

Investments in DC Plans: Results and Analysis From the 2010 Survey of DC Plan Sponsors

By Tomeka Hill

As employers continue to close and freeze their defined benefit (DB) plans, defined contribution (DC) plans have become the primary retirement plan for many workers. In most cases, DC plan participants — rather than plan sponsors — decide how much to save and where to invest. The investment decisions participants make should reflect sound investing principles as well as their own goals, needs and risk preferences. Unfortunately, the evidence suggests a tremendous disconnect between employee risk preferences and their investment decisions.

To help employees better align their goals with their decisions, plan sponsors can design investment options that support such alignment. The recent economic downturn has diminished many workers' confidence in their DC plans and their own decisions, thereby making the need for investment education and support greater than ever.

Investment menus in DC plans vary considerably among plan sponsors. Choosing appropriate investment options is challenging for sponsors, as plans must serve workers with wide-ranging needs. Some workers are financially savvy, motivated savers, others need to be nudged to participate at all, and many fall somewhere in the middle. Participant populations contain different mixes of these investor types, so employers must devise their strategies to reflect the needs of their entire workforce.

To more fully engage and inform all participants, sponsors need to improve their communications and framing of investment options. For unengaged participants with little financial expertise, the right plan defaults can improve participation, saving rates and investment choices. For more knowledgeable and engaged workers, providing appropriate investment choices is most effective, so they can align their risk preferences and goals with their investment decisions themselves.

To better understand how plan sponsors are helping employees manage today's investment challenges, Towers Watson's *2010 Survey of DC Plan Sponsors*

asked employers about investment menus, communications regarding investments and other issues.

Number of investment options

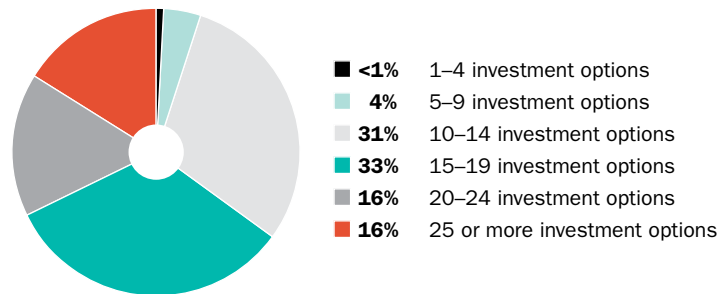
It is important for employers to offer an appropriate number of investment options. Offering too few is likely to leave out options that might best serve some participants' investment goals, while too many may confuse participants. Two-thirds of plan sponsors in our survey offer between five and 19 investment options (*Figure 1*). Roughly one-third of respondents have 20 or more investment options.

“Two-thirds of plan sponsors in our survey offer between five and 19 investment options.”

Default investments

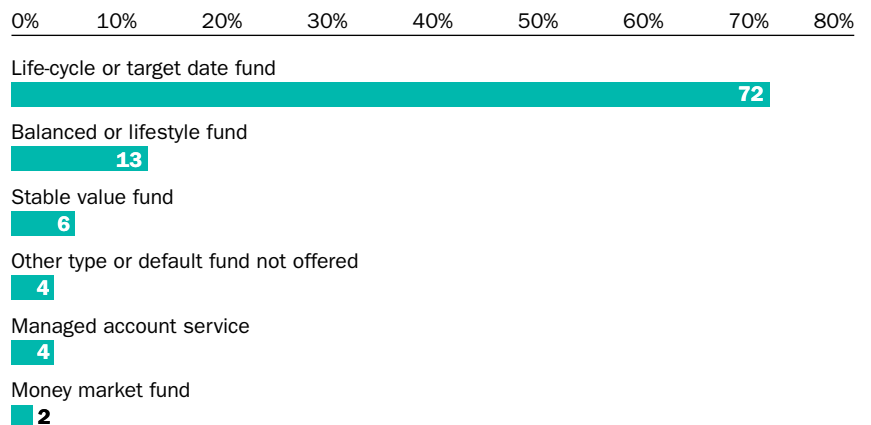
Seventy-two percent of plan sponsors use a life-cycle or target date fund (TDF) as the default investment option, and 13% use a balanced or lifestyle fund (*Figure 2*). Sponsors of smaller plans are more likely

Figure 1. Number of investment options offered



N=334
Notes: Target date series and brokerage count as one option each; options may not sum to 100% due to rounding.
Source: 2010 Survey of DC Plan Sponsors.

Figure 2. Default investment options



N=333
Note: Options may not sum to 100% due to rounding.
Source: 2010 Survey of DC Plan Sponsors.

Figure 3. Type of default investment option by plan size (asset value)

Assets	Life-cycle or TDF	Other default investment or no default investment
\$10 million–\$99.9 million	78%	22%
\$100 million–\$249.9 million	73%	27%
\$250 million–\$499.9 million	75%	25%
\$500 million–\$999.9 million	69%	31%
\$1 billion or more	68%	32%

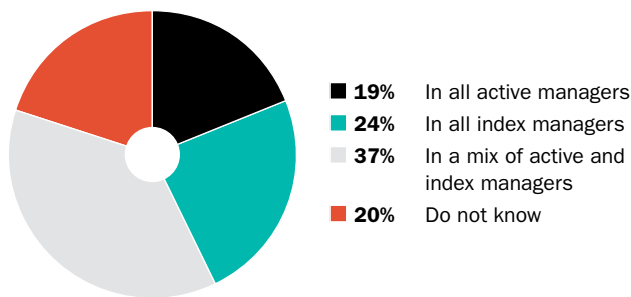
N=333
Source: 2010 Survey of DC Plan Sponsors.

Figure 4. Default investment by industry

Industry	Life-cycle or TDF	Other default investment
Media, communications and technology	86%	14%
Transportation*	86%	14%
Manufacturing	82%	18%
Pharmaceuticals	73%	27%
Utilities and energy	69%	31%
Health care	68%	32%
Retail/wholesale	68%	32%
Business and financial services (incl. insurance)	62%	38%
Other	59%	41%
Food services and beverages	46%	54%

N=332
*The transportation industry has fewer than 10 plan sponsors.
Source: 2010 Survey of DC Plan Sponsors.

Figure 5. Underlying investments of target date funds



N=237
Source: 2010 Survey of DC Plan Sponsors.

Figure 6. Underlying investments and core funds

TDF's underlying investments are different from core funds		TDF's underlying investments are the same as core funds	
and are affiliated with company's record keeper (proprietary off-the-shelf)	and are <i>not</i> affiliated with company's record keeper (non-proprietary off-the-shelf)	i.e., custom	and in other funds not available in the lineup, i.e., custom plus
47%	31%	9%	12%
78%		22%	

N=234
Note: Columns may not sum to 100% due to rounding.
Source: 2010 Survey of DC Plan Sponsors.

to use TDFs — 78% of plans with \$10 million to \$99.9 million in assets use TDFs compared with 68% of plans with \$1 billion or more (Figure 3).

Life-cycle funds or TDFs are the most common default investments and are most prevalent (86%) in the media, communications and technology industry and the transportation industry (Figure 4). Only 46% of plan sponsors in the food services and beverages industry use a life-cycle fund or TDF as the default investment option. Instead, all but one of the other food and beverage plan sponsors with a default investment option use a balanced or lifestyle fund.

Nineteen percent of respondents with default TDFs make the underlying investment in all active managers, 24% in all index managers, and 37% in a mix of active and index managers (Figure 5).

Seventy-eight percent of plan sponsors use different underlying investments for their core funds¹ and their TDFs (Figure 6). Forty-seven percent of those sponsors say the investments underlying their TDF are affiliated with the record keeper, while 31% say they are not. Nine percent say the TDF's underlying investments are the same as those of their core funds (i.e., custom), and 12% say the TDF's underlying investments are the same as those of their core funds and in others (i.e., custom plus).

While plans of all sizes utilize custom TDF strategies, they are used most frequently in plans holding \$250 million to \$499.9 million in assets (Figure 7). Of these respondents, 62% use TDFs with underlying investments that are different from core funds and are affiliated with their record keeper, and 23% use TDFs with underlying investments that are different from core funds and that are not affiliated with their record keeper. For respondents with \$10 million to \$99.9 million in assets, only 34% use TDFs with underlying investments that are different from core funds and are affiliated with the record keeper, and 21% use TDFs that are different from core funds and are not affiliated with their record keeper.

“Life-cycle funds or TDFs are the most common default investments.”

¹ Core funds are individual collective trust funds designed to track a specific asset class.

Figure 7. TDF structure by DC plan size

TDFs with underlying investments that are...	\$10 million–\$99.9 million	\$100 million–\$249.9 million	\$250 million–\$499.9 million	\$500 million–\$999.9 million	\$1 billion or more
Different from core funds and are affiliated with record keeper (proprietary off-the-shelf)	34%	53%	62%	39%	41%
Different from core funds and are <i>not</i> affiliated with record keeper (nonproprietary off-the-shelf)	21%	30%	23%	41%	37%
The same as the core funds (custom)	17%	7%	13%	2%	10%
The same as core funds as well as other funds not available in the lineup (custom plus)	28%	9%	2%	17%	13%

N=234
 Note: Columns may not sum to 100% due to rounding.
 Source: 2010 Survey of DC Plan Sponsors.

Company stock

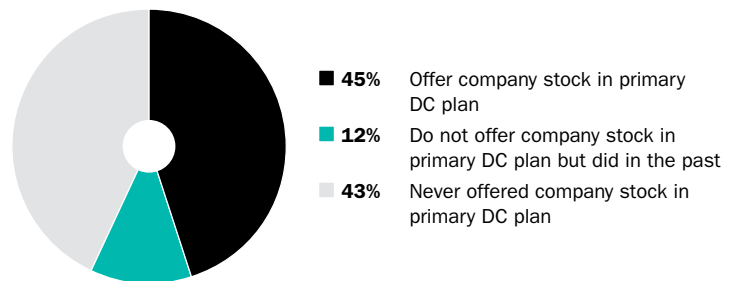
Offering company stock as an investment option gives participants a relatively easy way to invest in their company. Plan sponsors offer company stock for several reasons. Some offer company stock to reduce their cash flow needs and benefit from the tax deductions associated with dividends. Some believe owning company stock motivates workers to become more engaged. Unfortunately, some participants invest heavily in company stock because they're more familiar with it and thus perceive it as less risky than other investment options. Too large a share of company stock, however, can potentially put participants at risk of insufficient diversification.

Forty-five percent of our survey respondents offer company stock in their primary DC plan (Figure 8). Of the remaining plan sponsors, 12% do not offer company stock (although they did in the past), and 43% have never offered company stock.

Eighty-five percent of plan sponsors in the utilities and energy industry offer company stock as an investment option (Figure 9). Plan sponsors in the pharmaceutical and food services and beverages industries follow with 55% and 54%, respectively. At 15%, health care companies are the least likely to offer company stock as an investment option, primarily because most hospitals are nonprofit organizations and so do not have company stock to offer.

Forty-seven percent of plan sponsors that offer company stock as an investment option for participants also make employer matching and/or non-matching contributions in company stock, and only 3% are considering discontinuing this practice (Figure 10).

Figure 8. Company stock in investment option lineup



N=333
 Source: 2010 Survey of DC Plan Sponsors.

Figure 9. Company stock in investment option lineup by industry classification

	Offer company stock in primary DC plan	Do not offer company stock in primary DC plan but did in the past	Never offered company stock in primary DC plan
Utilities and energy	85%	3%	12%
Pharmaceutical	55%	18%	27%
Food services and beverages	54%	15%	31%
Manufacturing	46%	15%	39%
Media, communications and technology	45%	14%	41%
Business and financial services	43%	15%	42%
Transportation*	43%	14%	43%
Retail/wholesale	42%	16%	42%
Other	34%	13%	53%
Health care	15%	0%	85%

Source: 2010 Survey of DC Plan Sponsors.
 *The transportation industry has fewer than 10 plan sponsors.

Figure 10. Plan sponsors that make employer contributions in company stock

Plan sponsors that currently make employer contributions in company stock		Plan sponsors that do not make employer contributions in company stock	
Will continue to contribute company stock	Considering discontinuing contributing company stock	Used to make contributions in company stock	Never made contributions in company stock
44%	3%	25%	29%
47%		53%	

N=150
 Note: Rows may not sum to 100% due to rounding.
 Source: 2010 Survey of DC Plan Sponsors.

Figure 11. Relationships between company stock and additional retirement plans offered

	Offer traditional DB or hybrid plan	Offer additional DC plans	No other plans
Offer company stock in primary DC plan	48%	43%	37%
Do not offer company stock in primary DC plan but did so in the past	12%	10%	13%
Never offered company stock in primary DC plan	41%	47%	50%

N=333

Note: Columns may not sum to 100% due to rounding.

Source: 2010 Survey of DC Plan Sponsors.

Figure 12. Current and potential changes to company stock investment option

	Currently in progress or already took action	Considering action for next year	Not considering taking action
Limit investment in employer stock (e.g., to a maximum percentile)	28%	12%	60%
Disallow new participant contributions or transfers into company stock	19%	3%	78%
Hire independent fiduciary (not company's record keeper) for stock option	7%	3%	91%
Require affirmative election to remain invested in company stock	5%	3%	91%
Eliminate company stock as an investment option	3%	5%	93%

N=149

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

Source: 2010 Survey of DC Plan Sponsors.

Figure 13. Impact of stronger emphasis on diversification of asset allocation and the default investment option on participants' investment changes in last six months

Explanatory variables	Marginal effects (dy/dx)		
	Increase in participant investment changes	No change in participant investment changes	Decrease in participant investment changes
Increased emphasis on diversification of asset allocations in DC communication	10%*	-9%*	-1%
Increased emphasis on description of default investment option in DC communication	12%*	-11%*	-1%*

*Significant at the 10% level.

Source: 2010 Survey of DC Plan Sponsors.

“Plan sponsors that offer additional retirement plans are more likely to offer company stock as an investment option.”

Plan sponsors that offer additional retirement plans are more likely to offer company stock as an investment option (Figure 11). Forty-eight percent of DC plan sponsors that also offer a DB plan offer company stock, as do 43% of plan sponsors that offer one or more additional DC plans, compared with 37% of those with no additional retirement plans. One could argue that workers with additional retirement plans can “afford” more risk than those who have only one DC plan.

We asked plan sponsors that offer company stock whether they have set limits on its investment since the recession or are considering such limits. Forty percent have either limited or are considering limiting investment in employer stock (e.g., to a maximum percentage) (Figure 12). Nineteen percent do not allow new participant contributions or transfers into company stock, and 3% are considering such restrictions. Only 8% have recently eliminated or are considering eliminating company stock as an investment option.

Impact of communication on participant investment decisions

To better understand how employers' communications affect participants' investment decisions, we asked respondents several questions about participant behavior and their communication, including whether participants had changed their investment options within the last six months. We also asked whether sponsors had increased their emphasis on specific topics since the economic crisis began.

To determine the relationship between changes in the number of participants making investment changes and an increased emphasis on specific topics, we ran an ordered logit regression model.² Control variables include industry classification, other retirement plans offered, asset size and the DC plan type.

The findings suggest that enhancing the emphasis on asset diversification increases by 10% the probability of participants' changing their allocations (Figure 13). It reduces the probability of having no change in volume of participant changes by 9% and the probability of having fewer investment changes by 1%. Increasing the emphasis on the description of the default investment raises by 12% the probability of participants' changing their allocations. It reduces by 11% the probability of having no change in volume of participant investment changes and reduces by 1% the probability of having fewer participant investment changes.

² This is a statistical technique that can be used with an ordered (from low to high) dependent variable, such as bond ratings and opinion surveys with responses ranging from “strongly agree” to “strongly disagree.”

Conclusions

American workers increasingly rely on DC plans as their primary retirement savings vehicle. Since the economic crisis, however, many workers worry about whether their DC plans will see them through their retirement years. Account balances in DC plans have fluctuated widely over the last two years, leaving many participants unsure about how much to contribute and where to invest. Plan sponsors can help by developing investment strategies that support employees' efforts to satisfy their risk tolerance and meet their rate-of-return goals.

Plan sponsors need to offer enough investment options to enable participants to diversify, but not so many as to overwhelm them. Although most employers offer 15 or fewer options, 16% offer 25 options or more. That many options might be fine for more confident investors, but less engaged and less experienced employees might find that many choices confusing.

Auto-enrollment has proven useful to nudge unengaged workers to participate in DC plans. Having an appropriate default investment option is very important, so workers who are not well-informed or motivated to compare investment options can also land on their feet.

Overall, the most popular default investment option is the TDF, although it is more prevalent among smaller plans and in the media, communication and technology industries. Choosing the right TDF is important, so plan sponsors must consider where the TDFs make underlying investments, their glide path — the formula under which the portfolio's asset allocation rebalances over time — and active versus passive management. Because of their popularity and growing evidence that participants did not fully understand these investments and their associated risks, the Department of Labor has issued educational information on TDFs for participants. The department is also considering issuing guidance to help fiduciaries select TDFs and to require more specific disclosures for TDFs.

Offering company stock as an investment option gives plan sponsors much to consider. While investing in their own company motivates workers to help their employer succeed, it carries risks as well.

“Offering company stock as an investment option gives plan sponsors much to consider.”

In some cases, participants may not adequately diversify. Although few companies are considering eliminating company stock as an investment option entirely, some have chosen to limit investment in company stock or not allow new participants to contribute or transfer money into company stock.

To help employees understand their risk tolerance, retirement goals and the importance of making appropriate investment choices, plan sponsors should continue providing financial education. The evidence suggests that emphasizing the importance of diversifying investment options and providing information about TDFs encourages employees to think about and change their investment options. As more employers and workers adjust to a DC-only savings environment, more communication will likely be necessary to help participants contribute enough, minimize their risks and make the right choices to meet their own retirement goals.

About the survey

Between mid-April and mid-May 2010, Towers Watson surveyed DC plan sponsors about critical issues such as plan design, investment, fees, communication and governance. The survey reflects responses from 334 companies with more than 1,000 employees and at least \$10 million in assets across a broad range of industry sectors. These companies have an average of 18,426 employees and together represent more than 6 million employees.

The respondents' DC plans vary widely 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 respondents have \$1 billion or more in assets in their primary DC plans.

For more information about the survey results and the respondents, please refer to Towers Watson's *New Strategies in Defined Contribution Plan Design: Results From the 2010 Survey of Defined Contribution Plan Sponsors*.

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