Insider

Volume 21 | Number 2 | February 2011

Towers Watson Comments on Target Date Fund Disclosure Proposed Regulations

By Alec Dike, Francis Grealy and Sue Walton

Target date funds are the predominant choice of fiduciaries for qualified default investment alternatives (QDIAs) in defined contribution (DC) plans and are popular with plan participants as well. Their growing popularity emphasizes the importance of encouraging fiduciaries to be prudent in selecting and monitoring target date funds, and of helping participants better understand their features, design and intended operations.

Towers Watson recently submitted comments to the Department of Labor (DOL) on its proposed amendments to regulations on QDIAs and to disclosures required for participant-directed investments as they relate to target date funds. The comments address identifying assumptions in disclosures, the effective date, benchmarking and considerations for plan fiduciaries in choosing target date funds.

Proposed amendments

The DOL's proposed amendments to its participant-level disclosure regulations for target date funds would require participant notices to disclose more specific investment-related information, including:

- The age group for which the investment is designed
- The relevance of the date in the fund's name
- Any assumptions about contribution and withdrawal intentions on or after such date
- The investment alternative's asset allocation
- How the asset allocation will change over time
- The point in time when the investment will reach its most conservative asset allocation (including a graphic representation, e.g., a chart or table that illustrates the change in asset allocation)

Similar requirements are added for the notices issued when a target date fund is used as a QDIA.

Towers Watson's suggestions

Towers Watson made the following suggestions to the DOL.

Identify assumptions in disclosures

Disclosures should identify assumptions about the participant's other investments/asset classes. This would help participants assess whether the fund is consistent with their risk profile and other retirement assets.

Change the effective date

Towers Watson recommends the final effective date be plan years beginning on or after November 1, 2011 (assuming final publication in the *Federal Register* at least 90 days earlier). This is consistent with both the general date for new disclosures for participant-directed investments and past effective dates for QDIA rules. Thus, calendar-year plans would need to comply with the QDIA policies for the 2012 plan year.

Modify benchmark requirements

We suggest reconsidering the ERISA section 404(a) participant disclosure regulations requirement that target date funds offer a benchmark that is a broad-based securities market index. Towers Watson believes a proportionately weighted benchmark composed of broad-based indices that is tailored to the actual or intended equity, fixed-income and other holdings of a target date fund should be sufficient. Having a single benchmark would reduce potential confusion and better support participant comparisons and analysis. Changing this requirement would acknowledge the absence of a single "broad-based" glide path and the consequent absence of a single broad-based market index for target path funds.

The DOL's preamble allows a customized, proportionally weighted benchmark to be used in addition to a broad-based index, and refers to actual asset allocations as the source of such a customized benchmark. Towers Watson believes the allocations intended under the fund's asset allocation policy

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***Insider* is a monthly newsletter developed and produced by the company's Research and Innovation Center.**

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should also be allowed and might be preferable. Target date funds operate through frequent but often less than constant rebalancing. Some rebalancing aims to spread investment gains and losses to restore the current glide path position, i.e., "tactical" rebalancing. Rebalancing to move a fund along a glide path could be called "strategic." Our experience is that the frequency of both tactical and strategic rebalancing varies, with possible frequencies including daily, quarterly, semiannual and annual. Target date funds that do not rebalance daily should be allowed to report performance history based on the performance of each underlying fund using the intended policy allocations.

Similarly, the appropriate benchmark should be based on the intended policy allocations using broad-based market indices. Managers that have policy discretion to allocate along their glide path or that depart from their policy raise special considerations where the underlying principle of like-to-like comparisons is especially important. Using actual benchmark weights rather than policy benchmark weights would not adequately reflect the manager's active asset allocation decisions.

As all fiduciaries might not have access to the resources needed for a proportionally weighted benchmark specific to their glide path — and some might not agree that two benchmarks for a single fund could be confusing — we suggest allowing fiduciaries to choose among three alternatives for each target date fund:

1. A broad-based market index
2. A benchmark made up of passively managed indices that are themselves broad-based, and that are used in proportional weights to actual or intended asset allocations
3. Both (1) and (2), as two separate benchmarks. Adding (2) as a choice would allow fiduciaries to offer a single benchmark for each fund and not treat a given series of target date funds differently from all other funds. At the same time, (2) requires that any glide-path-specific benchmark be composed, at an asset class level, of broad-based indices and so should meet concerns about objectivity.

Broaden the emphasis in guidance for fiduciaries

Plan fiduciaries should be encouraged to carefully consider and evaluate alternative target date fund series. The regulations focus on glide path and fees, which are very important. However, other criteria are equally important, and we look forward to continued market innovation.

In considering additional guidance for plan fiduciaries on the processes and criteria intended to support prudent selection and monitoring of target date funds, Towers Watson urges the DOL not to formulate an all-inclusive list of criteria or processes but instead focus attention on other facets of risk assessment, while also noting that, as markets evolve, new criteria will likely emerge.

A non-exclusive list would include such considerations as active versus passive strategies, the degree of alignment of underlying managers with managers of other investment menu choices, the potential for using glide paths and managers that are not affiliated with other providers, the use of alternative asset classes, and implementation strategies and tactics.

Conclusion

The increasing importance and ongoing evolution of target date funds make it important that the proposed DOL guidance on target date fund disclosure requirements be informed by the experience and perspectives of active DC plan practitioners. Towers Watson is appreciative of the opportunity to comment and will monitor future regulatory and market developments.

Education and Communication About DC Plans: Results and Analysis From the 2010 Survey of DC Plan Sponsors

By Tomeka Hill

Many employers have closed or frozen their traditional defined benefit (DB) plans over the past decade, leaving increasing numbers of American workers to rely on their defined contribution (DC) plans, such as 401(k) plans, as their primary retirement savings vehicle. This has shifted investment and savings risk from plan sponsors to employees, who are now more fully responsible for building up an adequate retirement nest egg.

While this trend might suit investment-savvy workers who prefer an easy-to-understand, portable retirement benefit, other workers may need help determining how much to save and aligning their investments with their risk profiles. Workers who are much less engaged might need a nudge to participate at all. The recent economic crisis has shaken the confidence of DC plan participants, many of whom now fear their plans will not see them through retirement.

Plan sponsors are also concerned about their employees' saving and retirement behaviors. Participants without DB plans who don't save enough or fail to manage their investments well are more likely to delay retirement, which could create unpredictable retirement patterns and significant costs and disruption to business operations.

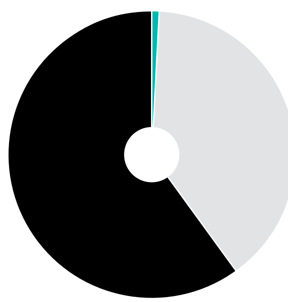
In response to these issues, plan sponsors are using education and communication to help participants map out a path to a financially secure retirement. Towers Watson's 2010 Survey of DC Plan Sponsors asked plan sponsors how they now use education to help participants manage their DC plans.

New communication

In late 2008 and early 2009, 401(k) plan participants saw their account values nose-dive. From mid-2009 through 2010, however, stock values surged. To help participants manage these dramatic fluctuations, 39% of plan sponsors (and/or vendors) provided new communication about the DC plan in the last year (see *Figure 1*).

> "The recent economic crisis has shaken the confidence of DC plan participants."

Figure 1. Change in DC plan communication from the plan sponsor or vendors in the last year



Source: Towers Watson's 2010 Survey of DC Plan Sponsors.

Figure 2. Change in emphasis when communicating with employees in last few months compared with early last year

	Significantly stronger emphasis	Stronger emphasis	Same emphasis	Less emphasis	Significantly less emphasis	Not applicable
Diversification of participant asset allocations	6%	40%	51%	1%	0%	1%
Participating in DC plan	8%	29%	60%	4%	0%	0%
Increasing awareness of available plan features	5%	29%	61%	2%	0%	3%
Increasing contribution levels	3%	27%	67%	2%	0%	1%
Retirement income adequacy	4%	25%	65%	1%	0%	5%
Decision making within context of broader, current economic environment	2%	26%	63%	2%	1%	7%
Description of default investment option	5%	20%	70%	2%	0%	3%
Decision making within context of total benefits	3%	18%	71%	1%	0%	7%
Fee transparencies	2%	16%	73%	1%	1%	7%
Retirement distribution options	2%	8%	82%	2%	0%	5%
Taking loans or in-service withdrawals	0%	9%	80%	5%	1%	5%

Source: Towers Watson's 2010 Survey of DC Plan Sponsors.

"The evidence suggests that changing plan communications may affect employees' savings behavior."

We also asked plan sponsors whether they had changed their communication emphasis on different aspects of their DC plan in 2010. Forty-six percent of respondents put a significantly stronger or stronger emphasis on diversification of asset allocations, and 37% a significantly stronger or stronger emphasis on the importance of participation (*Figure 2*). However, most employers did not increase their focus on retirement distribution options, loans or in-service withdrawals.

The evidence suggests that changing plan communications may affect employees' savings behavior. Fifty-three percent of plan sponsors whose participation rates increased during the past six months (late 2009 to early 2010) also put a significantly stronger or stronger emphasis on communicating the importance of plan participation (*Figure 3*). Of plan sponsors whose participation rates stayed the same, only 29% put a significantly stronger or stronger emphasis on communicating the importance of participation. Of plan sponsors whose participation levels decreased, 38% placed a significantly stronger or stronger emphasis on participation communications.

We find a comparable relationship between higher employee deferrals in the last six months and targeted communication from the plan sponsor. Fifty-three percent of plan sponsors whose employee deferrals increased in the last six months placed a significantly stronger or stronger communication emphasis on increasing contribution levels. Of plan sponsors whose employee deferrals stayed the same, only 22% placed a significantly stronger or stronger emphasis on increasing contribution levels. Of plan sponsors whose employee deferrals fell, 31% placed a significantly stronger or stronger emphasis on increasing contribution levels (*Figure 4*).

Our findings also suggest that communicating information about diversifying assets prompts participants to make more changes to their investment allocations. Fifty-nine percent of plan sponsors reporting an increase in the volume of participant investment changes in the last six months (late 2009 to early 2010) placed a significantly stronger or stronger emphasis on asset diversification in their communication (*Figure 5*). Of plan sponsors whose participant investment changes remained constant, 42% placed a significantly stronger or stronger emphasis on asset diversification.

Of employers offering auto-enrollment, 40% also stepped up their emphasis on retirement income

Figure 3. Emphasis on participation by change in participation levels in last six months

Change in participation rates last six months	Significantly stronger emphasis or stronger emphasis on participation	Same emphasis on participation	Less emphasis or significantly less emphasis on participation
Increase	**53%**	**44%**	**4%**
No change	**29%**	**69%**	**3%**
Decrease	**38%**	**56%**	**6%**

Source: Towers Watson's 2010 Survey of DC Plan Sponsors.

Figure 4. Emphasis on increasing savings by change in employee deferrals in last six months

Change in employee deferrals	Significantly stronger emphasis or stronger emphasis on increasing contribution levels	Same emphasis on increasing contribution levels	Less emphasis or significantly less emphasis on increasing contribution levels
Increase	**53%**	**47%**	**0%**
No change	**22%**	**76%**	**2%**
Decrease	**31%**	**61%**	**8%**

Source: Towers Watson's 2010 Survey of DC Plan Sponsors.

Figure 5. Emphasis on diversification by change in volume of participant investment changes

Change in volume of participant investment changes	Significantly stronger emphasis or stronger emphasis on diversification	Same emphasis on diversification	Less emphasis or significantly less emphasis on diversification
Increase	**59%**	**41%**	**0%**
No change	**42%**	**57%**	**1%**
Decrease	**50%**	**50%**	**0%**

Source: Towers Watson's 2010 Survey of DC Plan Sponsors.

adequacy in the past year, suggesting that they are using both communication and plan defaults to encourage participation and saving. More than half of employers offering 20 or more investment options also placed a strong emphasis on diversification in the past year.

Conclusions

All participants do not share the same retirement goals, so retirement savings plans need to be flexible enough to meet a range of needs. Many plan sponsors are beefing up their communication to participants about several aspects of DC plans, and their efforts appear to be helping. Most plan sponsors are also using default features such as auto-enrollment, auto-escalations and qualified default investment alternatives. Plan sponsors realize that while using default plan features can help steer unengaged participants toward more effective savings behavior, communication and education are necessary for more engaged workers who need guidance. Effective communication can help all participants align their savings decisions with their retirement goals and gain a better understanding of how to prepare for retirement.

About the survey

Between mid-April and mid-May 2010, Towers Watson surveyed DC plan sponsors to learn how they are addressing critical issues such as plan design, investment, fees, communication and governance. This survey report reflects responses from 334 companies across a broad range of industry sectors with more than 1,000 employees and at least $10 million in plan assets. These companies have an average of 18,426 employees and together employ more than 6 million workers and hold $386.5 billion in plan assets.

For more information about the survey results and the respondents, please refer to Towers Watson's *New Strategies in Defined Contribution Plan Design: Results and Analysis From the 2010 Survey of Defined Contribution Plan Sponsors* at www.towerswatson.com/assets/pdf/3537/Towers-Watson-Plan-Design.pdf.

"All participants do not share the same retirement goals, so retirement savings plans need to be flexible enough to meet a range of needs."

Educational Institutions Must Review "Incentive Pay" Programs Before July 1, 2011

By Steve Seelig and Heidi Töppel

The Department of Education (ED) recently finalized regulations that will require institutions of higher learning to reexamine their incentive pay practices. Organizations can no longer rely on the 12 safe harbors adopted by the ED in its 2002 regulations under the Higher Education Act (HEA). Instead, they must refocus their attention to the original 1992 HEA that prohibited schools from paying bonuses, commissions or other financial incentives based — either directly or indirectly — on the success of recruiters and loan officers in securing enrollments and financial aid.

Unless lobbying campaigns to change the rules succeed, the final regulations will take effect July 1, 2011, which means institutions need to terminate any pay practices or programs that rely on the soon-to-be-defunct safe harbors. The final regulations affect variable pay, merit pay, promotion and performance review practices at both for-profit and nonprofit institutions of higher learning that are eligible for HEA financial assistance funds.

Educational institutions accepting Title IV assistance should be prepared to demonstrate their compliance with the ban, so we advise documenting the rationale for concluding pay programs do not run afoul of the rules, perhaps in concert with legal counsel. For-profit institutions might also consider a market review of public documents, including Securities and Exchange Commission filings, that disclose actions taken by "early adopters" in response to the new rules.

To comply with the regulations, educational institutions must review compensation practices and structures for everyone even tangentially involved in the enrollment and admission processes, including employees, executives and third-party contractors. A key first step will be defining the institution's risk tolerance — its willingness to risk being found in violation of the ban on incentive compensation. Some institutions might not be willing to tolerate any risk, while others might be comfortable occupying a less certain middle ground necessitated by the required application of a facts and circumstances test. Affected institutions should conduct a risk assessment by July 1, 2011, and carefully develop new practices that will be acceptable under the new rules.

Figure 1 presents Towers Watson's perspective on which activities are likely to be permissible and which are likely prohibited for institutions undertaking performance reviews or pay actions.

"Educational institutions must review compensation practices and structures for everyone even tangentially involved in the enrollment and admission processes."

Figure 1. Prohibited/permissible factors in performance/pay actions and activities

Prohibited factors	Permissible factors
1. Enrollment	1. Recruitment of foreign students (who are ineligible for financial aid)
2. Financial aid	2. Merit or salary increases not based on securing enrollments or financial aid
3. Retention of students	3. Student grades, GPAs
4. Graduation of students	4. Academic improvement
5. Matriculation of students	5. Successful athletic season
6. Program completion	6. Team academic performance
7. Any form of contact related to enrollment	7. Attending an open house
8. Top line revenue or net revenue*	8. Speaking with prospective students about the value of college education and/or virtues of attending a particular institution
9. More than two changes in base pay in a calendar year	9. Added responsibility
	10. Seniority or length of employment
	11. Student satisfaction
	12. Class sizes
	13. Rate of tuition increase
	14. Endowment-related goals
	15. Ratings or awards by external organizations (e.g., best place to work, Baldrige Award)
	16. Bond rating

* The ED appears to believe that revenue measurements cannot be separated from enrollment-based measurements because Title IV tuition assistance received by an institution is an inherent component of revenue. However, an executive compensation program that properly decoupled enrollment from revenue might be able to meet the regulatory test.

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* Dates and topics are subject to change. You will be notified of any changes via e-mail.

The Defined Contribution Plans of *Fortune* 100 Companies in 2009

By Erika Kummernuss and Brendan McFarland

Employers increasingly provide retirement benefits through defined contribution (DC) plans such as 401(k) plans. With more workers relying on these plans as their primary source of retirement income, DC plan designs affect the financial security of millions of Americans and deserve thorough evaluation and careful management.

This Towers Watson study analyzes *Fortune* 100 companies'[1] accounting reports attached to Form 5500 filings for the largest DC plans covering salaried employees for the 2009 plan year.[2] The analysis looks at eligibility and vesting rules, employee and employer contributions, and plan investments, as well as four-year trends in plan design and practices.

Most of these employers did not suspend or reduce their match to their workers' DC plans in 2009, and investment returns in these plans were strong. Automatic enrollment in DC plans is becoming increasingly popular, and while most employers continue to offer company stock as an investment, employees are slowly but steadily shifting away from it. When employers froze or closed their defined benefit (DB) plan, they tended to increase their investment in the DC plan.

As the data are publicly available, the sample is well defined and consistent, with no apparent sample bias. Some inconsistency exists, however, among a few public disclosures. Moreover, our analysis does not reflect the three *Fortune* 100 companies whose accounting reports were not available on the Department of Labor website.

Among the 97 *Fortune* 100 companies in our study, net revenue was at least $24.5 billion and DC plan assets averaged roughly $5 billion in 2009. These plans held approximately $522 billion in total DC plan assets in 2009, as shown in *Figure 1*.

Aggregate plan assets grew by 21% over 2009, with most of the growth attributable to investment gains.

Figure 1. Aggregate balance sheet of DC plans in the 2009 *Fortune* 100

	2009 ($billions)
Beginning-of-year assets	$431
Company contributions	$13
Employee contributions	$24
Rollovers, incoming transfers	$17
Appreciation/depreciation, dividends and interest (investment income)	$73
Benefit payments	–$35
Expenses, outgoing transfers and reductions	–$1
End-of-year assets	$522

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

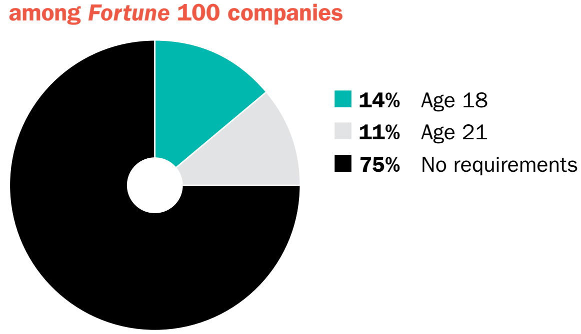
Eligibility and vesting

Most employers do not require employees to meet age and service eligibility requirements to participate in their DC plans. However, employees typically must meet a service requirement for non-matching contributions to fully vest.

Most companies have no age requirement for participation

Seventy-five percent of the analyzed companies did not require employees to be a certain age to participate (*Figure 2*). For the other 25%, the eligibility age was either 18 or 21 years old.

Figure 2. Age requirement for DC plan participation among *Fortune* 100 companies



N=95

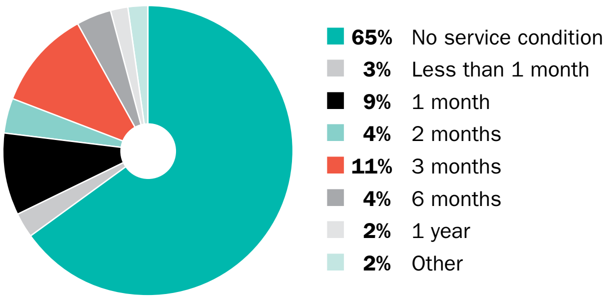
Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

"The analysis looks at eligibility and vesting rules, employee and employer contributions, and plan investments, as well as four-year trends in plan design and practices."

[1] *Fortune* magazine's annual *Fortune* 100 list consists of the largest U.S. companies based on net sales.

[2] Ninety-four percent of the *Fortune* 100 employers in this study use the calendar year as the plan year-end date as reported in Form 5500 filings.

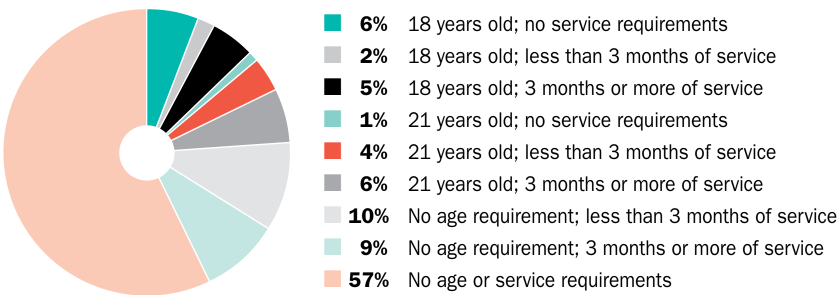
Figure 3. Service requirements for DC plan participation among *Fortune* 100 companies (employee contributions only)



N=96

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

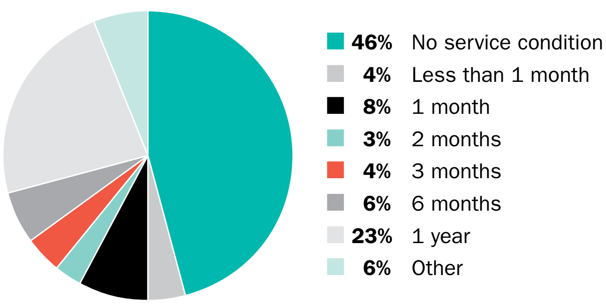
Figure 4. Combination of age and service requirements for DC plan participation among *Fortune* 100 companies (employee contributions only)



N=97

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

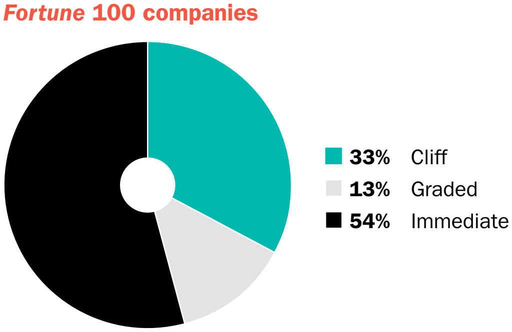
Figure 5. Service requirements for employer contributions among *Fortune* 100 companies



N=96

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 6. Vesting requirements for employer contributions among *Fortune* 100 companies



Of those who have cliff vesting (N=30)

1 year	**7%**
2 years	**30%**
3 years	**63%**

Of those who have graded vesting (N=12)

2 years	**8%**
3 years	**8%**
4 years	**17%**
5 years	**67%**

N=92

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Service requirements for participation vary

Service requirements for DC plan eligibility vary among the *Fortune* 100. Sixty-five percent of these companies had no service requirements for DC plan participation (*Figure 3*). Eleven percent required three months of service, 9% required one month of service, 2% required one year of service, and the others required varying short periods of service to participate in the DC plan.

Figure 4 depicts the combination of age and service requirements for plan participation.

The majority of companies in this analysis did not require employees to meet age or service requirements to participate in their DC plans.

Service requirements for employer contributions differ greatly

While 46% of companies had no service condition, 23% required one year of service before providing employer contributions (*Figure 5*).

Sixty-one percent of the companies reported that employees become eligible to receive employer contributions at the same time they become eligible to participate in the DC plan. The remaining 39% had more restrictive eligibility conditions for receiving employer contributions than for participating in the plan.

Employer matching contributions often vest immediately

In a majority of companies, employer matching contributions to DC plans vested immediately. Three-year cliff vesting was also common, as was a graded vesting schedule that begins during the second year of service and continues for another one to four years, typically ending with the fifth year. With cliff vesting, employees must meet the service requirement (typically three years) before they can take company contributions with them if they leave their employer. With graded vesting, the amount employees can take with them depends on how long they have worked for the company. *Figure 6* shows 2009 vesting requirements.

Matching contributions vested immediately in 54% of these companies. Of the others, 33% imposed cliff vesting and 13% applied a graded vesting schedule over two to five years of service.

Employer non-matching contributions usually take longer to vest

Employees typically must wait to fully vest in non-matching contributions (see *Figure 7*). Of the 41% of employers that offered non-matching contributions, however, 36% vested them immediately, 13% used a graded schedule, and 51% used cliff vesting. Among these companies, the three-year cliff vesting schedule was by far the most common.

Contributions and match rates

Employers with active DB plans are less likely to offer non-matching contributions

In 2009, 57% of *Fortune* 100 companies offered only matching contributions to employees' DC plan accounts (*Figure 8*). Most of the remaining companies — 38% — made both matching and non-matching contributions. Only 2% of the employers contributed nothing to their employees' DC accounts, and the other 3% made only non-matching contributions.

Of companies offering only a DC plan to their newly hired employees in 2009, 48% offered matching contributions only, 47% offered both matching and non-matching contributions, and 5% provided only non-matching contributions. Of companies that sponsor active DB plans; i.e., plans open to newly hired employees, 69% offered only matching contributions to their DC plans, 26% offered both matching and non-matching contributions, while 5% provided neither.[3]

Employers with only DC plans make higher contributions as a percentage of pay

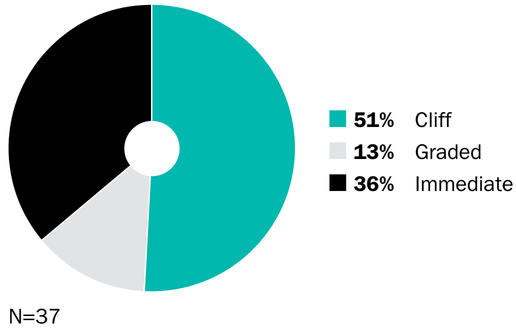
We define matching contribution amounts as the maximum match promised by the employer. In 2009, both average and median employer matching contributions to DC plans were roughly 4.5% of pay. *Figure 9* shows the distribution of employer matching contributions.

Among companies that provided non-matching contributions in 2009, 50% of such contributions were discretionary, ranging from 0 to 14% of compensation. A quarter of plans whose non-matching contributions were discretionary did not make them in 2009. For the remaining 50% of companies that offered a fixed non-matching contribution in 2009, the average contribution was 2.9% of pay, while the median was 2%.

In 2009, total contributions (matching plus non-matching) averaged 5.3% of pay, while the median was 5% of pay.

For companies that offer only a DC plan to new hires, the average and median matching contribution was 4.5% of pay in 2009. Of non-matching contributions, 47% were discretionary and the other 53% were fixed. The average and median fixed non-matching contributions were 3.1% and 2.5%, respectively. Total contributions (matching plus non-matching) made by companies offering only DC plans averaged 5.8% of pay, while the median was 5%.

Figure 7. Vesting requirements for non-matching contributions among *Fortune* 100 companies



Of those who have cliff vesting (N=20)

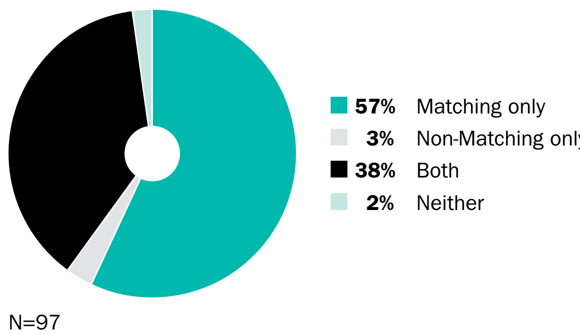
1 year	5%
2 years	25%
3 years	60%
4 years	5%
Other	5%

Of those who have graded vesting (N=5)

4 years	20%
5 years	80%

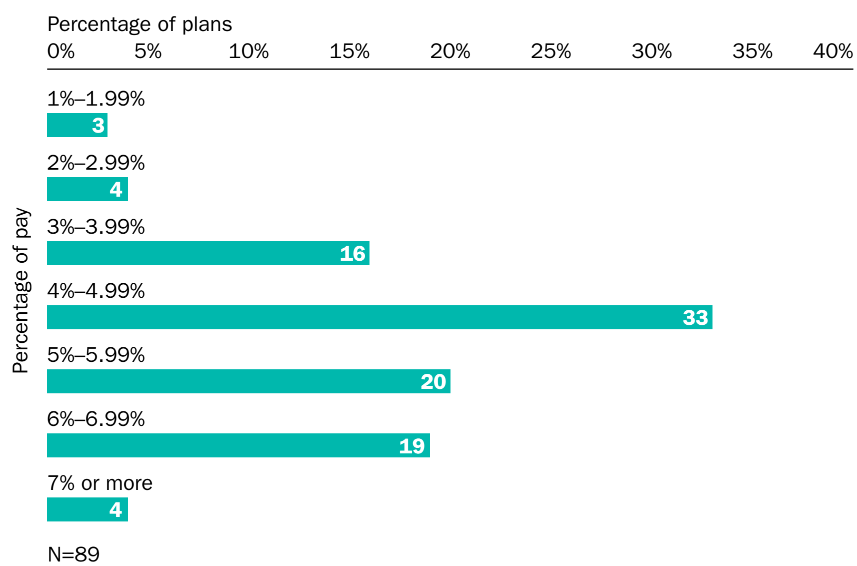
Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 8. Types of employer contributions provided to newly hired employees among *Fortune* 100 companies



Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

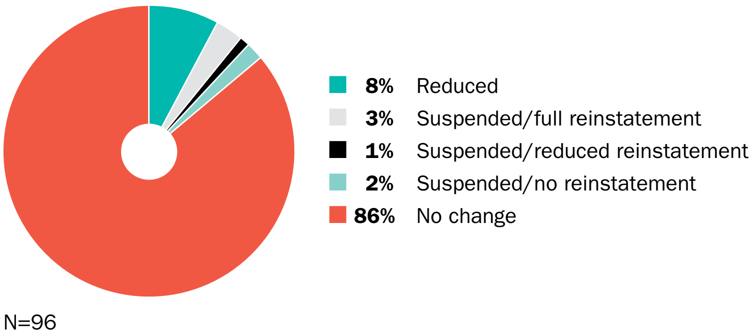
Figure 9. Distribution of employer matching contributions among *Fortune* 100*



*Three of the 92 companies that provided a match offered a fixed-dollar match.
Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

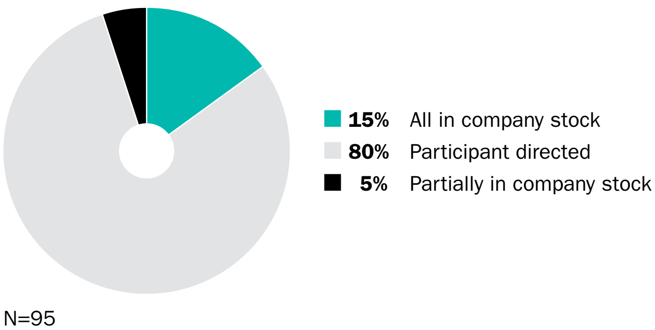
[3] Roughly 40% of companies in this analysis have an active DB plan for salaried employees, according to various other sources.

Figure 10. Match suspension or reduction over the past year among *Fortune* 100 companies



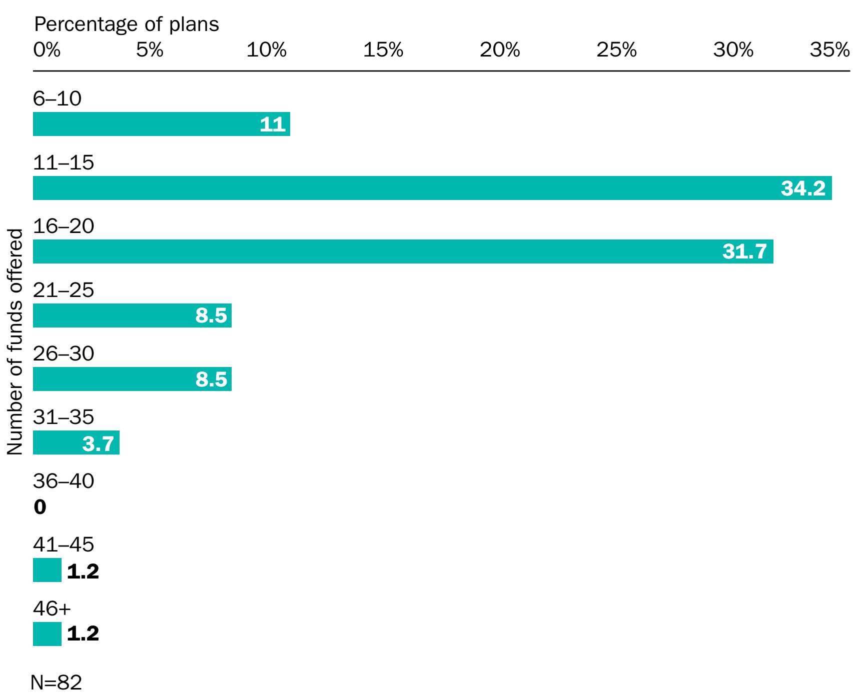
Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 11. How matching contributions are invested



Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 12. Investment funds offered in DC plans among *Fortune* 100 companies*



*This analysis considers target date funds as one investment option.
Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Of companies that offer an active DB plan as well as a DC plan, the average matching contribution was 4.4% of pay, and the median was 4.3%. Sixty percent of non-matching contributions were discretionary, and the other 40% were fixed. DB plan sponsors contributed an average (matching plus non-matching) 4.4% of pay, while the median contribution was 4.5%.

Few companies suspended or reduced their match over the past year

While the vast majority of these companies — 86% — did not suspend or decrease their plan match due to financial difficulties, 8% reduced it and 6% suspended it (*Figure 10*). Of the 6% that suspended their match, half fully reinstated it over the next year, one employer reinstated it but also reduced it, and two had yet to reinstate. For those that reduced their rate (outright or through a reinstatement), the average reduction was from 4.5% to 2.9% of pay.

Matching contributions are mostly participant-directed investments

Employer contributions to employees' accounts can take several forms. The investment might be at the participant's direction, in company stock or a combination of the two. As shown in *Figure 11*, 80% of plans allowed participants to choose their investment. Of the remaining employers, 15% made contributions solely in the form of employer stock, and 5% split their contributions between employer stock and participant direction.

Of companies that made their match in company stock, all but two allowed employees to diversify out of the company stock match immediately. One plan allowed diversification according to the plan's vesting rules, and the other allowed diversification at the next valuation date.

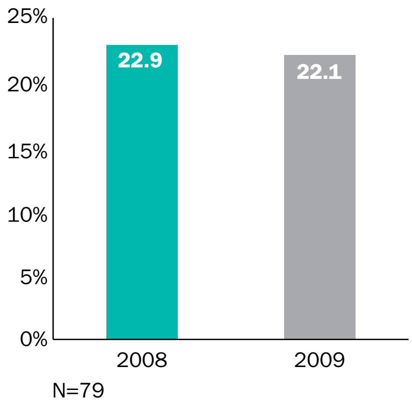
Most companies offer from 11 to 20 investment options

These *Fortune* 100 companies' DC plans offered from six to 61 investment options, with a median of 16 funds. *Figure 12* shows the distribution of the number of options offered.

Prevalence of employer stock in DC plans declines

Between 2008 and 2009, the overall percentage of net plan assets invested in employer stock declined slightly among DC plans with employer stock (see *Figure 13*). Eighty-six percent (79 of 92 companies) of all plans sponsored by publicly traded companies included some employer stock in their asset allocation. Five of the 97 companies in this analysis had no publicly traded stock.

Figure 13. Average plan assets invested in employer stock in *Fortune* 100 DC plans for companies with employer stock



Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

At the plan level, the percentage of plan assets invested in employer stock varied, as shown in *Figure 14*. Of DC plans that maintained company stock, 35% held less than 10% of plan assets in employer stock at year-end 2009, and 19% held between 10% and 20%. The majority of DC plans with company stock — roughly 80% — invested less than 30% of their assets in company stock during 2009. Only 3% of *Fortune* 100 plans with company stock invested more than 70% of plan assets in this asset class in 2009.

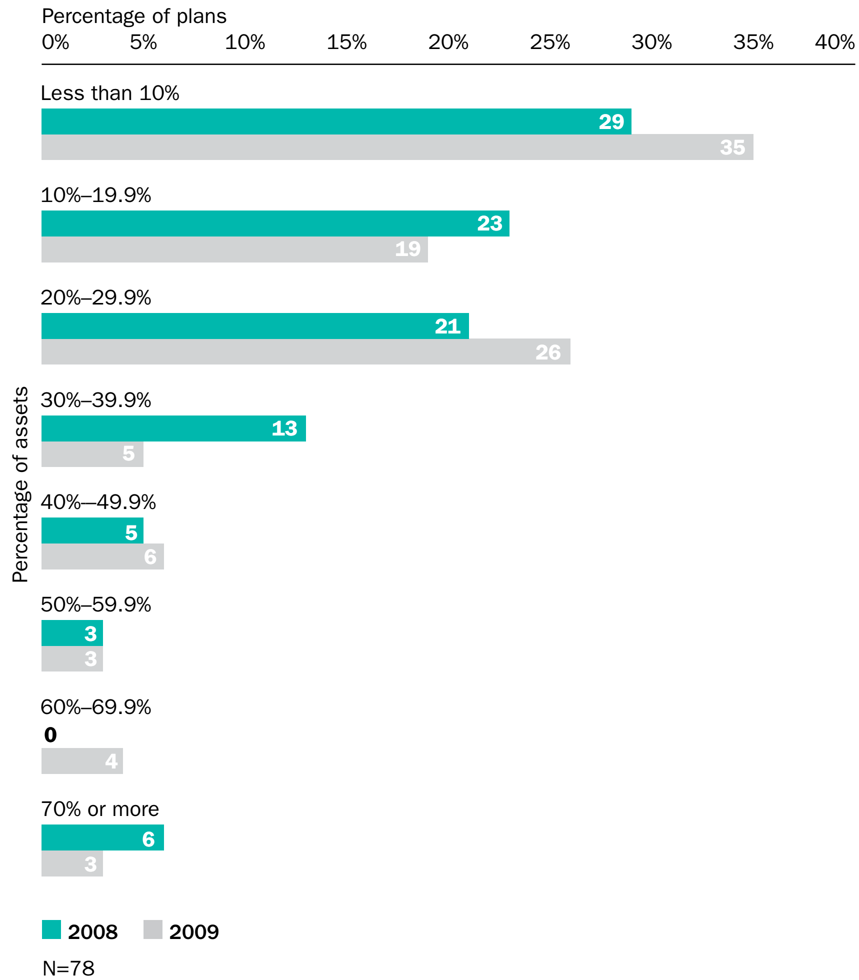
The number of plans with relatively low allocations to company stock increased between 2008 and 2009. In 2008, 29% of DC plans had less than 10% of plan assets invested in company stock, and in 2009, the percentage rose to 35%.

Investment returns were strong during 2009

We also looked at 2009 returns on assets in the DC calendar-year plans of *Fortune* 100 companies for which data are available. Overall investment returns averaged 20.4% during 2009, and the median return was 20.1%. Returns were between 15% and 25% for 60% of plans in this analysis. *Figure 15* shows the distribution of 2009 investment returns across plans. The one plan with negative returns was heavily invested in company stock, which had depreciated over the year.

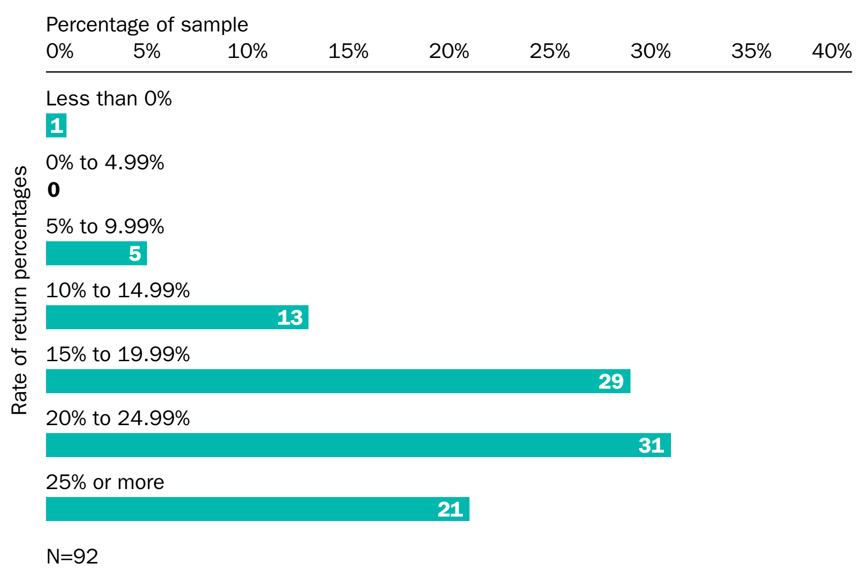
For companies in this study that also manage DB plan assets, the average return on DC plan assets was 18.9%, while the average return on their DB plan assets was 16.8%.

Figure 14. Percentage of net plan assets in employer stock in companies that maintain this investment class (2009 versus 2008)



Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 15. Distribution of *Fortune* 100 investment returns for 2009

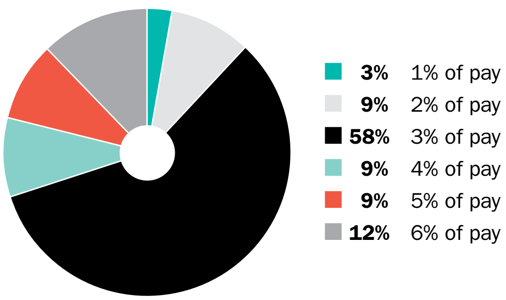


Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Automatic enrollment

Thirty-eight percent of these companies automatically enrolled employees into their DC plans. Of these, 41% also automatically increased employees' contribution percentages over time, with all but one increasing it by 1% annually. The initial default contribution percentage was most commonly 3%, although it ranged from 1% to 6%. Contributions can eventually reach 15% of an employee's salary.

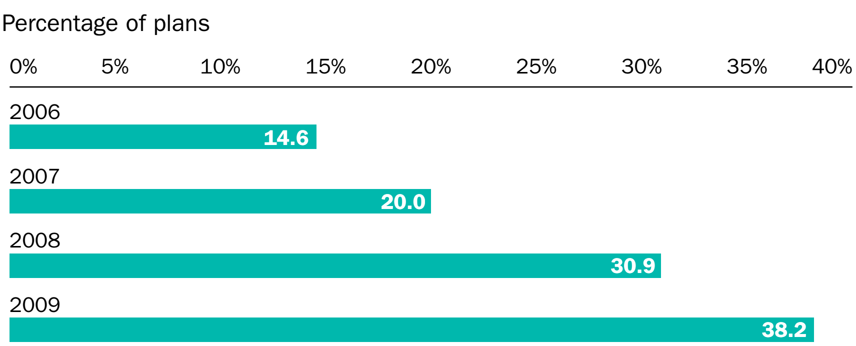
Figure 16. Default employee contribution rates among *Fortune* 100 companies with automatic enrollment



N=34

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

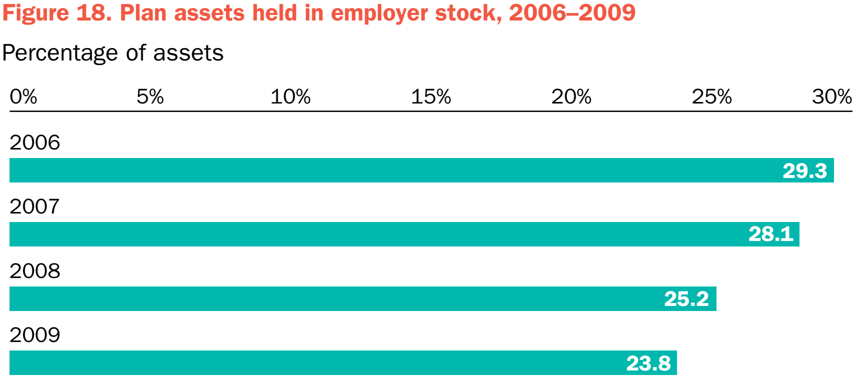
Figure 17. Automatic enrollment among *Fortune* 100 companies, 2006–2009



N=55

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 18. Plan assets held in employer stock, 2006–2009



N=53

Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure 16 shows the distribution of initial default contribution percentages for companies with automatic enrollment.

Four-Year trends

Towers Watson has been conducting this analysis for four years. To see recent trends, we analyzed data on the 55 companies that have been in our study for all four years.

Automatic enrollment is becoming increasingly popular

Among the 55 *Fortune* 100 companies in the four-year group, automatic enrollment jumped from 15% in 2006 to 38% in 2009 (see *Figure 17*).

Employer stock is becoming less popular

Employers and employees are increasingly shying away from company stock as a pension investment. Employer stock as a percentage of total assets fell in each of the last four years. *Figure 18* shows the gradual yet steady shift away from employer stock.

Investment returns have fluctuated widely over last four years

Figure 19 shows the returns on assets in DC plans over the last four years. The four-year average is 3.98%.

After freezing/closing DB plan, companies contribute more to DC plans

Of the 55 companies in the study group for the last four years, 12 froze or closed their DB plans between December 31, 2006, and December 31, 2009. It is particularly interesting to note the changes these companies made to their DC plans to offset the loss of retirement income associated with freezing or closing the DB plan, specifically in terms of contribution amounts and types.

After freezing or closing their DB plans, many of these employers added a non-matching contribution to the DC plan design. In 2006, 66% of these plans provided only matching contributions, 18% provided both matching and non-matching contributions, and 8% made no contributions. In 2009, 25% of plans provided only matching contributions, and 75% made both matching and non-matching contributions.

Many employers also increased their total DC contributions as a percentage of pay after freezing or closing their DB plan. In 2006, the average and median total employer contributions to DC plans among this group were 4.2% and 3.5% of pay, respectively. By 2009, the group's average and median total employer contributions had increased to 6.7% and 6.4%, respectively. These higher contributions, however, are not likely to fully make up for the loss in future retirement income associated with losing an active DB plan.

Conclusion

DC plans have become increasingly important to American workers. All the *Fortune* 100 employers offer DC plans, and roughly two-thirds offer them to employees of all ages with just one month or less of service. Moreover, almost all these employers offer matching contributions, and many also make non-matching contributions.

For DC plans to be effective retirement savings vehicles, however, employees must take advantage of them. Employers are moving beyond making these benefits available — they are designing plans to encourage participation, adequate savings and educated investment decisions. Of companies in this study, for example, roughly two in five automatically enroll employees in their DC plan. Assuming DC plans continue to provide an increasingly large share of retirees' income, employers will likely continue to enhance their DC plan designs and introduce new features to help employees meet their retirement income needs.

Appendix: Plan investments

Most plan assets are fair value Level 1

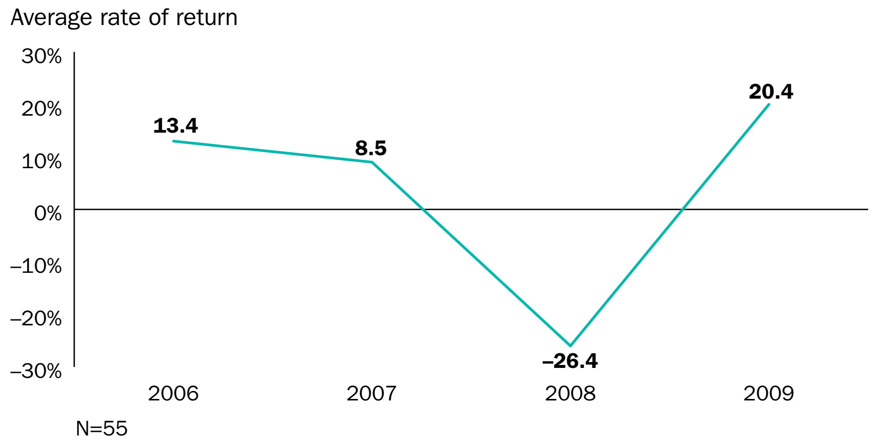
There are three asset valuation levels:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities (as is typical for Treasury securities and the common stock of large U.S. companies)
- Level 2: Unadjusted quoted prices for similar assets in active or inactive markets, or other observable inputs (as is common for corporate debt)
- Level 3: Unobservable inputs that are supported by little or no market activity

Figure A-1 depicts the aggregate (weighted by plan asset size) and simple average values reported for each fair value asset level. In both 2008 and 2009, most asset valuation was at Level 1. From 2008 to 2009, there was a shift away from Level 1 and Level 3 assets to Level 2 assets.

Fair value asset levels for DB plans are very different. For the 2009 plan year, the majority of *Fortune* 1000 DB assets were Level 2.[4]

Figure 19. Investment returns for 2006–2009



Source: Towers Watson analysis of 2009 Form 5500 filings for *Fortune* 100 companies.

Figure A-1. Distribution of assets by fair value levels

	Level 1	Level 2	Level 3	Total
2009 Aggregate	**52.05%**	**45.16%**	**2.79%**	**100%**
2009 Average (N=97)	**58.59%**	**37.78%**	**3.63%**	**100%**

	Level 1	Level 2	Level 3	Total
2008 Aggregate	**55.19%**	**40.62%**	**4.19%**	**100%**
2008 Average (N=89)	**59.00%**	**35.84%**	**5.15%**	**100%**

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2: Unadjusted quoted prices for similar assets in active or inactive markets, or other observable inputs.
Level 3: Unobservable inputs that are supported by little or no market activity.

[4] See "Asset Allocations of Corporate Pension Plans as of Year-End 2009," *Insider*, November 2010.

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TW-NA-2010-19746

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