# The Four Pillars and Public Policy

## Prudential Financial's positions on legislative issues impacting retirement security in America

Prudential
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Public policy affects nearly every aspect of our everyday lives, and its impact on business is no different. There is a direct connection between public policy and Prudential's ability to provide products and services for the secure retirement of Americans.

As a thought leader on retirement issues, Prudential and its External Affairs Department have been active participants in public policy discussions in both Washington, DC and the 50 states.

**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 considerations for today's and tomorrow's retirees.**

External Affairs has developed positions on legislative issues impacting the Four Pillars of U.S. Retirement:

- Social Security
- Employment-Based Retirement Plans
- Personal Savings
- Retirement Choices

## SOCIAL SECURITY

Social Security is the foundation of Americans' retirement security. In debates over the future of Social Security, it has been generally acknowledged that while funds presently exist to pay current levels of Social Security benefits for the next 25-30 years, there is a long-term solvency problem.

It is likely that an eventual solution will involve tax increases, benefit cuts, or some combination of the two. The debate on Social Security has taken a temporary backseat to issues such as economic recovery, regulatory reform, and healthcare, but is expected to be renewed in the next few years.

## EMPLOYMENT-BASED RETIREMENT PLANS

Employment-based retirement plans are a key component in achieving retirement security for workers and their families. However, traditional employer-funded defined benefit (DB) pension plans, under which workers receive guaranteed lifetime monthly income, are no longer commonly offered, because employers are no longer able or willing to bear the unpredictability and costs of funding such plans.

Rather, over the last two decades, many employers have converted to or adopted plans with lower and more predictable costs. These include cash balance plans (a more modern "hybrid" form of DB plan) and defined contribution (DC) arrangements, such as 401(k)s, in which workers generally make the lion's share of the contributions and bear all the investment risk. This represents a dramatic shift in responsibility from employers to employees to provide for their own retirement security. The Pension Protection Act of 2006 (PPA) brought significant changes to the framework for maintaining the financial strength of DB plans while increasing worker participation in DC plans.

Prudential will continue to support efforts that help preserve DB plans, while at the same time assuring that such plans are able to meet their commitments. We will also continue to support efforts to increase Americans' retirement security through DC plans.

***Automatic Enrollment*** **–** The PPA encouraged DC plan sponsors to offer automatic enrollment by preempting state laws that prohibit employers from making automatic deductions from employees' paychecks, and protecting plan sponsors from liability for choosing default investments for workers' contributions. In addition, the provisions authorized plans to automatically increase the amount contributed by workers (which, of course, workers may opt out of) and provide certain streamlined compliance procedures. "Auto enrollment" provisions have been very successful in increasing employee participation in 401(k) plans, and discussion has begun on whether to institute *mandatory* automatic enrollment to increase participation even further.

Through its support of these automatic features, the PPA strengthened the retirement savings aspect of DC plans. Prudential believes we could further improve outcomes for workers by extending the "automatic" concept to the distribution phase, as described below.

***Encouraging Use of Guaranteed Income for Life as a Defined Contribution Distribution Option*** **–** With the continuing shift from DB to DC plans, retirees will more often be faced with the option of receiving a lump sum at retirement rather than a monthly paycheck for life. Individuals who choose to take a lump sum will run the risk of either prematurely exhausting or excessively hoarding their funds.

In an effort to encourage retirees to receive a monthly check for life rather than a lump sum payment, it has recently been proposed that a two-year "trial period" be established during which retirees would receive a portion of their DC plan funds as monthly income. It is hoped that after the trial period, participants will opt to continue receiving monthly income in lieu of a lump sum.

We support measures to provide protection from fiduciary liability for employers who make guaranteed income for life the default distribution from DC plans. We also recommend that tax incentives be approved for participants who choose guaranteed income for life, whether that income is in the form of guaranteed minimum withdrawal benefits or traditional annuity payments.

***Target-Date Funds*** – One of the PPA provisions established target-date funds as a Qualified Default Investment Alternative for DC plans. Target-date funds have become the dominant Qualified Default Investment Alternative, but still leave participants vulnerable to critical risks that threaten their ability to retire when planned, and with the desired level of retirement income. That vulnerability was demonstrated in dramatic fashion during 2008, when even target-date funds designed for participants retiring as soon as 2010 lost as much as 41% of their value. It is clear that a critical component needed for a secure retirement is still missing from today's DC plans.

Target-date funds could be strengthened by combining them with an income guarantee designed to:

- Protect future retirement income from sharp market downturns in the years immediately preceding retirement.
- Guarantee a base level of retirement income, regardless of broader market performance, for as long as the participant lives.
- Provide participants with the opportunity to increase their retirement income to protect against the potential erosion of purchasing power due to inflation.

Prudential believes that combining target-date funds with income guarantees is the logical next step to enhance retirement security, while preserving the opportunities for market appreciation, control, and flexibility that today's pre-retirees and retirees value.

***Stable Value*** – The recent market turmoil has underscored the importance of safe investment options in retirement savings vehicles such as DC plans. Plan sponsors should include among the investment options provided to their participants a stable value fund, which is one of the safest investment options possible – one that would protect a participant's principal investment, provide a predictable stream of returns, and generate sufficient returns such that growth in the participant's principal investment will at least keep pace with inflation.

Prudential believes that stable value products, with their low volatility and protection features, such as capital reserves to back guarantees, provide a compelling solution. Prudential has taken the position that the Department of Labor should reconsider its decision not to include stable value as a stand-alone Qualified Default Investment Alternative, and has made this recommendation to the Department of Labor's ERISA Advisory Council.

***Investment Advice*** – The PPA also recognized the need to improve workers' ability to make good investment choices, and authorized plan sponsors to offer professional investment advice. The effective date of a previously finalized Department of Labor regulation on investment advice has been delayed, and there will apparently be further debate on the issues. Prudential supports the offering of investment advice, including that available through long-standing, previously approved, computer-based models.

The target date is the approximate date when investors plan to start withdrawing their money. The principal value of an investment in a target date fund is not guaranteed at any time; including the target date. The asset allocation of target date funds will become more conservative as the target date approaches by lessening your equity exposure and increasing your exposure in fixed income type investments.

*Selection of an Annuity* – In addition, the PPA changed the standard for selecting annuity providers under defined contribution plans. The new, clearer standard may help encourage more defined contribution plans to offer guaranteed lifetime income forms of distribution.

*Defined Contribution Plan Fee Transparency* – As DC plans have assumed heightened importance, legislators and regulators have been focusing on enhanced fee transparency as a way to improve retirement savings outcomes for employees. The Department of Labor proposed fee disclosure regulation in 2008, but it was not finalized, as Congress continues to debate the issue. It is expected that Congress will act to move legislation on this issue forward in the next year. Thus far, Congressional hearings have focused on disclosure practices by plan service providers to employers and by employers to participants. Prudential supports useful, meaningful, and cost-effective disclosure to both employers and participants, and is working to ensure that any resulting revisions to current disclosure rules will be meaningful and beneficial.

*Coverage* – With roughly half of all U.S. workers not covered by an employer-sponsored retirement plan, there is a significant need for a formalized framework to bolster retirement savings among this segment of the population. One proposal to encourage people to save more – the Automatic IRA – would require employers who employ more than ten people and do not sponsor retirement plans to establish payroll-deduction IRA arrangements for their employees. Proponents argue that employers would not be burdened by the administrative costs of maintaining a DC plan and that, with features such as automatic enrollment and payroll deduction, personal savings would increase.

Among other possible solutions is a Multiple Employer Plan (MEP), whereby a private plan provider would establish a MEP and supply the underlying administration and investment management services. The MEP would be created for groups of employers who could enter a MEP through alliances, trade or affinity groups, geographic or regional location, or other common links. Individual participants could opt out of the program if desired.

Prudential supports measures to increase coverage through workplace savings programs, as long as such measures do not discourage new DC plan formulation or encourage existing DC plan termination.

## PERSONAL SAVINGS

Personal savings, such as individual retirement accounts, annuities, and mutual funds, are another important component of retirement security. While the personal savings rate has recently increased, Americans are still not saving enough for retirement.

*Tax Incentives for Annuitization* – With Americans living longer and spending more years in retirement than ever before, fewer people having access to traditional DB pensions, and the impact the market decline had on retirement nest eggs, there are growing concerns about the ability of retirees to manage their savings in retirement. To help address the problem of retirees outliving their assets, tax incentives have been proposed that would encourage retirees to use a portion of their DC plan accumulations or other savings to create a monthly paycheck for life, either through traditional annuitization or through annuities that offer a guaranteed stream of income for life through a guaranteed minimum withdrawal benefit.

Prudential believes that giving people the tools to manage savings to last a lifetime, such as products that offer guaranteed income for life, is a critical component of a sound retirement security policy, and encourages measures that lead individuals to consider such options.

## RETIREMENT CHOICES

In addition to the traditional "three-legged stool" of retirement security, Americans need to consider other ways to create and protect retirement income. The fourth Pillar represents lifestyle and financial choices that are taking on greater significance given the challenging nature of retirement in America. These choices are even more critical in light of the recent difficulties in the financial markets and the larger economy that have significantly impacted retirement savings.

Lifestyle choices include when to start retirement and where to live. Financial choices include how to allocate assets in retirement, convert assets into income, and protect assets and income. Life insurance, which can help protect a surviving spouse and other dependents from loss of income, and long-term care insurance, which can help cover costs for services required for protracted illness, are important components of retirement security.

Prudential was a proponent of federal legislation to expand Long-Term Care Partnership Programs; the Programs have now been expanded to include over half the states. We also support proposals to include long-term care insurance in cafeteria plans and flexible spending accounts. Finally, we support proposals to allow 401(k) plan participants to use account monies to pay for long-term care insurance.

Prudential also supports legislative and regulatory initiatives that remove barriers to nontraditional sources of income. These include proposals such as one partially addressed by the PPA that would allow people to continue working part-time while still receiving a portion of their employment-based DB pension.

## Prudential's Four Pillars of Retirement

The Four Pillars of Retirement represent the foundation of retirement security today, from Social Security to the choices made in retirement. Prudential uses these pillars as a framework for research reports, press releases and other information about the retirement issues and challenges facing Americans today.

SOCIAL SECURITY

EMPLOYMENT-BASED PLANS

PERSONAL SAVINGS

RETIREMENT CHOICES

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