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# The Four Pillars and Public Policy

Prudential's positions on legislative and regulatory issues impacting retirement security in America

Prudential

Public policy affects many aspects of our everyday lives, and its impact on business is no different. It establishes a framework upon which Prudential's ability to provide products and services for the secure retirement of Americans is built.

As a thought leader on retirement issues, Prudential has been an active participant in public policy discussions in both Washington D.C., 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 Retirement 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.**

Prudential has developed positions on legislative and regulatory 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, there is a long-term solvency problem.

An eventual solution is likely to involve tax increases, eligibility changes, benefit cuts, or some combination of these measures. Recent reform proposals, such as the report of the National Commission on Fiscal Responsibility and Reform, have elevated the debate on the critical issues related to the ongoing health of Social Security.

## EMPLOYMENT-BASED RETIREMENT PLANS

Employment-based retirement plans are a key component of retirement security for workers and their families. However, the prevalence of traditional employer-funded defined benefit (DB) pension plans, in which workers receive guaranteed lifetime monthly income, has declined significantly over the last two decades, primarily in the corporate sector.

Many employers, no longer able or willing to bear the unpredictability and costs of funding such plans, have converted to or adopted plans with lower and more predictable costs. These include cash balance plans (a "hybrid" form of a DB plan) and the more common defined contribution (DC) arrangements, such as 401(k)s, in which workers contribute a percentage of their salary – often supplemented by some level of employer matching funds – and bear all the investment and longevity risks. This represents a dramatic shift in responsibility from employers to employees to provide for their own retirement security.

The Pension Protection Act (PPA) of 2006 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 as well as efforts that help ensure that employers have access to flexible strategies, such as risk transfer solutions, to meet their commitments. We will also continue to support efforts to increase Americans' retirement security through DC plans, particularly through the use of automatic features and by protecting important benefits, such as tax-preferred retirement contributions.

**Savings Adequacy**

The passage of the PPA cleared the way for the use of automatic features in DC plans that, when implemented by plan sponsors, can enhance the opportunities for workers to accumulate savings for retirement. The PPA encouraged DC plan sponsors to offer automatic enrollment, by preempting state laws that prohibit employers from making automatic deductions from employees' paychecks. To further facilitate automatic enrollment, the PPA provided for the identification of certain investments as Qualified Default Investment Alternatives, or QDIAs, and protected plan sponsors from liability for choosing such a default investment for workers' contributions. In addition, the provisions of the PPA authorized plans to automatically increase the amount contributed by workers to their DC plans. Automatic features (which always allow employees to opt out), have been very successful in increasing employee participation in DC plans and creating a path towards accumulating higher levels of savings for retirement.

Through its support of these automatic features, which apply principles from the field of behavioral finance, the PPA strengthened the retirement savings aspect of DC plans. Prudential believes outcomes for workers could be further improved by extending the "automatic" concept to the post-retirement distribution phase, when individuals need to begin drawing down DC assets to create retirement income, as described below.

**Guaranteed Retirement Income**

With the continuing shift from DB to DC plans, retirees will face the responsibility of managing distribution risks such as protecting savings from market volatility, converting savings into guaranteed lifetime income, and taking steps to ensure that they do not outlive their nest eggs.

While options to mitigate a number of savings accumulation risks already exist, corresponding distribution risks remain largely unaddressed.

The U.S. Department of Labor and the Department of the Treasury ("Agencies") have begun to consider proposals that would determine whether and, if so, how, the Agencies could or should enhance the retirement security of participants in employer-sponsored retirement plans.

We believe the Agencies and Congress can play a critical role by promoting a number of important measures that would provide support for employers and improve the retirement security of American workers.

*Education –* All stakeholders in the retirement plan industry need to change the way they provide retirement education to workers. In large measure, education has focused primarily on helping participants make informed investment decisions to accumulate assets. Absent in many educational efforts has been a focus on the management of assets during the post-retirement distribution phase. More can and should be done.

The workplace has proven to be a venue well-suited for delivering participant education, as it allows for education on a large scale, at a relatively low cost, and in convenient locations. The Agencies can play a role in expanding participant education to include the distribution stage by equipping plan sponsors and participants with access to educational resources through their sponsorship of publications, websites, webcasts, media campaigns, and seminars. Furthermore, the Department of Labor should amend Interpretive Bulletin 96-1 to expand its scope to the distribution phase of retirement planning and to make clear to employers that providing information and materials regarding the distribution phase, including solutions designed to generate guaranteed lifetime income, will be considered participant education and not investment advice.

*Access to and Adoption of Guaranteed Lifetime Income –* It is estimated that fewer than 20% of the nation's DC plans offer in-plan access to guaranteed lifetime income solutions. Unfortunately, legislative and regulatory changes in reaction to the shift from DB to DC plans have not sufficiently promoted access to an employer-sponsored solution that, like DB plans, would generate guaranteed lifetime income.

To address this gap, Prudential supports measures that would expand access to guaranteed lifetime income solutions, thus affording workers the opportunity to create more DB-like retirement outcomes from their DC plans. Facilitating greater access would be achieved by enacting legislation that would require all DC plans to offer guaranteed lifetime income as a distribution option. We also encourage the Department of Labor to clarify safe harbors related to the selection of lifetime income providers, as well as the use of these solutions as part of a QDIA. Together, these measures would help provide employers with a level of support and ultimately create an environment in which more workers have access to such solutions.

*Innovative and Market-Tested Solutions –* Innovation in the marketplace is spawning a new generation of lifetime income solutions that address the primary concerns that have limited greater acceptance of guaranteed lifetime income by employers and workers in the past. The most significant concern has been the requirement for individuals to surrender control of their assets. We support clarifying and simplifying the rules associated with the offering of guaranteed lifetime income solutions to ensure that plan sponsors have the ability to select from a number of lifetime income solutions, including new products such as Guaranteed Minimum Withdrawal Benefit (GMWB)[1] products that provide and protect lifetime income while affording flexibility and control over an individual's assets.

*Lifetime Income Disclosure –* Given the importance of retirement income and the need to change perceptions that a retirement account is simply a "savings account," we support enacting legislation that would require plan sponsors to disclose on participants' account statements the amount of guaranteed lifetime income that could be generated by participants' current account balances. This concept is consistent with the Lifetime Income Disclosure Act, and similar provisions were included in the Small Businesses Add Value for Employees Act (SAVE Act), both of which were introduced during the 111th Congress.

**Target-Date Funds**

One provision of the PPA established target-date funds as a QDIA for DC plans. Target-date funds have become the dominant QDIA, but they do not provide guaranteed retirement income and therefore still leave participants vulnerable to critical risks that threaten their ability to retire when planned, and with the desired level and duration of retirement income.[2] That vulnerability was demonstrated in dramatic fashion during 2008, when target-date funds designed for participants retiring as soon as 2010 lost as much as 41% of their value.

Although regulators have taken steps to reform target-date funds to provide greater disclosure and transparency, it is clear that additional measures and solutions are needed to address a critical component still missing from today's DC plans.

[1]GMWBs provide investors with the opportunity to receive a stream of guaranteed lifetime income from their assets, while also providing access to their account values at any time. GMWBs protect retirement income against the risk of falling markets while providing the potential for retirement income to increase due to rising markets. Participants have flexibility and control with respect to their assets, as well as the ability to include spousal guaranteed lifetime income benefits.

[2]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 the investor's equity exposure and increasing the investor's fixed income exposure.

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.

**Coverage by Employment-Based Plans**

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 narrow the retirement plan coverage gap and bolster retirement savings among this segment of the population. Building solutions that will enhance the existing employer-sponsored system is the best way to achieve greater access and increase participation in saving for retirement. One proposal to encourage people to save more – the Automatic IRA – would require certain employers that do not sponsor retirement plans to establish payroll-deduction individual retirement account (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.

A complementary alternative is to enhance existing Multiple Employer Plans (MEPs), which allow groups of employers to join a single DC plan sponsored by an affinity group or similar organization. MEPs can serve as a framework for a new plan, the Multiple Small Employer Plan (MSEP), that is tailored specifically for small employers, where the retirement coverage gap is most significant. The MSEP is designed to address concerns about costs and administrative burden – the two issues most often cited by small employers that discourage them from offering a retirement plan.

This new solution is intended for employers with no more than 100 employees and would allow such employers to join the MSEP through alliance, trade, or affinity groups, geographic or regional location, or other common links.

By allowing employers to pool their resources under a single plan, MSEPs could provide lower costs and simplified administration to sponsors. Participants would likewise benefit from cost savings via access to institutionally priced investments, as opposed to the retail offerings available in IRAs.

MSEPs would offer many of the best features of today's DC plans, including mandatory automatic enrollment, contribution escalation, and default investments into a QDIA. Individual participants could opt out of the program if desired.

Current regulations already provide a framework for the MSEP. However, additional legislative and regulatory actions are necessary to minimize plan design decisions, simplify alternatives for plan administrators to satisfy certain plan duties, clarify fiduciary responsibilities, and address certain tax risks.

Prudential supports measures to increase the number of employees who could benefit through workplace savings programs, as long as such measures do not discourage new DC plan formulation or encourage existing DC plan termination. We applaud the Administration's proposal to expand, improve, and strengthen the existing employment-based retirement system by doubling the Small Employer Pension Plan Startup Credit, a tax credit for part of the ordinary and necessary costs of starting a qualified plan.

**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. Prudential supports relevant and cost-effective disclosure to both employers and participants. We were encouraged by the Department of Labor's issuance of both servicer and participant fee disclosure regulations in 2010, and are hopeful that Congressional action will not be necessary.

**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. In February 2010, the Department of Labor proposed rules implementing section 601 of the PPA. Although the rules have not been finalized, we are hopeful that the offering of investment advice, including that available through long-standing, previously approved, computer-based models, will be preserved.

**Stable Value**

Recent market turmoil has underscored the importance of safe investment options in retirement savings vehicles such as DC plans. Plan sponsors should include a stable value fund – one of the safest investment options available – among investment options offered. A stable value fund would protect a participant's principal investment, and provide a predictable stream of returns.

Under the sweeping Dodd-Frank regulatory reform legislation passed in 2010, the broad and ambiguous definition of contracts constituting a swap could be interpreted to include stable value investment options. We recommend that the Commodity Futures Trading Commission and the Securities and Exchange Commission clarify the swap definition in order to exclude insurance contracts or transactions, including stable value products, from the definitions of swap and security-based swap.

Prudential believes that stable value products, with their low volatility and their protection features, such as capital reserves to support guarantees, play an important role in delivering retirement security through DC plans. Prudential has taken the position that the Department of Labor should reconsider its decision not to include stable value as a stand-alone QDIA, and has made this recommendation to the Department of Labor's ERISA Advisory Council.

## PERSONAL SAVINGS

While the personal savings rate has recently increased,[3] Americans are still not saving enough for retirement or adequately protecting assets from market fluctuations.

Personal savings, such as individual retirement accounts, annuities, and mutual funds, are another important component of retirement security.

The retail annuity market has demonstrated individuals' growing acceptance of, and demand for, guaranteed living benefits, particularly GMWBs, to provide guaranteed lifetime income. In fact, guaranteed living benefits were elected on nearly 90% of new variable annuity purchases through third quarter 2010. Solutions such as GMWBs address individuals' reluctance to annuitize by providing control, flexibility, and access to account values.

### Tax Incentives for Generating Guaranteed Lifetime Income

With Americans living longer and spending more years in retirement, there are growing concerns about the ability of retirees to manage their savings in retirement. This is particularly true now that fewer people have access to traditional DB pensions, and given the demonstrated impact of market volatility on retirement nest eggs. 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 personal savings to create a monthly paycheck for life, either through traditional annuitization or through other solutions that offer a guaranteed stream of income for life, such as GMWBs.

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. Prudential 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 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 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.

## CONCLUSION

A number of legislative and regulatory changes can be enacted to enhance Americans' retirement security. Any such measures that are introduced should be focused on outcomes and be flexible enough to encourage continued innovation of retirement products and solutions.

[3]Bureau of Economic Analysis, 2010.

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