

# Prevalence of Retirement Plan Types in the *Fortune* 100 in 2011

## Account-Based Benefit Plans Dominate

By Brendan McFarland

Towers Watson has been tracking retirement plans offered to newly hired salaried employees of *Fortune* 100 companies for many years. In 2011, the number of these large companies offering new salaried employees only a defined contribution (DC) plan, such as a 401(k) plan, grew significantly. Today, less than a third of these companies offer any defined benefit (DB) pension to newly hired salaried employees, and only 13 sponsor a traditional DB plan open to newly hired workers.

Large employers have been rethinking their retirement offerings for some time now. Over the last 10 years, many of them have shifted from traditional DB plans to DC and account-based DB plans. Several factors have driven the shift, including a desire to reduce overall retirement costs (perhaps due to higher compensation and benefit costs elsewhere, especially health care), greater mobility in the workforce, the popularity of account-based designs with employees, government and accounting regulations, market trends and board pressures, and a belief that such a shift reduces financial risk.

The shift to DC plans as the primary retirement vehicle transfers the responsibility and risk for capital accumulation for retirement from employers to employees, who are left to manage their own contribution levels, withdrawals (and loans), investments and retirement distributions. For the employer, the move creates other risks, such as that counter-cyclical workforce trends will necessitate

increased severance pay, raise benefit costs and result in less mobility within an organization.

### History of *Fortune* 100 plan sponsorship

Since 1998, there has been a steady — yet dramatic — overall shift in retirement offerings to newly hired employees. At the end of 1998, 90 of the *Fortune* 100 companies offered some sort of DB benefit, either a traditional or hybrid (account-based, usually cash balance) plan. Today, only 30 companies offer DB plans to their new hires (see *Figure 1*).

Consequently, offering DC plans as the sole retirement plan became increasingly common over this period, jumping from only 10 *Fortune* 100 companies at year-end 1998 to 70 companies in this year's *Fortune* 100.

The decline of traditional DB plans is striking. A traditional DB plan provides a defined benefit amount at retirement, usually in the form of an annuity, based on a formula that normally relates to pay and years of service. The value of benefit accruals is typically back-loaded, meaning benefit values increase faster as participants near retirement. As such, traditional DB plans are better suited to long-tenured employees than to those with shorter tenures. After all, one reason for establishing these plans was to encourage valuable workers to stay with the employer (another was to enable employees to retire with sufficient income to maintain a reasonable standard of living in retirement). Over time, however, employers have changed their focus from providing retirement income to workers who stay until retirement to providing a more uniform level of retirement-directed capital accumulation for all employees. So, many companies have instead opted for more portable, account-based retirement programs such as hybrid DB and DC plans.

“In 1985, 89 *Fortune* 100 companies offered a traditional DB plan to their newly hired workers. Today, only 13 offer traditional DB plans.”

**Figure 1. *Fortune* 100 retirement plan prevalence for new hires (1985–2011)**

	1985	1998	2002	2004	2005	2006	2007	2008	2009	2010	Today
Total DB pension plans	90	90	83	73	62	57	53	47	43	37	30
Traditional DB plan	89	67	48	38	32	28	27	23	19	17	13
Hybrid pension plan	1	23	35	35	30	29	26	24	24	20	17
DC plan only	10	10	17	27	38	43	47	53	57	63	70

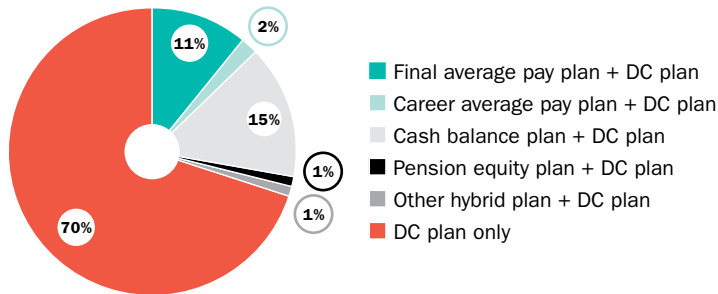
Note: Sponsorship is shown as type of plan offered to salaried new hires at the end of the year and is based on the following year's *Fortune* 100 list. For example, the 2010 data are based on the 2011 list and include plans offered at year-end 2010. The "Today" column reflects changes implemented between January 1, 2011, and May 31, 2011.  
Source: Towers Watson.

**Figure 2. Retirement prevalence trend for new hires for 2011 Fortune 100 companies (1998–2011)**

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Today
Total DB pension plans	72	72	72	71	70	69	66	64	57	50	45	40	37	30
Traditional DB plan	64	59	58	53	47	40	37	36	33	29	22	20	17	13
Hybrid pension plan	8	13	14	18	23	29	29	28	24	21	23	20	20	17
DC plan only	28	28	28	29	30	31	34	36	43	50	55	60	63	70

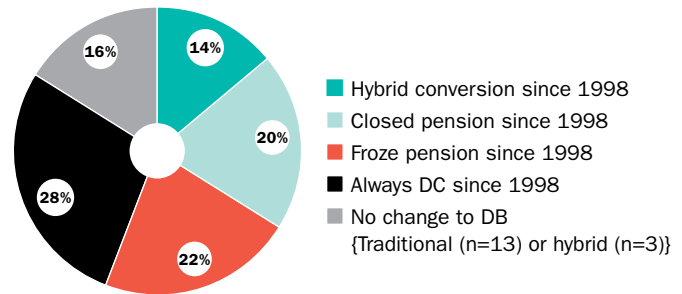
Note: Sponsorship is shown as type of plan offered to salaried new hires at the end of the year. The “Today” column reflects data through May 31, 2011. Trend data are shown for the 2011 Fortune 100 companies and capture changes to retirement plans for these companies since 1998. Source: Towers Watson.

**Figure 3. Plan types offered today by Fortune 100 companies (for newly hired employees)**



N=100  
Source: Towers Watson.

**Figure 4. Most recent change in newly hired employee retirement program since 1998**



N=100  
Source: Towers Watson.

In hybrid plans, the employer defines, that is, specifies, the retirement benefit — similar to a traditional DB plan — but the final benefit is defined as a lump-sum account balance rather than as an annuity. The benefit value of hybrid plans typically accrues more evenly over a worker’s career (though designs can vary benefit accrual by age, service or a combination of the two). If hybrid plan participants leave their employer, they usually can take their lump-sum account balance with them, transferring it to an individual retirement account, much like DC plan participants, or they can convert the account balance into an annuity. (Note that many traditional DB plans also now provide for lump-sum distributions at retirement.)

In 1985, 89 Fortune 100 companies offered a traditional DB plan to their newly hired workers, while 11 offered only an account-based plan. Over the past 25 years, the pattern has flipped almost completely. Today, 87 of today’s Fortune 100 companies offer only account-based retirement plans to newly hired workers, while 13 offer traditional DB plans.

### A historical look at the retirement plans of today’s Fortune 100

Some of the changes in the reported retirement offerings arise from annual turnover in the Fortune 100 list, reflecting mergers, spin-offs, new or rapidly growing businesses, and bankruptcies. Historically, seven to eight companies drop off the list in any given year. Six companies are new to the 2011 list,

and, over time, we have found that new list members are less likely to have ever offered a DB plan. For example, at year-end 1998, 28 companies in today’s Fortune 100 provided only a DC plan to new hires (see Figure 2), while 10 companies in the 1999 Fortune 100 sponsored only a DC plan (Figure 1).

Nevertheless, while list turnover has had some effect on the trend, there is no escaping the conclusion that companies have moved away from traditional DB plans. Indeed, to control for annual turnover in the Fortune 100, we analyzed the evolution of retirement offerings from this year’s Fortune 100 list of companies since 1998 (Figure 2).

The movement away from traditional plans to account-balanced retirement plans and its timing is still apparent. Today, 70 of the 2011 Fortune 100 offer only a DC plan to new hires, compared with 28 of those same companies back in year-end 1998. Between year-end 2010 and May 2011, seven more companies stopped offering DB plans to new hires and adopted a DC-only retirement benefit approach. Of the 30 companies currently offering a DB plan to new hires, half sponsor cash balance plans (as shown in Figure 3). Traditional final-average-pay plans make up the second-largest DB offering, with career-average-pay plans and other hybrid plan types making up the remainder.

Forty-two of the 70 companies that currently offer only a DC plan to new hires froze or closed their traditional pension plan after 1998 (see Figure 4).

“Forty-two of the 70 companies that currently offer only a DC plan to new hires froze or closed their traditional pension plan after 1998.”

When a sponsor freezes a DB plan, benefits tied to service, those tied to pay or all benefits stop accruing for some (based on age, years of service or both) or all plan participants. When a sponsor closes a pension plan, benefits for current participants typically continue to accrue, but the plan does not admit employees hired after a certain date. Twenty-two companies in this year's *Fortune* 100 list have frozen a pension plan since 1998, while 20 have closed plans to newly hired employees.

Fourteen sponsors took a different route, converting their traditional DB plans to hybrid plans. *Figure 5* depicts the timing of these hybrid conversions since 1998.

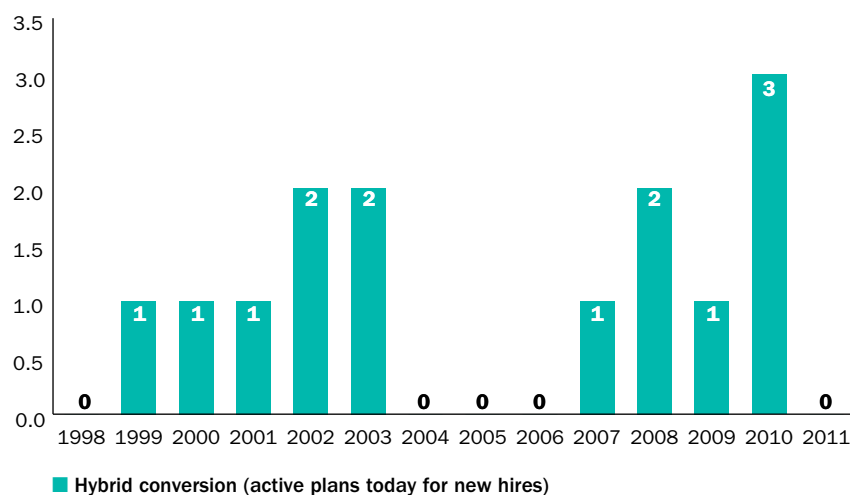
Over the last several months, none of the *Fortune* 100 companies transitioned from a traditional DB to a hybrid plan. Before 2004, hybrid conversions were occurring at a steady pace. Between 2004 and 2006, there were no conversions, most likely due to legal and regulatory uncertainty created by the 2003 *Cooper v. IBM* ruling, which found that cash balance plans were inherently age discriminatory. But later rulings and the Pension Protection Act of 2006 (PPA) cleared away some of the legal fog that had surrounded these plans and appeared to trigger new conversions. Of *Fortune* 100 companies that converted to hybrid plans (that are still active for new hires today), half the conversions took place before the PPA was signed into law and half after.

### Transitioning workers from a DB plan to a DC plan: Grandfathering, partial grandfathering and no grandfathering

There are various approaches for managing the transition of pension-eligible employees to a DC-plan-only environment, and most companies take one of three broad approaches. The first is full grandfathering, where all those participating in the DB plan as of a certain date continue accruing benefits, either at the same or a reduced level. The second approach is partial grandfathering, in which only participants who meet certain age and/or service requirements continue accruing benefits in the DB plan. All other participants are switched over to whatever retirement plan is offered to new hires. The third approach is not to grandfather anyone — all current participants stop accruing benefits and are enrolled in the DC plan offered to new hires.

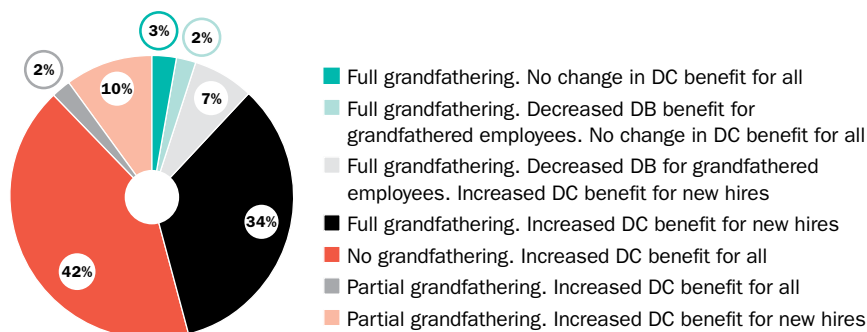
Of the 41 companies we analyzed, 46% implemented full grandfathering, 12% opted for partial grandfathering,<sup>1</sup> and the remaining 42% did not grandfather anyone.<sup>2</sup>

**Figure 5. Hybrid conversions for active plans for newly hired employees (1998–2011)**



N=14  
Source: Towers Watson.

**Figure 6. Transition approaches of Fortune 100 sponsors moving from DB to DC**



N=41  
Source: Towers Watson.

As shown in *Figure 6*, within the three broad transition approaches, employers varied the details. The most frequent approach (42%) was not grandfathering anyone and increasing benefits in the DC plan for all workers. The next most common tack (34%) was offering full grandfathering with unreduced benefits for current participants and increasing DC benefits for newly hired workers relative to what their pension-eligible counterparts received. Nine percent of companies fully grandfathered their workers but reduced future DB accruals (2% used full grandfathering, decreased the DB plan benefit and did not change the DC benefit for anyone, and 7% used full grandfathering, decreased the DB plan benefit and increased DC benefits for new hires).

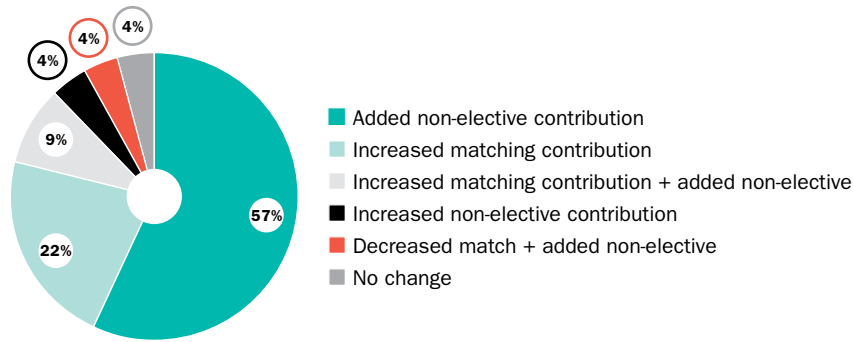
“Over the last several months, none of the *Fortune* 100 companies transitioned from a traditional DB to a hybrid plan.”

<sup>1</sup> Of the five companies that used partial grandfathering, four based eligibility on points (combination of age and service). The thresholds varied from 45 points (two companies) to 62 points (one company) to 65 points (one company). The fifth company that implemented partial grandfathering based its criteria on age only (40 years old).

<sup>2</sup> If a company implemented one grandfathering approach and later changed it, these results capture its latest approach. For the 17 companies that offered no grandfathering, four previously offered full grandfathering and closed their plan to new hires. These companies later froze their plan and subsequently offered no grandfathering.

“The dominant approach among these grandfathering companies was to add a non-elective contribution to the DC plan.”

**Figure 7. Actions taken for new-hire DC plan in companies that fully or partially grandfathered pension-eligible workers**



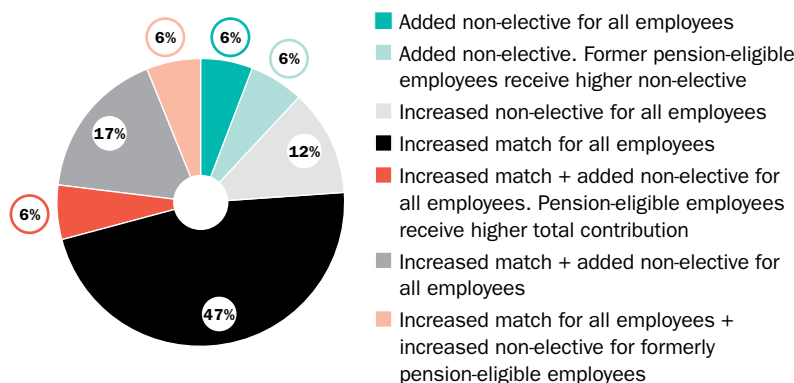
Note: Results are shown where transition data were available for 23 of the 24 companies that fully or partially grandfathered their workers.  
N=23  
Source: Towers Watson.

**Figure 8. DC employer contributions from companies that fully or partially grandfathered pension-eligible workers (new hires versus grandfathered employees)**

	Total matching contribution	Total non-elective contribution	Total DC contribution
Grandfathered employees	3.90%	1.18 %	5.09%
New hires	4.25%	3.55%	7.80%

Note: Results are shown where full contribution data were available for 22 of the 24 companies that fully or partially grandfathered their workers. If discretionary contributions were shown in ranges, the maximum value was used. The data assume employees make the contributions necessary to receive the maximum matching contribution.  
N=22  
Source: Towers Watson.

**Figure 9. Actions taken in DC plan by non-grandfathering companies**



N=17  
Source: Towers Watson.

### Changes made by Fortune 100 companies to DC plans after eliminating the DB formula

Almost all companies that offered some level of grandfathering (58%) increased DC benefits for new employees to mitigate the loss of the pension benefit. As shown in Figure 7, the dominant approach (57%) among these grandfathering companies was to add a non-elective contribution to the DC plan — meaning the employer contributes whether or not the employee does (similar to cash balance plan pay credits). All the changes depicted in Figure 7 are for newly hired workers or existing workers who did not meet age and service requirements for grandfathering.

The second most popular approach (22%) was increasing the matching contribution for workers who were no longer pension-eligible.

Because non-pension-eligible workers receive higher DC benefits than their grandfathered counterparts, we next quantify DC contributions as a percentage of pay for these two groups among the grandfathering companies. Figure 8 shows total DC employer contributions for a newly hired 35-year-old employee earning \$50,000/year versus a grandfathered 35-year-old employee earning \$50,000/year with five years of service.

Total employer contributions to DC plans for new hires, on average, are roughly 2.7% of compensation higher than contributions for their pension-eligible counterparts. Most of this increase reflects a higher non-elective contribution for new hires. The higher DC benefit for new hires, however, typically does not fully mitigate the pension loss.<sup>3</sup>

We next analyze what happened to DC plans when the sponsor did not grandfather any DB plan participants and moved everyone to a DC-only program. As shown in Figure 9, 76% of companies that did not grandfather any plan participants increased their matching contribution to the DC plan, and 53% added or increased a non-elective contribution. It is interesting to observe that, in 18% of non-grandfathering companies,<sup>4</sup> workers whose DB pensions were frozen received bigger DC contributions than those who had never had a pension.

### Transitioning workers from a traditional DB plan to a hybrid plan

Some companies chose to convert their traditional DB plan to a hybrid plan. Of the 14 companies that converted to hybrid plans since 1998, five kept existing workers in the traditional plan and enrolled newly hired employees in the hybrid plan,<sup>5</sup> and four allowed employees to choose between the traditional

pension and the hybrid plan. The remaining five froze the current traditional plan benefit and moved all workers over to the hybrid plan.<sup>6</sup>

## Annual allocations for account-based retirement plans

Eighty-seven percent of *Fortune* 100 companies now offer their newly hired employees only account-based plans. We next analyze the percentage of pay employers allocate to these accounts annually.

*Figure 10* shows the total retirement (DB plus DC) allocation from *Fortune* 100 sponsors of account-based plans to 35-year-old newly hired employees earning \$50,000/year.

On average, sponsors of hybrid pension plans provide 9.04% of pay to their newly hired employees' retirement accounts. Newly hired employees with only a DC plan receive 6.46% of pay — roughly 2.5% of pay less than at companies that also sponsor hybrid pensions. The higher allocations from hybrid plan sponsors are not surprising. These companies chose to switch from a traditional plan to a hybrid plan rather than move to a DC-only approach, arguably demonstrating a stronger commitment to providing retirement benefits to their employees.

Among companies providing only a DC plan to new hires, employer contributions vary significantly, depending on whether the company once sponsored a pension (7.67%) or was always a DC-plan-only employer (4.77%).

The difference in allocation amounts (shown in *Figure 11*) between employers that always had a DC plan and those that once had a pension is attributed to companies' eliminating their DB benefits and then boosting the match, adding a non-elective contribution or both, as discussed earlier in this analysis.

## Conclusion

The established trend away from traditional DB pension plans continues as more companies adopt DC-only or account-based DB approaches going forward. Today, 70 *Fortune* 100 companies provide DC-only retirement benefits to new hires, a significant increase since the late 1990s.

Companies use various approaches in transitioning from a DB to a DC-only environment. Some

**Figure 10. Total annual allocations for account-based retirement plans for new hires**

	n	Total retirement contribution	Total hybrid contribution	Total DC contribution
Hybrid pension plans (DB+DC)	17	9.04%	4.56%	4.47%
DC only	67	6.46%	n/a	6.46%
DC — once DB	39	7.67%	n/a	7.67%
Always DC-only	28	4.77%	n/a	4.77%

Note: Results are shown where full contribution data were available. If discretionary contributions were indicated in ranges, the maximum value was used. Matching and non-elective contributions are included. The data assume employees make the contributions necessary to receive the maximum matching contribution.

N=84

Source: Towers Watson.

**Figure 11. Retirement contributions from companies providing only a DC plan to new hires**

	n	Total matching contribution	Total non-elective contribution	Total DC contribution
DC — once DB	39	4.57%	3.10 %+	7.67%
Always DC	28	3.63%	1.14%*	4.77%

Note: Employer contributions are shown for a newly hired employee at age 35 earning \$50,000/year. Results are shown where full contribution data were available. If discretionary contributions were indicated in ranges, the maximum value was used. The data assume employees make the contributions necessary to receive the maximum matching contribution.

+ Twenty-eight of 39 companies provide a non-elective contribution to their DC plan. The vast majority of these companies began the non-elective contribution after eliminating the pension plan for new hires. For companies that once offered a pension but now provide this additional contribution, the average non-elective contribution for a 35-year-old new hire earning \$50,000/year is 4.32% (median is 3%).

\* Of the 28 companies that have not provided a DB plan since 1998, only six make non-elective contributions. The average contribution for these companies is 5.33% (median is 4%).

N=67

Source: Towers Watson.

grandfather existing workers, while others stop DB accruals for everyone. While the loss of future pension accruals is substantial, most companies provide additional DC contributions, at least partially replacing the value of the lost DB accruals.

So far in 2011, there have been more retirement changes than usual — seven companies have given up their DB plans in favor of an all-DC retirement environment for new hires. There were no conversions to hybrid plans during this period.

These recent changes — and more almost certainly on the horizon — signal a large-scale redistribution of corporate resources for retirement. Employers are spreading their retirement dollars more evenly across the workforce, rather than concentrating benefits on older workers. Traditional DB plans offered employers greater control over workforce retirement patterns. Account-based plans generally place more responsibilities on employees and are less directed toward traditional retirement patterns.

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<sup>3</sup> See Towers Watson's "Employer Commitment to Retirement Plans in the United States," December 2009, found at [www.towerswatson.com](http://www.towerswatson.com).

<sup>4</sup> Six percent added non-elective contributions and gave formerly pension-eligible employees higher non-elective contributions. Six percent increased the match and added non-elective contributions, with pension-eligible employees receiving higher DC contributions. Six percent increased the match for all employees and increased non-elective contributions for formerly pension-eligible employees.

<sup>5</sup> All five of these were implemented after the PPA was passed.

<sup>6</sup> One company previously allowed choice but later moved all grandfathered workers into the hybrid plan.