

Perspectives



New Strategies in Defined

Contribution Plan Design:

Results and Analysis From the 2010

Survey of Defined Contribution Plan Sponsors

January 2011



Executive Summary

To be successful, a defined contribution (DC) retirement plan sponsor must consider and manage participant engagement, savings rates, investment elections, employer contributions, distribution strategies, plan expenses, and communication and education solutions. Many plans fall short of their potential to deliver benefits despite apparent success in one of these areas.

Even if the final accumulation is sufficient, the retiree may have limited choices for the actual payout approach or lack a de-accumulation strategy, which could cause the retirement strategy to fail. Overall success in a DC plan requires attention to all the components and how they integrate — or don't.

Addressing each component of a DC plan has become more challenging since the recent economic crisis. Employer concerns regarding the expense of retirement plans and the significant volatility in employees' retirement savings have increased. Participant confidence has also been shaken, leading to detrimental effects on participation and savings rates.

To better understand what employers are doing to improve the success of DC plans during these difficult economic times, Towers Watson conducted its 2010 Survey of DC Plan Sponsors. Some of our key findings on plan design include:

- DC plans are a primary source of benefits for new employees. A majority of respondents also sponsor defined benefit (DB) plans that are now inactive. Slightly more than a quarter of respondents offer a second DC plan.
- Fifty-seven percent of plan survey respondents employ auto-enrollment with the choice of opting out. Eighteen percent of all respondents auto-enroll all employees, and 39% of respondents auto-enroll only new employees. The opt-out rate among employees is very low, but slightly higher when auto-enrollment is applied to all employees rather than to just new hires. The need to offer auto-enrollment to all employees stems from employers adopting the new safe harbor plan provisions allowed under the Pension Protection Act.
- Auto-enrollment significantly improves plan participation.
- While improving participation, the initial default savings rates are often fairly low. To improve saving rates, 58% of plan sponsors that offer auto-enrollment also offer contribution escalation. Notably, auto-escalation is correlated with a lower opt-out rate.
- While auto-enrollment and escalation are already dominant, almost half of respondents not currently using these designs are planning to add them or are considering them. We expect to see continued innovation in how these designs are deployed, communicated and evaluated.
- While employers are encouraging employees to save more, they are also contemplating more effective ways of providing the company match. Almost half of employers that reduced or suspended their matching contribution during the economic crisis have moved to a new match approach.

About the Survey

Between mid-April and mid-May 2010, Towers Watson surveyed DC plan sponsors to determine how they are addressing critical issues such as plan design, investment, fees, communication and governance practices in the current environment. The survey findings reflect responses from 334 plan sponsors with more than 1,000 employees and at least \$10 million dollars in plan assets across a broad range of industry sectors. These plan sponsors have an average of 18,426 employees and a combined total of more than six million employees and \$386.5 billion in plan assets.

The following sections provide more details about our findings.

Background

Our survey respondents come from a wide variety of industry sectors (*Figure 1*); the most highly represented are Manufacturing (24%), Financial Services (including insurance) (14%), Health Care (12%) and Technology (10%).

The most popular type of DC plan offered by the respondents is the 401(k) plan (*Figure 2*). In addition to offering a DC plan, almost 60% of our respondents offer traditional DB plans, and nearly 30% offer hybrid plans, although many of these are now inactive (*Figure 3*). Slightly more than a quarter of the respondents offer an additional DC plan.

Figure 1. Respondents by industry sector

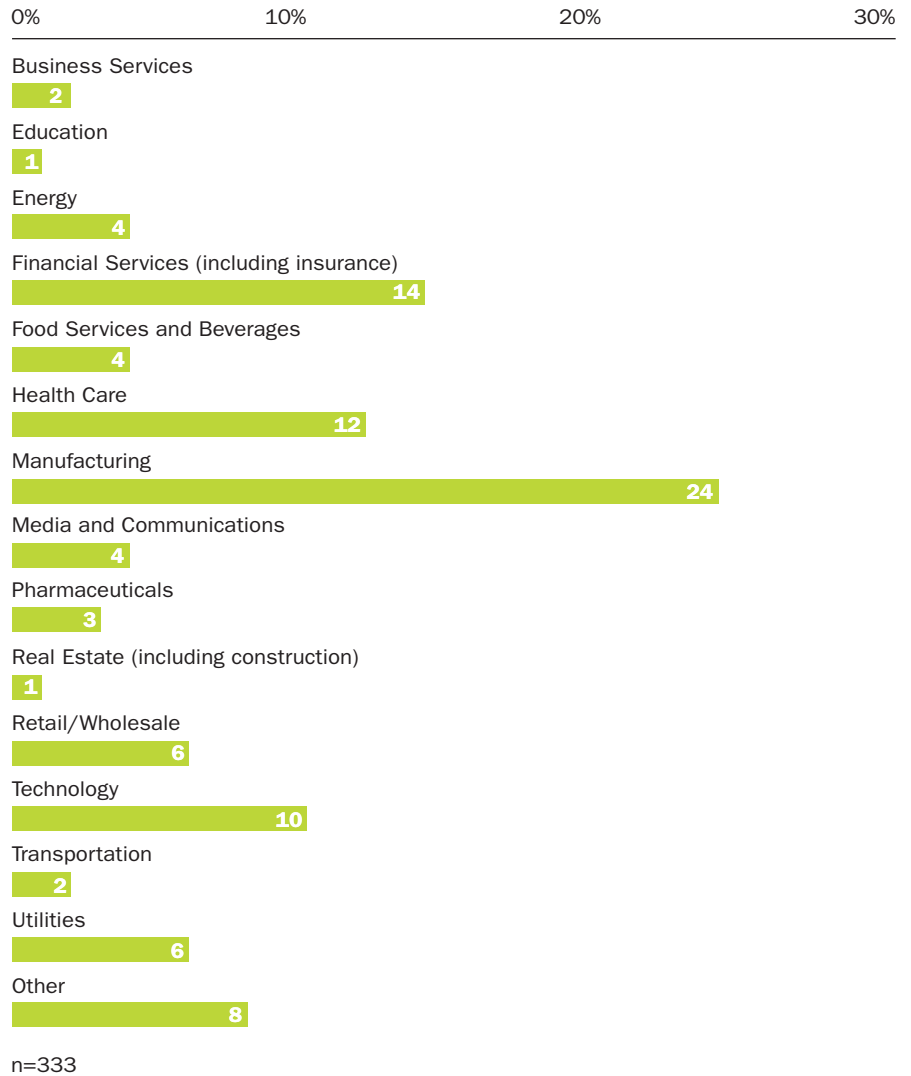
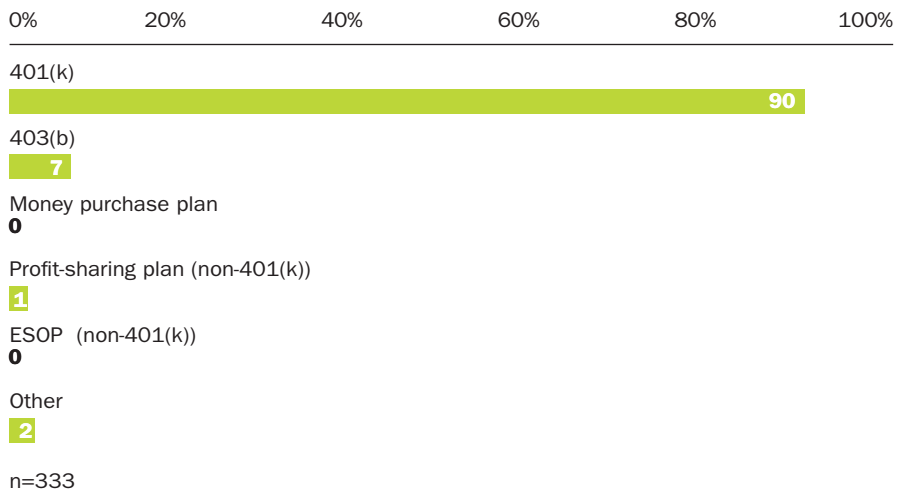


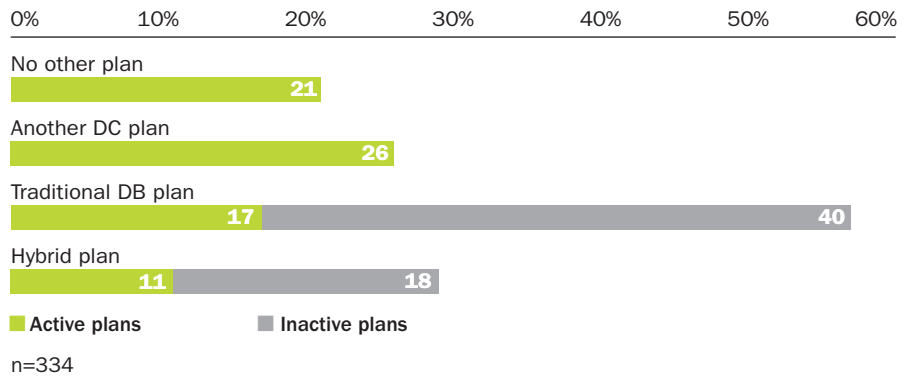
Figure 2. Type of DC plan



The DC plans offered by our survey respondents vary greatly by asset size. The plans represent a total of \$386.5 billion in DC plan assets with a median of \$477.5 million. Twenty-eight percent of the respondents reported having \$1 billion or more in assets in their primary DC plans. *Figure 4* shows the distribution of plan asset size.

Respondents to this survey represent 5.3 million total plan participants (including active participants, retirees and beneficiaries) and 3.6 million active plan participants. The plans have an average of 16,385 total participants and a median of 7,700 total participants. Active plan participants average 11,421, with a median of 5,625 active participants. *Figure 5* shows the distribution of total and active participants.

Figure 3. Other qualified retirement plans offered



Note: Because plan sponsors offer more than one type of retirement plan, the percentages do not total 100%

Figure 4. Distribution of plan asset size as of year-end 2010

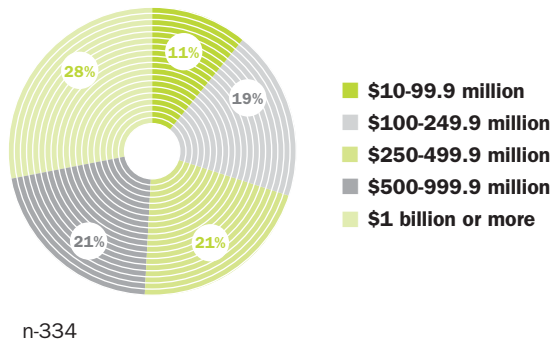
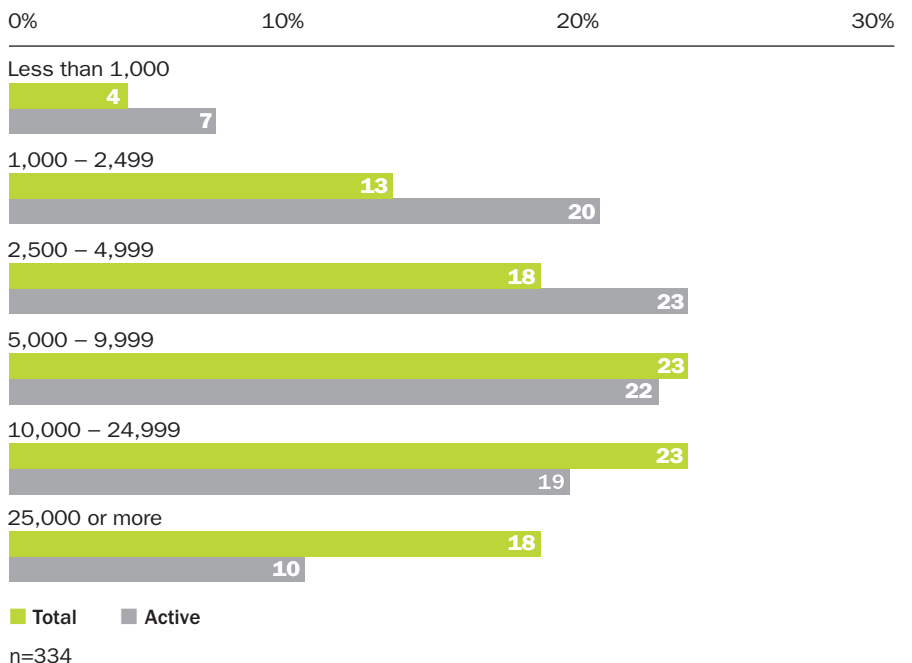


Figure 5. Respondents by number of active and total participants in DC plan



Although there are DC plans with low participation rates, overall, almost 75% of the respondents in our survey reported their participation rate is over 70% (Figure 6). Twenty percent report that their participation rate is over 90%. The percentage of plan sponsors by industry with at least 80% participation is highest among Pharmaceuticals (100%), Utilities and Energy (63%), and Business and Financial Services (54%). Figure 7 shows the distribution.

Figure 6. Participation rates

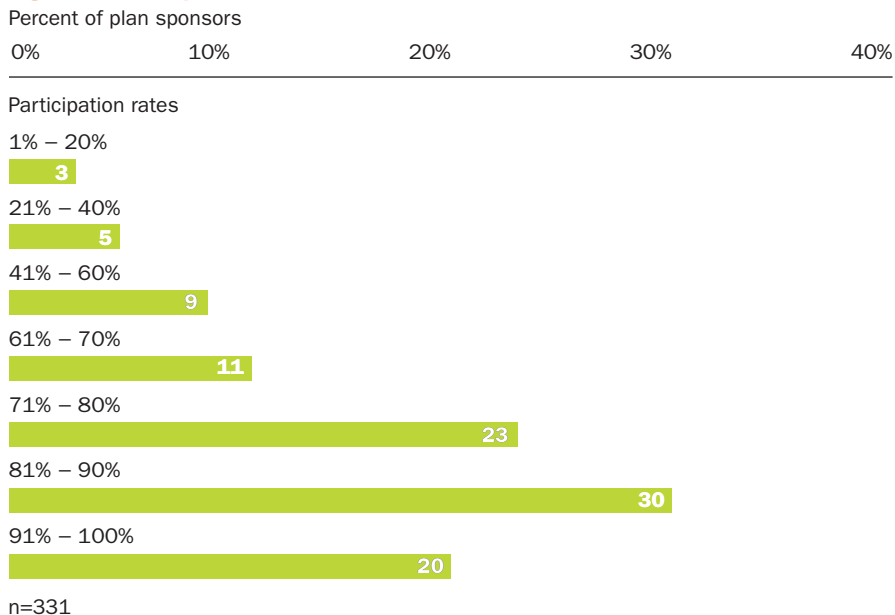


Figure 7. Participation rate by industry

Industry	1% – 40%	41% – 60%	61% – 70%	71% – 80%	81% – 90%	91% – 100%	Total
Business and Financial Services	2%	4%	12%	29%	35%	19%	100%
Food Services and Beverages	15%	23%	8%	0%	15%	38%	100%
Health Care	8%	25%	18%	20%	18%	13%	100%
Manufacturing	5%	6%	14%	25%	32%	17%	100%
Media, Communications and Technology	2%	9%	11%	25%	25%	27%	100%
Pharmaceuticals	0%	0%	0%	0%	55%	45%	100%
Retail/Wholesale	42%	11%	5%	16%	5%	21%	100%
Utilities and Energy	3%	0%	6%	29%	40%	23%	100%
Other	13%	13%	5%	28%	33%	8%	100%

n=330

Note: Rows may not total 100% due to rounding.

Plan Design

Auto-enrollment

To encourage employees to participate and save for retirement, 57% of plan survey respondents offer auto-enrollment with the choice of opting out (Figure 8). Based on the survey results, 18% of all respondents auto-enroll all employees, and 39% of respondents auto-enroll only new employees. For the remaining plan sponsors, 3% are planning to auto-enroll for 2010 or 2011, 18% are considering it and 22% are not considering it.

Auto-enrollment is most prevalent in the Manufacturing industry as 24% of those plan sponsors auto-enroll all employees, and 43% auto-enroll new employees (Figure 9). Auto-enrollment is least common in the Retail/Wholesale industry. Only 16% auto-enroll all employees, and 21% auto-enroll new employees in this industry.

Interestingly, a higher percentage of plan sponsors that have inactive (closed or frozen) DB plans use auto-enrollment (Figure 10). Only 39% of plan sponsors that have inactive traditional DB or hybrid plans do not auto-enroll, 17% offer auto-enrollment to all employees, and 44% offer auto-enrollment to new employees. Forty-three percent of plan sponsors that offer additional DC plans do not auto-enroll, 13% offer auto-enrollment to all employees, and 43% offer auto-enrollment to new employees. Plan sponsors that do not offer any additional plans are most likely not to auto-enroll. Forty-nine percent of these sponsors do not auto-enroll, only 17% auto-enroll all employees, and 34% auto-enroll new employees.

Figure 8. Auto-enrollment

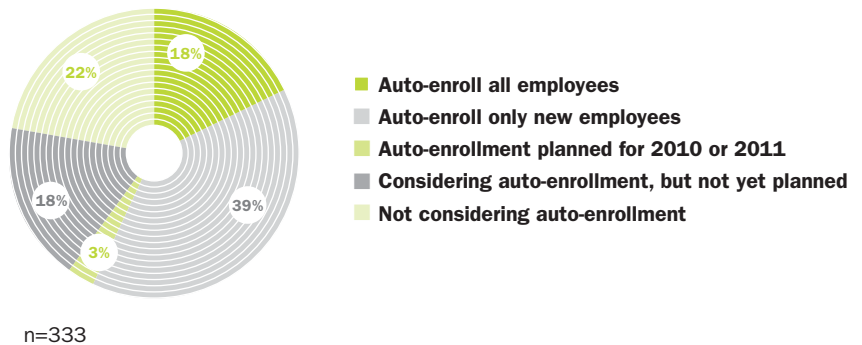


Figure 9. Auto-enrollment by industry

Industry	Auto-enroll all employees	Auto-enroll new employees	Do not auto-enroll	Total
Business and Financial Services (incl. insurance)	17%	32%	51%	100%
Food Services and Beverages	23%	38%	38%	100%
Health Care	23%	33%	45%	100%
Manufacturing	24%	43%	33%	100%
Media, Communications and Technology	18%	41%	41%	100%
Pharmaceuticals	9%	36%	55%	100%
Retail/Wholesale	16%	21%	63%	100%
Transportation	14%	57%	29%	100%
Utilities and Energy	11%	40%	49%	100%
Other	9%	50%	41%	100%

n=333

Note: Rows may not total 100% due to rounding.

Figure 10. Auto-enrollment by other retirement plans offered

	Auto-enroll all employees	Auto-enroll new employees	Do not auto-enroll	Total
Inactive traditional DB or hybrid plan offered	17%	44%	39%	100%
Additional DC plans offered	13%	43%	43%	100%
Active traditional DB or hybrid plan offered	22%	32%	46%	100%
No other plans	17%	34%	49%	100%

n=332

Note: Rows may not total 100% due to rounding.

Offering auto-enrollment has a significant impact on participation. Plan sponsors that offer auto-enrollment to all employees and to new employees have much higher participation rates compared to plan sponsors that do not offer auto-enrollment at all (*Figure 11*). Ninety-three percent of respondents that auto-enroll all employees report having a participation rate of more than 70%. Eighty-four percent of plan sponsors that auto-enroll only new employees reported a participation rate above 70%. Only 53% of sponsors that do not offer auto-enrollment have a participation rate higher than 70%.

Although all participants who were auto-enrolled in their DC plan may elect to opt out, survey respondents say that the great majority of participants stay in the plan (*Figure 12*). Fifty-three percent of plan sponsors that offer auto-enrollment to all employees report that fewer than 5% of eligible participants opt out, while only 5% report an opt-out rate of 15% or more. Fifty-nine percent of sponsors that offer auto-enrollment only to new employees say that fewer than 5% of eligible participants opt out, while 5% report an opt-out rate of 15% or more. However, it seems that offering additional DC plans increases the opt-out rate, while the sponsorship of a DB plan reduces the opt-out rate (*Figure 13*).

Figure 11. Participation rate by auto-enrollment

Participation Rate	Auto-enroll all employees	Auto-enroll new employees	Do not auto-enroll employees
1% – 20%	0%	2%	4%
21% – 40%	0%	1%	11%
41% – 60%	0%	5%	17%
61% – 70%	7%	8%	15%
71% – 80%	13%	23%	28%
81% – 90%	39%	35%	20%
91% – 100%	41%	26%	5%
Total	100%	100%	100%

n=331

Note: Rows may not total 100% due to rounding.

Figure 12. Opting out by auto-enrollment status

Percent who opt out of auto-enrollment	Auto-enroll all employees	Auto-enroll new employees
Less than 5%	53%	59%
5% – 9%	27%	28%
10% – 14%	15%	8%
15% or more	5%	5%
Total	100%	100%

n=183

Note: Rows may not total 100% due to rounding.

Figure 13. Relationship of opt-out rates to offering other qualified retirement plans

Percent who opt out of auto-enrollment	Traditional DB or hybrid plans offered*	Additional DC plans offered	No other plans
Less than 5%	57%	31%	68%
5% – 9%	28%	38%	24%
10% – 14%	11%	25%	0%
15% or more	4%	6%	9%
Total	100%	100%	100%

n=183

*Includes employers that offer both DB plans and additional DC plans

Note: Rows may not total 100% due to rounding.

Contribution Escalation

Plan sponsors need to ensure that employees are not only participating in the plan, but also saving enough. To do this, some plan sponsors have added contribution escalation to the auto-enrollment feature. Of the sponsors that offer auto-enrollment, 58% offer contribution escalation (*Figure 14*).

Contribution escalation is more common for plan sponsors that offer auto-enrollment for all employees. This may be due to the fact that combining these features is a requirement of the new (post-Pension Protection Act) safe-harbor plan provisions. It may also be because some sponsors have learned that designs with automatic features attract and retain new enrollees or because these features make DC plans more successful by increasing savings.

As noted above, offering auto-enrollment to all employees substantially improves participation relative to limiting auto-enrollment to new employees. Similarly, offering automatic escalation with auto-enrollment substantially improves savings rates relative to providing auto-enrollment without escalation. For those that offer auto-enrollment to all employees, 68% offer contribution escalation compared to 53% of those that offer auto-enrollment only to new employees (*Figure 15*).

Contribution escalation is strongly associated with higher participation rates. Seventy-nine percent of plan sponsors that escalate contribution rates have participation rates of at least 80%, while only 50% of plan sponsors that do not escalate contributions have participation rates of at least 80% (*Figure 16*).

Figure 14. Contribution escalation among those with auto-enrollment

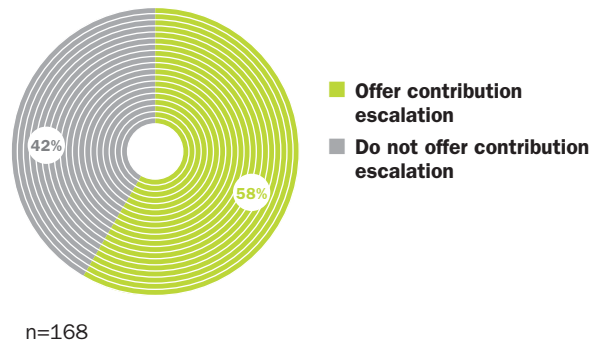


Figure 15. Contribution escalation by type of auto-enrollment

Auto-enrollment	Contribution escalation	No contribution escalation	Total
Auto-enroll all employees	68%	32%	100%
Auto-enroll only new employees	53%	47%	100%

n=188

Note: Rows may not total 100% due to rounding.

Figure 16. Participation rate by contribution escalation

Participation Rate	Contribution escalation	No contribution escalation
1% – 20%	1%	3%
21% – 40%	0%	1%
41% – 60%	2%	6%
61% – 70%	4%	13%
71% – 80%	15%	27%
81% – 90%	41%	29%
91% – 100%	38%	21%
Total	100%	100%

n=187

Note: Rows may not total 100% due to rounding.

Participants who are auto-enrolled and have their contribution rates periodically escalated are less likely to opt out compared to participants who are not offered escalation features (Figure 17). Only 1% report that more than 15% of participants opted out, while 10% of respondents that do not offer escalation have a 15% or higher opt-out rate.

Escalation features are really important if the default savings rate is low. In last year's DC plan sponsor survey, we found that plan sponsors set their initial median contribution rate at 3% and their final median contribution rate at 6%.*

Matching Contributions

Another provision that employers use to encourage participation is a matching contribution. This incentive can be useful in encouraging participation as employees are receiving "free money" for participating in the plan. Ninety-four percent of plan sponsors report that they offer a matching contribution (Figure 18). However, due to the economic recession, a minority of respondent plan sponsors have temporarily suspended their matching contribution. Since late 2008, 13% of respondents have suspended their match, and 5% have reduced their match (Figure 19).

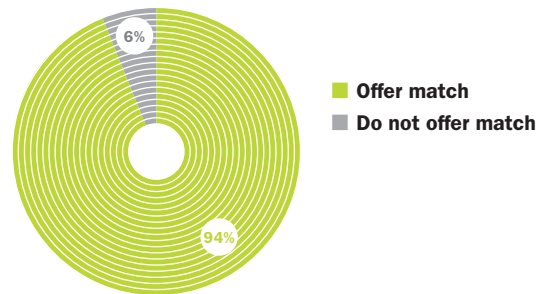
Figure 17. Opt-out rates by contribution escalation adoption for plan sponsors that offer auto-enrollment

Percent who opt out of auto-enrollment	Contribution escalation	No contribution escalation
Less than 5%	61%	52%
5% – 9%	27%	28%
10% – 14%	11%	10%
15% or more	1%	10%
Total	100%	100%

n=182

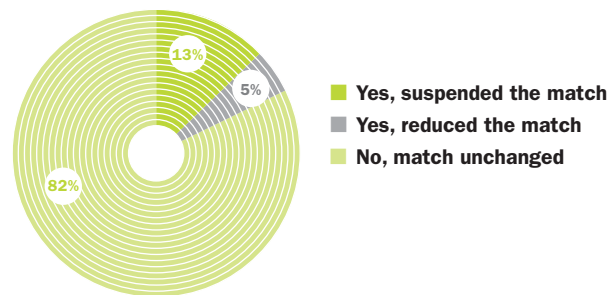
Note: Rows may not total 100% due to rounding.

Figure 18. Matching contribution



n=333

Figure 19. Suspension of matching contribution



n=312

*Managing Defined Contribution Plans in the Current Environment: 2009 Defined Contribution Plan Trend Report, Towers Watson

Plan sponsors reporting low participation rates suspended their matching contribution more often than those with higher participation rates. Twenty-one percent of plan sponsors with participation rates less than 40% suspended the match (Figure 20). By contrast, only 7% of plan sponsors with participation rates greater than 80% suspended the match.

Suspension of the matching contribution was also more prevalent in the Retail/Wholesale (27%) and Manufacturing (21%) industries (Figure 21). None of the plan sponsors in the Pharmaceutical or Food Services and Beverages industries changed their matching contribution.

With some improvement in the economy, 46% of the plan sponsors that suspended their match reinstated it, with most (37%) restoring the full match (Figure 22). For those that have not reinstated the matching contribution, most are considering reinstating the match within the next 12 months.

Figure 20. Suspension of company match by participation rates

Participation rates	Company Match			Total
	Suspended	Reduced	Unchanged	
1% – 40%	21%	11%	68%	100%
41% – 60%	22%	4%	74%	100%
61% – 70%	24%	3%	73%	100%
71% – 80%	20%	4%	76%	100%
81% – 90%	4%	8%	88%	100%
91% – 100%	3%	2%	95%	100%

n=310

Note: Rows may not total 100% due to rounding.

Figure 21. Matching contribution suspensions by industry

Industry	Suspended	Reduced	Unchanged	Total
Business and Financial Services	6%	10%	84%	100%
Food Services and Beverages	0%	0%	100%	100%
Health Care	7%	4%	89%	100%
Manufacturing	21%	5%	74%	100%
Media, Communications and Technology	20%	2%	77%	100%
Pharmaceuticals	0%	0%	100%	100%
Retail/Wholesale	27%	7%	67%	100%
Utilities and Energy	0%	3%	97%	100%
Other	17%	3%	80%	100%

n=311

Note: Rows may not total 100% due to rounding.

Figure 22. Reinstating matching contribution after suspension

Yes, we reinstated the full company match to its previous level	37%	46%
Yes, we reinstated a smaller fixed match	5%	
Yes, but the match may change year to year as it is now contingent upon certain goals being met	5%	
No, but we are currently considering reinstating something within the next 12 months	49%	54%
No, we are not currently considering reinstating the company match	5%	
Total	100%	100%

n=41

Note: Rows may not total 100% due to rounding.

Conclusions

The decision to design DC plans that better prepare employees before and at retirement has been pushed to the forefront due to the closures and freezing of DB plans in the last decade, especially during the recent economic crisis. Many plan sponsors have attempted to better engage participants by designing DC plans that encourage participation, promote higher saving rates and educate employees about their investments.

Auto-enrollment has now become dominant among large plan sponsors. We see that plan sponsors offering auto-enrollment to all employees and to new employees have much higher participation rates compared to plan sponsors that do not offer auto-enrollment. Many plan sponsors that offer auto-enrollment also automatically escalate the contribution rate. There is evidence that the use of contribution escalation along with auto-enrollment also improves participation rates when we compare the participation rates of those sponsors that escalate contributions with those that do not.

Most plan sponsors are also offering a matching contribution. This feature has been successful in helping improve participation partly because employees view it as an enticement to participate: The reward for doing so is “free money” in their account.

Due to the economic recession, suspending and reducing matching contributions has had some appeal as a money-saving tool for plan sponsors seeking to cut costs. We find that suspending and reducing employer contributions was done mostly by plan sponsors that currently have low participation rates.

Despite the positive impact on participation as a result of adopting certain plan design features, further improvements are still needed if DC plans are to fulfill their promise as an appropriate vehicle for retirement savings. Although the use of certain plan design features has improved participation rates, and in some cases employee deferrals, the practice of allowing plan design to shape and develop employees’ retirement plans has its limitations.

This is because planning for retirement cannot be uniform for all employees, and employees are not always engaged. To ensure participants are on the road to success, plan sponsors must continue to provide information to help the participants better gauge how much they’ll need in order to meet their personal needs in retirement. Ensuring that participants have an arsenal of tools to effectively manage their retirement finances should be a near-term priority for employers.

Glossary of Terms

Auto-enrollment — A defined contribution plan design feature that provides for enrollment as soon as the employee meets the plan's eligibility requirements, with fixed pretax salary reductions taken automatically from the employee's paycheck. The auto-enrollment and salary reduction occur unless the employee actively elects to opt out.

Closed plan — A defined benefit plan that is frozen for only some participants, typically those hired after a certain date or those that do not meet specific age and service criteria.

Company matching contribution — Employer contributions to a defined contribution plan that are contingent upon an amount the employee contributes to the plan.

Contribution escalation — A defined contribution plan design feature in which pretax salary reductions are automatically taken from the employee's paycheck and are automatically increased on an annual basis. The contribution increase occurs unless the employee actively elects to opt out.

Defined contribution (DC) plan — A retirement plan, such as a 401(k) or 403(b), in which the benefits participants will receive are the total collected in the DC plan account. The total in the account comes from the contributions adjusted for investment performance, and typically includes both employee contributions (automatic or elective reductions from their pay) and employer contributions (usually a match — in most cases, participants select from a menu of investment options determined by the employer; in some plans, the investment [and deferral] selections are through default).

Frozen plan — A defined benefit plan in which service, pay or all benefit accruals have ceased.

Hybrid pension plan — A type of retirement plan that guarantees the amount of an employee's benefits, as with a traditional pension plan, but describes the benefit as a lump sum account balance.

Traditional defined benefit (DB) plan — A type of retirement plan that provides a guaranteed benefit amount at retirement, typically in the form of an annuity. The amount of the benefit is based on a formula, which is usually related to pay and years of service.

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.