had more than reversed.

## Participation by Plan Type for Private-Sector Employees Who Are Covered by a Retirement Plan: 1979-2005




Source: U.S. Dept. of Labor, Form 5500 Summary Report (Summer 2004); EBRI estimates for 2000 – 2005.

The shift away from traditional DB plans is also seen in the development of cash balance or "hybrid" plans. These plans, first introduced in 1988, are DB plans in which a stated percentage of employees' salaries, plus interest, is credited to personal employee accounts by the plan sponsor. Cash balance plan sponsors are required to offer an annuity form of distribution among the distribution options in their plans. Like DC plans, the balance is portable if an employee leaves a company, there is no guaranteed retirement benefit, and the decision as to whether and how to draw down the balance to create retirement income is left to the individual.

### IMPLICATIONS FOR INDIVIDUALS

DC plans do offer individuals more flexibility and control than DB plans. For example, DC plans are usually portable: When a worker changes jobs or retires, he or she has the option to leave assets in the plan, move them to a new employer's plan, roll them over to an IRA, or withdraw them as a lump sum.

But with this flexibility and control comes significant responsibility—and data would indicate that workers are not always making the right decisions to ensure a secure retirement.

- Only about three-quarters of workers who are eligible to participate in a DC plan actually do so.[6]
- Average 401(k) contribution levels are 5.4% for lower-paid employees and 6.9% for higher-paid employees[7]; often, contributions are not enough to earn the full company match. About three-quarters of companies provide a match, with the most typical being $0.50 for each dollar up to 6% of pay.[8]
- For 2006, the average 401(k) balance was $61,346 and the median was $18,986—not nearly enough to provide for a retirement that can last 20 years or more.[9]
- Only 6% of retirees who had the opportunity to receive retirement benefits in a lump sum from a DB or DC plan took an annuity option,[10] thereby generating a retirement "paycheck."

The good news is that employers and other plan sponsors have the opportunity, through the design of their DC plans, to help participants help themselves. Recent legislation has encouraged retirement savings, and proposed legislation may take this a step further.

## RECENT DEVELOPMENTS

The PPA was enacted in 2006 to increase participation and savings rates in DC plans by supporting the use of "autopilot" features in DC plans—including automatic enrollment, contribution escalation, investment defaults, and asset rebalancing. In addition, the PPA authorized plan sponsors to offer professional investment advice.

Early indications are that the PPA has been successful in facilitating the transformation of DC plans into more robust retirement savings vehicles. The percentage of employers that automatically enroll participants increased from 19% in 2005 to 34% in 2007. This is especially significant—when new hires are automatically enrolled in a 401(k) plan, participation reaches about 90% on average, compared to an average participation rate of 78% for eligible employees in all companies' 401(k) plans.[11] A Prudential study found that older workers "wish they'd had" automatic enrollment and other automatic plan features and wholeheartedly endorse these options.

Increasingly, individuals will need to view their DC plan as more than just a savings vehicle—they must also view it as a retirement planning tool from which to convert their savings and generate an assured amount of income to support the remainder of their lives. The next logical step may be for Congress to extend the autopilot concept to the retirement income phase and build on the success of the PPA by enacting measures that encourage Americans to create guaranteed streams of lifetime income.

# Personal Savings

Beyond Social Security and employment-based plans, personal savings are another important source of individuals' retirement security. Certain types of personal savings—such as assets in Individual Retirement Accounts (IRAs) and annuities—are generally considered as dedicated retirement savings. Other types of savings cover a variety of needs, including retirement.

### INDIVIDUAL RETIREMENT ACCOUNTS

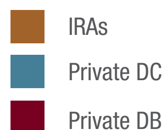
Traditional IRAs have been available since 1981 and allow tax-deductible contributions for individuals, depending upon whether the individual has an employment-based plan and the amount of the individual's income. Roth IRAs, to which contributions are non-deductible, have been in existence since 1998. Certain income limits also apply to Roth IRAs. Investment returns are tax-deferred under both forms. Withdrawals from traditional IRAs are taxable, while withdrawals from Roth IRAs are potentially tax-free.

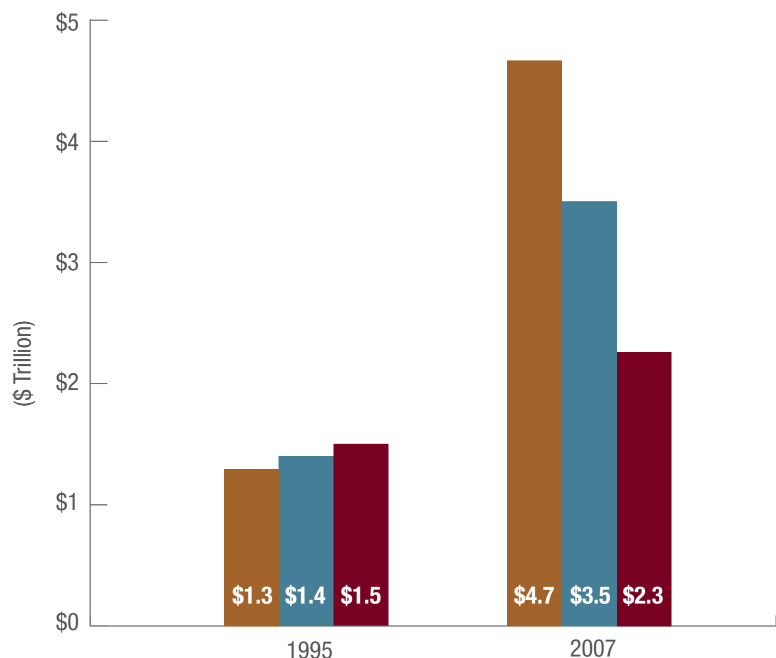
IRAs are funded either through contributions or through "rollovers" of tax-deferred assets from employment-based plans. These assets are generally available for rollover when employees change jobs or retire. In 2005, 42% of surveyed retirees rolled their retirement assets into IRAs upon retirement, and 36% of job changers rolled assets from their qualified retirement plans into IRAs upon termination.[12]

IRAs have grown rapidly over the past decade, and now represent a larger pool of assets than either private DC or private DB plans. (See chart below.)

The rapid growth in IRAs has been driven by rollovers from employment-based plans. Traditional IRA assets are projected to grow by $2.4 trillion between 2007 and 2012, $2.1 trillion of which is expected to be primarily driven by rollovers from retiring Baby Boomers.[13]

IRA, Private DC, and Private DB Assets, 1995–2005




Source: *Flow of Funds Accounts of the United States*, June 2008.

## ANNUITIES

Annuities are another form of personal savings that provide for tax-deferred growth. Though the concept behind an annuity is an insurance contract that can convert a pool of assets into a series of guaranteed* payments over a set amount of time or a lifetime, annuities are currently used predominantly as a vehicle to accumulate retirement savings.

Annuities often have protection features, such as death benefits. Death benefits can contribute to the security of the investor's beneficiaries by ensuring they receive at least the amount invested if the annuity contract holder dies before annuity distributions begin. Death benefit options can secure market gains to protect against market volatility, or guarantee a certain amount of account growth each year that would be available to beneficiaries.

Several years ago, annuity providers began introducing new protection features—often referred to as "living benefits"—which benefit annuity holders while they are still alive. Living benefit options, which are offered at an additional cost, can help protect retirement savings by locking in gains from strong investment performance and protecting invested principal against market downturns. More recently, living benefits have been introduced that guarantee lifetime income payments without requiring annuitization; with this option, individuals can elect to receive lifetime withdrawals while still maintaining control of the remaining asset balance.

### A FEW FACTS ABOUT ANNUITIES:

- Annuities can be either fixed or variable.
  - -A fixed annuity offers a fixed, guaranteed rate of return.
  - -A variable annuity offers a non-guaranteed, varying rate of investment return.
  - -Most "variable" annuities are actually combination products that offer fixed-rate and variable investment options.
  - -About two-thirds of individual annuity assets are in variable annuities, and one-third in fixed annuities.[14]
- Annuities can be either immediate or deferred.
  - -With an immediate annuity, a lump sum of assets is used to purchase scheduled payouts over a set amount of time or a lifetime. These payments must commence within one year of purchasing the annuity.
  - -With a deferred annuity, contributions are made and assets may grow over time; these assets may or may not ultimately be converted into a series of payments.
- Annuity assets are categorized as either qualified or non-qualified.
  - -Qualified annuity assets are held in tax-qualified retirement vehicles, e.g., IRAs and DC plans.
  - -Non-qualified annuity assets are held by individuals outside of qualified retirement vehicles (but asset growth is still tax-deferred).
  - -As of 2006, 60% of annuity assets (67% of variable and 42% of fixed) were in qualified vehicles.[15]

Withdrawals from both non-qualified and qualified annuities may be subject to surrender charges, income taxes and, if taken prior to age 59½, an additional 10% federal income tax penalty.

Since tax deferral is provided by IRAs and other qualified retirement plans, a variable annuity contract should be used to fund a qualified retirement plan to benefit from the annuity's features other than tax deferral, including lifetime income payout option, the death benefit protection, and the ability to transfer among investment options without sales or withdrawal charges.

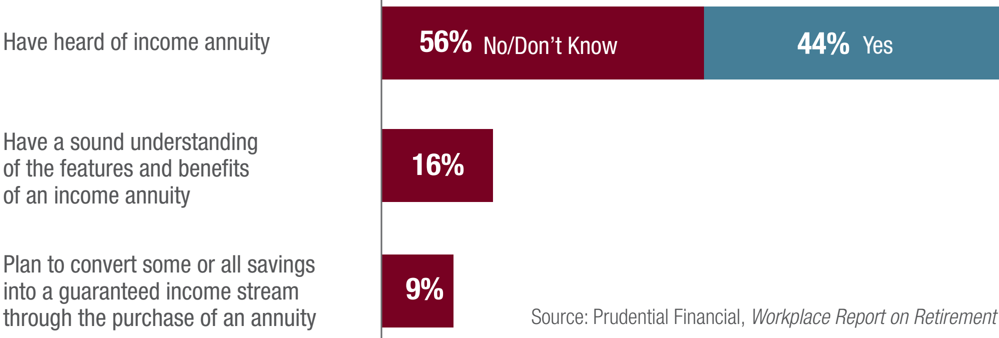
*Guarantees are dependent on the claims-paying ability of the issuing company.

However, most pre-retirees do not seem to accept annuities as a solution to their need for income during retirement. A recent Prudential Financial study found that less than half of near-retirees have heard of an income (or immediate) annuity, less than one in six have a good understanding of its features and benefits, and just 9% plan to utilize the benefits of income annuities.

Utilization of living benefits features, though, appears to be higher. A recent study of contracts with living benefits sold before 2006 indicated that 23% had at least some withdrawal activity during 2006.[16]

Other than Social Security, annuities are virtually the only way for individuals not covered by DB pension plans to receive a lifetime "paycheck" in retirement, yet extremely low rates of annuitization persist. Based on the combination of immediate annuity sales and deferred annuities that are converted to annuity payments, it is estimated that less than 1% of total annuity assets are annuitized per year.[17]

## Near-Retirees Who...

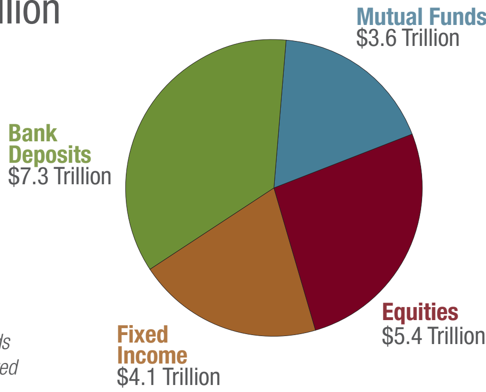



Source: Prudential Financial, *Workplace Report on Retirement Planning*, 2005.

### OTHER PERSONAL SAVINGS

In addition to assets held in IRAs and annuities, individuals save through a number of other instruments; in 2007, a total of $20.4 trillion of U.S. individual wealth was held in bank deposits, mutual funds, and individually held securities. These assets address a variety of savings objectives, including retirement.

## 2007 Other Personal Savings $20.4 Trillion

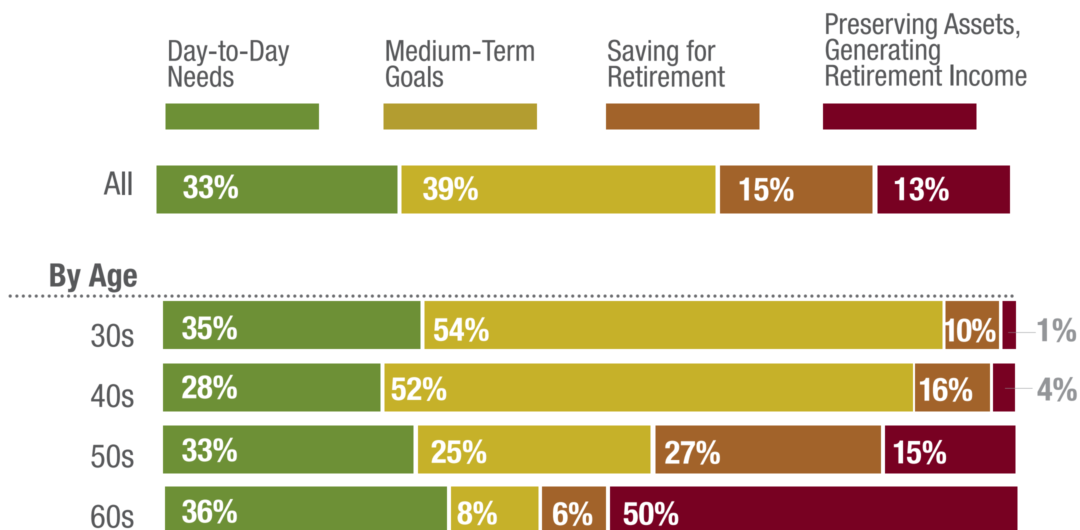



Source: *Flow of Funds Accounts of the United States*, June 2008.

## DAY-TO-DAY NEEDS IMPACT RETIREMENT SAVINGS

Though personal savings are an important source of retirement security, the reality is that more immediate needs often get in the way of saving for retirement—even for those nearing retirement age.

Concerns have also been raised about the absolute level of savings in America; the U.S. savings rate is below that of most other developed countries.[18] A stronger focus on personal savings—particularly savings for retirement—is key if Americans are to enjoy financial security in their retirement years.




Source: Prudential Financial, *Roadblocks to Retirement*, 2005.

# Retirement Choices

In addition to the three traditional sources of retirement income—Social Security, Employment-Based Plans, and Personal Savings—there is an emerging Fourth Pillar of retirement in America today: Retirement Choices.

This Pillar is becoming increasingly relevant given the convergence of a few key trends:

- Longer retirements:
  - While lifespans are increasing, the average retirement age decreased from the 1950s to the late 1990s from about age 68 to between the ages of 62 and 63.[19] However, indications are that this trend may have started to reverse. According to a recent survey, the age at which workers say they plan to retire has climbed from a midpoint of age 62 in 1996 to age 65 in 2006-2008.[20] The result is a longer retirement for many Americans.
- Rising healthcare costs and declining healthcare coverage:
  - Healthcare spending is rising at about twice the rate of inflation,[21] dramatically impacting the amount that older Americans are projected to have to spend on healthcare.
  - The trend in recent years among employers has been away from retiree health benefits. In 1993, 46% of employers with 500 or more employees offered health benefits to early retirees. By 2006, it was down to 29%.[22]

These trends, coupled with the decreasing availability of DB plans and the general insufficiency of Americans' DC plan accumulations and personal savings, give rise to some considerations that are different for today's retirees than they were for their parents.

The "Retirement Choices" Pillar is intended to capture:

- Lifestyle choices, such as when to start retirement, whether to work in retirement, and where to live
- Financial choices including how to allocate assets in retirement, convert assets to income, and protect assets and income

## LIFESTYLE CHOICES

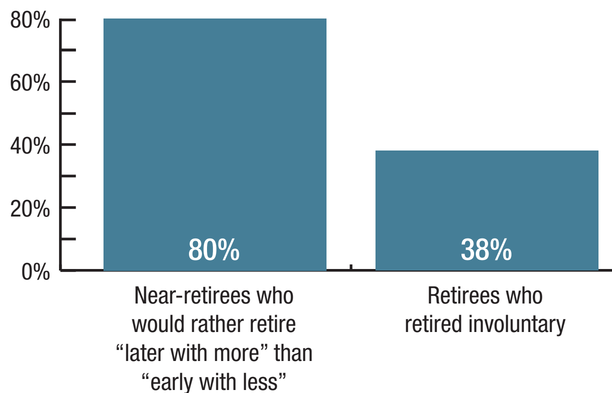
Many people have preconceived notions of what their retirement lifestyle will be, but longer years spent in retirement mean individuals have to think seriously about—or rethink—how they want to spend those years. Lifestyle choices both influence and are influenced by financial preparedness for retirement.

### When to start retirement

Many individuals have come to the realization that working longer may help provide them greater security in retirement. The benefits of postponing retirement include: more current income to cover expenses, a greater accumulation of retirement assets, and delaying the drawdown of assets.[23]

When given a choice, 80% of near-retirees would rather retire "later with more" than "early with less."[24] Yet, even though many would like to postpone retirement, the reality is that almost 40% of retirees were forced to retire earlier than anticipated. Further, 45% of these involuntary retirees were under the age of 60.[25] Downsizing, injury, health limitations, and family emergencies can contribute to unexpected early retirement. The financial impact of early involuntary retirement can be two-fold. The time people thought they had to catch up on retirement savings is cut short, and involuntary retirees often face higher costs for unexpected expenses such as medical bills.

## Intentions vs. Reality




Source: Prudential Financial, *Roadblocks to Retirement*, 2005.

### Whether to work in retirement

Increasingly, the "bright line" between working years and retirement years is morphing into a continuum—a gradual progression from more work time to more leisure time—or alternating periods of work and leisure. Many individuals indicate that they plan to work in some capacity in retirement—because they want to, need to, or both. For some individuals, working in retirement may be an extension of their previous career, or it may be an opportunity to start a second career. Individuals who choose to work may also consider, given the opportunity, whether to work full-time, part-time, or intermittently.

## Intention of Working in Retirement

| Years after Retirement | 1st 10 years | 2nd 10 years |
|---|---|---|
| Work to supplement income | 72% | 39% |
| Work for personal fulfillment | 71% | 44% |

Source: Prudential Financial, *Roadblocks to Retirement*, 2005.

Despite the desire and/or need to work in retirement, retirees often face impediments in trying to do so:

- Research shows that older workers may experience more difficulty in finding a job after having lost a job. Older workers are generally seen as more productive, particularly in white-collar jobs; however, they are also often perceived as more expensive.[26]
- Opportunities to work more flexible hours or in a phased retirement arrangement are limited. Many companies are not prepared to offer non-traditional career paths that involve fewer hours, more flexibility, or less responsibility, and, until the passage of the PPA, employers were reluctant to allow workers to simultaneously draw a DB pension and a salary due to regulatory restraints.
- Only one-third of surveyed employers would offer health benefits to phased employees—another one-third said they might.[27]

- Other financial impediments continue to face those who want to work in retirement. Individuals who are receiving Social Security but are under their full Social Security retirement age lose $1 of benefits for every $2 earned over $13,560 for years prior to the year they reach their full retirement age. Social Security retirement benefits become subject to income taxes if earnings exceed a threshold (currently $25,000 for individuals and $32,000 for couples).[28]

### Where to live

For many older adults, their homes represent the great majority of their wealth. Choices regarding homeownership, geographic location, and type of dwelling facility have lifestyle as well as financial implications.

Surveys indicate that most older Americans continue to own homes; the percentage of individuals who are homeowners (over 80%) remains stable between the ages of 60 and 80, and then declines slightly after age 80.[29]

Among those who sell their homes in retirement, some take the opportunity to move to another area for a different climate, a different setting, or a reduced cost of living. Relocating geographically can have a significant impact not only on housing expenses, but on a retiree's overall cost of living. Over half (54%) of the respondents in a recent Prudential study expect to move to a smaller home and/or to an area with a lower cost of living within 10 years of retirement.[30]

In addition to geographic location, retirees may be faced with decisions regarding the type of dwelling facility. The spectrum of housing solutions continues to evolve as the population ages, from traditional housing in traditional settings to retirement communities, assisted living facilities, and nursing homes.

## FINANCIAL CHOICES

Individuals have a number of choices to make in determining their lifestyle and related expenses, generating enough retirement income to cover those expenses, and protecting assets and income.

### How to allocate assets in retirement

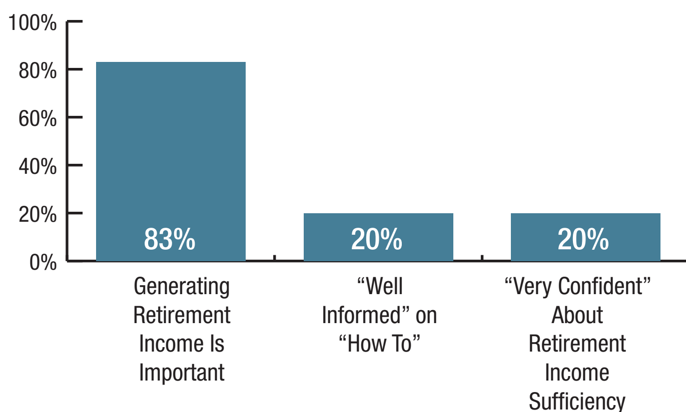
Although asset allocation is a topic most frequently discussed in the context of asset accumulation—when individuals are saving for retirement—deciding how to invest assets is also of great importance during retirement, when retirees begin to draw on retirement savings to create retirement income. In fact, there are two asset allocation questions retirees should consider. The first is the amount that should be devoted to generating guaranteed income streams. The second is the investment mix of remaining assets.

Using guaranteed cash flow streams to cover basic needs in retirement may improve the likelihood that a retirement plan will meet retirement income objectives. Using guaranteed income to meet basic needs may also allow investors to take a less conservative approach to asset allocation with their remaining assets, which, through greater exposure to investment risk, may increase the likelihood of meeting retirement income needs. For some, this two-step asset allocation strategy can produce more favorable outcomes than either step alone.[31]

### How to convert assets to income

Because the responsibility for generating retirement income has largely shifted to the individual, many retirees are faced with having to convert assets into a lifetime income stream. Only a small percentage of pre-retirees believe they are well-informed about how to do that.[32]

## Regarding Retirement Income, Percentage of Pre-Retirees Who Feel...




Source: *Prudential Financial's Fourth Annual Workplace Report on Retirement Planning,* 2005.

One simple method to create retirement income is to systematically draw down assets. A common rule of thumb is to withdraw 4% of assets each year. The advantages of this method are simplicity and control. The disadvantages are that having enough money is not guaranteed or, conversely, that retirees might unnecessarily underspend relative to their desired lifestyle expenses.

One product that is effective in generating guaranteed lifetime income is an annuity. Annuities give individuals options to invest for retirement in a tax-advantaged manner, and to derive income from their retirement investments. Annuities can protect against longevity risk, and therefore increase the likelihood of individuals having an adequate retirement income—that is, of not outliving their assets.

Guaranteed Minimum Withdrawal Benefits ("GMWBs") offer a contemporary approach to guaranteed lifetime income without requiring traditional annuitization. GMWBs guarantee that, even if the account is depleted during the lifetime of the income recipient, the insurer will continue sending checks for the guaranteed income amount for life. Unlike traditional annuitization, the individual maintains a measure of control—there is no requirement to turn over a lump sum in exchange for a monthly paycheck, and the recipient may choose to increase or decrease the withdrawals. (However, investment in specific investment options may be required. GMWBs and other "guaranteed living benefits" as options on annuity contracts are available for an additional fee. Annuity guarantees are based on the claims-paying ability of the issuing insurance company.)

Another product, longevity insurance, is a fixed annuity that converts payments made today to an income stream with a deferred start date, typically at around age 85. Longevity insurance may be appealing because of its relative cost advantage to an immediate annuity beginning at a younger age.

### How to protect assets and income

When developing retirement income plans, individuals should consider protection against the loss of assets and income that may result from a death or illness. A surviving spouse or dependent may incur financial burdens should the primary income recipient pass away and income from work, a pension, or Social Security cease or be reduced.

Life insurance pays a generally income-tax-free death benefit (IRC section 101(a)) and can be a cost-effective way to provide income to a surviving spouse and other

dependents. Another feature available in some life insurance policies is the living benefit. This benefit allows the policyholder to receive a portion of the death benefit under circumstances such as a terminal illness or an extended stay in a nursing home.*

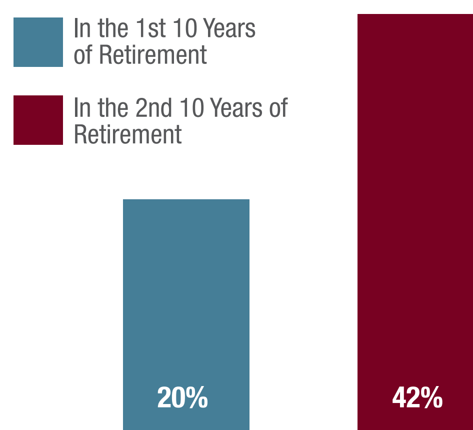
Healthcare expenses may significantly reduce an individual's retirement savings as well as the income generated from those savings. There are two types of healthcare costs to consider.

- The first type is day-to-day or periodic out-of-pocket medical expenditures. It is estimated that a 65-year-old couple with average longevity will need to have $376,000 to cover premiums and out-of-pocket expenses (assuming coverage is available through a former employer but is fully funded by the retiree) to achieve a 90% chance of having enough money to cover health expenses in retirement.[33]
- The second type of healthcare cost is associated with the potential need for long-term care. Among individuals interviewed in a study conducted by Prudential, 42% consider it likely they will require nursing home care in the second 10 years of retirement. Statistics show the likelihood of a catastrophic long-term care event in retirement for one individual of a couple is 50%. According to 2008 Prudential research, nursing home cost estimates can reach $140,000 to $240,000 for the average two- to three-year stay.[34] Individuals should consider long-term care insurance to protect against the expenses related to this type of unpredictable but potentially catastrophic event.

While an individual is still working, disability coverage should be considered as a means of protecting income. Without it, an individual may have to spend retirement savings, college funds, and other assets to meet everyday living expenses.

## Likely to Require Nursing Home Care

Among Americans 30-69 Years of Age




Source: Prudential Financial, *Roadblocks to Retirement*, 2005.

*Availability, terms and conditions of this feature vary by product and state. When a claim is paid, the death benefit is reduced and other fees may be deducted. Receipt of living benefits may be taxable and may affect eligibility for public assistance programs.

**Each of the Four Pillars—Social Security, Employment-Based Plans, Personal Savings, and Retirement Choices—plays an important role in supporting Americans' retirement security. It is important to consider all Four Pillars in saving and planning for retirement.**

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## Prudential's Four Pillars of Retirement

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