Willis Towers Watson

Unlocking Value From Effective Retirement Plan Governance

The 2016 Willis Towers Watson U.S. Retirement Plan Governance Survey

Organizations with effective retirement plan governance are better equipped to manage potential retirement plan risks, protect against fiduciary liabilities and capture opportunities to improve structures, strategies and metrics.

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Overview

As employers face increased scrutiny of their retirement benefits in the current legal and regulatory environment, the role of retirement plan governance becomes ever more critical. Retirement plan governance encompasses the policies, procedures, roles and responsibilities associated with the management and oversight of defined benefit (DB) and defined contribution (DC) plans. Organizations with effective retirement plan governance are better equipped to manage potential retirement plan risks, protect against fiduciary liabilities and capture opportunities to improve structures, strategies and metrics.

The Willis Towers Watson U.S. Retirement Plan Governance Survey examines current and evolving governance practices in order to help plan sponsors evaluate their own governance approaches and make more informed decisions. This research explores four areas critical to effective retirement plan governance: risk management, levels of governance, strategy and the measuring of plan effectiveness.

Three major trends emerge from the survey findings:

1 Employers have a growing concern over retirement benefit adequacy and financial well-being. Plan sponsors are increasingly concerned about the ability of their employees to retire in a timely manner. In fact, given the business implications such as a stagnant workforce, potentially higher labor costs and lower productivity, 39% of respondents view retirement readiness as a risk today, and 44% view it as a risk two years from now. Among DC plans, we expect to see a shift in resources toward benefit adequacy and retirement readiness over the next two years. Retirement benefit cost will still be top of mind for employers, but to a lesser extent during this period.

2 More employers are using third parties to assist with investment-related activities. A large majority of employers engage third-party advisors to assist with investment decisions related to their DB and DC plans. Sponsors of frozen DB plans are most likely to outsource investment-related responsibilities for their pension plan.

Survey highlights

58% conducted a review of **operational compliance** of their DC plan over the last two years, and 56% of respondents conducted a review of operational compliance of their DB plan.

53% selected **"investment volatility" as among the top three risks** their organization is concerned about regarding their retirement plans.

44% see **retirement readiness** as a risk two years from now, and another 20% see it as a risk today.

33% of DB sponsors **fully or partially outsource investment services** versus 26% of DC sponsors that fully or partially outsource investment services. In both cases, the main reason for outsourcing is **increased governance.**

3 Regulatory concerns are prevalent. Plan sponsors continue to cite regulatory concerns as a key risk – and with good reason. Over the past two years, approximately 31% of sponsors have faced a government audit of their plan(s), e.g., Internal Revenue Service (IRS) or Department of Labor (DOL). Larger plan sponsors report an even higher likelihood for audits: Roughly half of sponsors with at least 25,000 employees have faced an audit over the same time period.

The survey findings highlight the governance practices essential to managing risks and achieving positive outcomes that deliver value to both plan participants and employers.

Managing risks

Plan management concerns about risk, compliance reviews, recent audits and litigation

What are the key concerns of today's plan sponsors? Investment volatility (53%), retirement benefit costs (49%) and regulatory compliance (47%) top the list of concerns of DC and DB plan sponsors (*Figure 1,* page 4). Respondents indicated that they expect these risks to remain top of mind over the next two years.

Closely following the top three risks in importance, is the concern over workers' ability to retire in a timely manner. The percentage of sponsors identifying this as a top risk is expected to increase from 39% to 44% over the next two years, signaling the growing concern over retirement readiness and financial wellness. In fact, it is expected that in two years, retirement readiness will be roughly tied with regulatory compliance as the third-most important retirement plan risk.

Concerns about risks vary by plan offering

Our findings point to distinct differences in perceived risks by current plan offerings (*Figure 2,* page 5).

- **Retirement readiness.** As more companies move to DC plans, the ability of workers to retire in a timely fashion becomes critically important. Today, 58% of sponsors that have never offered a DB plan indicate that retirement readiness is their top risk, in contrast to 39% of all respondents.

The top risk of organizations that sponsor only a DC plan is retirement readiness.

- **Investment volatility.** Fifty-eight percent of sponsors with an open DB plan cite investment volatility as a top concern. Fifty-two percent of respondents that sponsor only a DC plan state investment volatility as a top risk. For the DC-only employers, investment volatility is related to fluctuations in workers, DC account balances, which can lead to workforce exit issues. Among those that sponsor a DB plan, volatility is related to fluctuations in their pension plan assets.
- **Retirement benefit costs.** Not surprisingly, retirement benefit costs are a much greater concern for those managing both a DB (active, frozen or closed) and DC plan, as opposed to those managing only a DC plan. Thirty-three percent of sponsors with only a DC plan regard costs as a top risk, as opposed to 59% of those with active DC and DB plans, 53% of those with a DC plan and an inactive DB plan, and 49% of all respondents.
- **Vendor service quality.** Vendor service quality is a higher concern for those that manage only a DC plan, with over a third (34%) in this group citing this issue as a key concern versus only 13% of sponsors with active DB and DC plans, and 22% of sponsors with a DC plan and an inactive DB plan.

Regulatory risks

Plan sponsors continue to rank regulatory compliance as a top three risk for today and two years from now. Fifty-eight percent of respondents have conducted a review of operational compliance for their DC plan and 56% for their DB plan in the last two years. Approximately two-thirds of respondents who selected regulatory compliance as their number one risk have conducted operational compliance reviews in the past two years.

Figure 1. **Investment volatility, retirement benefit costs and regulatory compliance are the top three risks today and in the next two years**

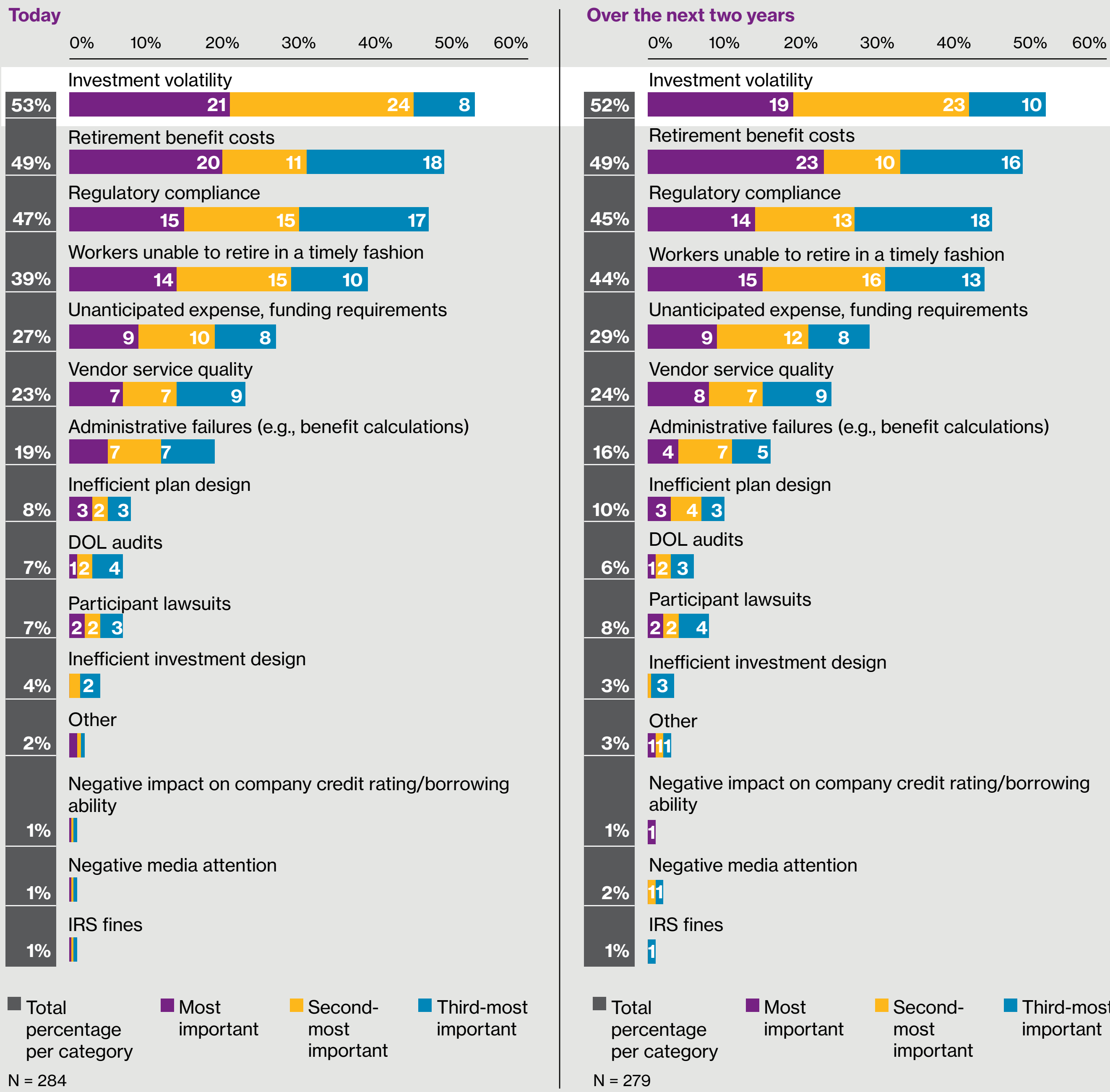


Figure 2. **Perceived employer risks vary by plan offerings**

Top risks today	All respondents	DC only	Active DB and DC plan	Inactive DB and DC plan
Investment volatility	53%	52%	58%	52%
Retirement benefit costs	49%	33%	59%	53%
Regulatory compliance	47%	42%	47%	49%
Workers unable to retire in a timely fashion	39%	58%	25%	36%
Unanticipated expense, funding requirements	27%	8%	32%	35%
Vendor service quality	23%	34%	13%	22%
Administrative failures	19%	19%	20%	20%

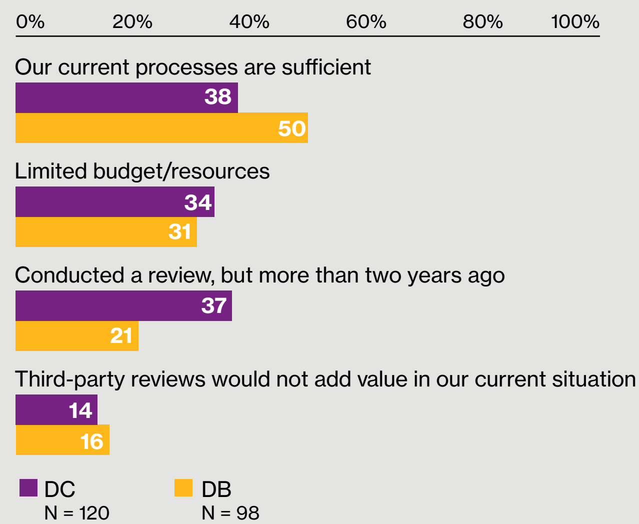
N = 284

What prompted these reviews? Fifty-four percent of DB plan sponsors and 57% of DC plan sponsors that conducted a review in the past two years have regularly scheduled compliance reviews. Roughly a quarter (23% of DB plan sponsors and 25% of DC plan sponsors) reported that they conducted a review due to plan design changes.

Larger employers were more likely to conduct operational compliance reviews. Sixty-eight percent of DC plan sponsors with at least 25,000 employees and 64% of DB plan sponsors with similar size employee populations conducted compliance reviews.

Regarding the barriers to conducting compliance reviews: Among those that didn't conduct a review on operational compliance in the past two years, roughly a third of plan sponsors indicated that limited budget/resources prevented them from conducting a review *(Figure 3).* Half of DB plan sponsors and 38% of DC plan sponsors that didn't conduct a review during this period say they have sufficient compliance processes in place and, therefore, don't require a review.

Figure 3. **Approximately a third of plan sponsors indicated that limited budget/resources prevented them from conducting a review**



Lawsuits and audits

Very few respondents, approximately 2%, have faced issues with fee and stock drop lawsuits over the past two years. However, almost a third (31%) of sponsors indicated that their retirement plans were audited by the IRS or DOL. Larger companies, in terms of the number of employees, were most likely to face a government audit. Approximately half (47%) of plan sponsors with at least 25,000 employees report being audited.

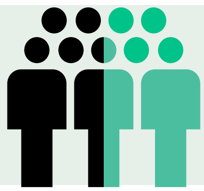
Sponsors that manage open DB plans were almost twice as likely to be audited as those that manage only a DC plan. Only 22% of employers with only a DC plan report that they faced an audit in contrast with 38% of those with open DB plans. Roughly a third of sponsors with closed (30%) and frozen (33%) DB plans also report being audited.

Levels of governance

Committees: structure, composition and training

Half of sponsors indicate that they have separate governance committees that deal with plan administration and investment. Smaller organizations, as well as those that maintain only a DC plan, are more inclined to have just one committee that is responsible for both plan administration and investment governance compared to larger companies and those that manage a DB plan.

Half of sponsors have separate committees for plan administration and investment governance.



The survey uncovered the following key trends and practices related to committee membership:

- Governance committees are comprised, on average, of 4.7 members; the CHRO, CFO and treasurer are included in the majority of committees.
- Organizations with separate plan administration and investment committees have slightly more members than organizations with a single committee (4.9 versus 4.5). For those that have separate committees, plan investment committees have, on average, slightly more members than plan administration committees (4.1 versus 3.6 members).
- Among respondents that selected “other” (46%) when asked to indicate the job titles of plan committee members and specified the job title, only 11% stated that they have risk officers as members of their plan committees.
- 87% of organizations appoint members based on some criteria involving job titles, with 40% saying they appoint members solely on job title.
- There is a sizable minority of organizations that don’t have a committee that looks specifically at administration or investment issues for their health and welfare, or other postretirement benefit plans.

With regard to training, more than half of members (62%) are formally trained either when they join a committee (26%) or on a scheduled basis (36%). Larger organizations are more inclined to train their members on a scheduled basis; almost half of employers with over 25,000 employees fit this criterion. Although a large number of organizations train their members on a scheduled basis, approximately a third (30%) indicated that they train their members on an ad hoc basis. Eight percent of organizations have no formal training and have their committee members learn on the job.

Investment oversight

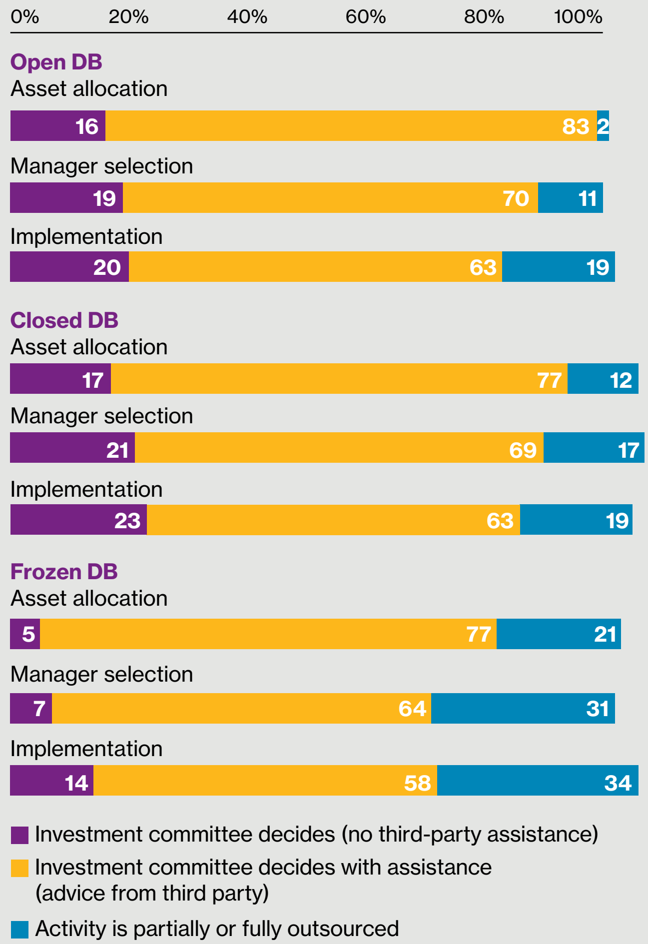
In the majority of cases, the investment committee makes decisions regarding investment services (e.g., asset allocation, manager selection and the coordination of implementation activities) with assistance from a third party regardless of plan type. Eighty-eight percent of DC plan sponsors engage a third party to assist with the investment options offered to participants, while 78% of DB plan sponsors have a third party assisting with their decisions on asset allocations. In regard to investment manager selection, 78% of DC plan sponsors and 67% of DB plan sponsors have a third party assisting with this process. Moreover, third parties provide assistance with investment implementation activities to 64% of DC plans and 61% of DB plans.

33% of DB plan sponsors fully or partially outsource at least one aspect of their investment services, and 26% of DC plan sponsors do so.

The survey also uncovered the following key findings related to outsourcing:

- 33% of DB plan sponsors fully or partially outsource at least one aspect of their investment services, and 26% of DC plan sponsors do so. Overall, DB plan sponsors implemented an outsourced investment option structure more often than DC plan sponsors.
- Manager selection and implementation activities are aspects that are most frequently outsourced. Yet, less than 20% of DC plans fully or partially outsource investment manager/fund selection and implementation.
- Among DB plan sponsors, implementation is the most likely investment activity to be outsourced, with 27% reporting that they fully or partially outsource these activities.
- The majority of plan sponsors seek investment advice for asset allocation for DB plans and investment option structure for DC plans, but these activities are infrequently outsourced.
- Plan sponsors with frozen DB plans are more likely to outsource investment functions than sponsors of open and closed DB plans *(Figure 4).*
- In the area of manager selection, 11% of sponsors with open plans outsource this activity – in whole or in part – in contrast to 31% of sponsors with frozen plans.
- Finally, when it comes to implementation activities, 19% of sponsors with open DB plans opt to partially or fully outsource these activities, while 34% of sponsors with frozen plans choose to do so.

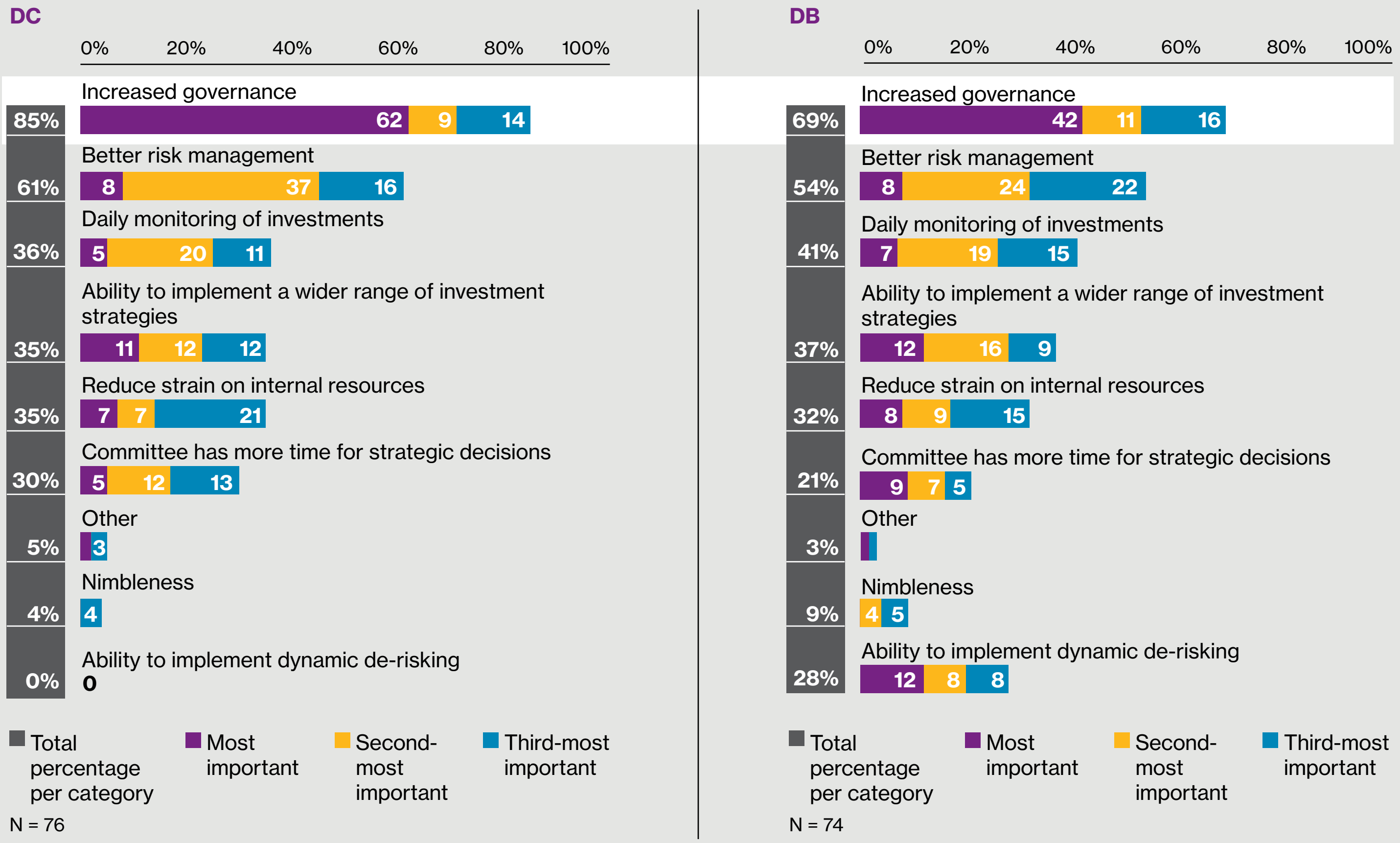
Figure 4. **Plan sponsors with frozen DB plans are more likely to outsource investment functions**



N = 232
Note: Sums may be greater than 100% since respondents could select more than one option.

Plan sponsors with frozen DB plans are more likely to outsource investment functions than sponsors of open and closed DB plans.

Figure 5. **Increased governance and better risk management are prompting sponsors to outsource investment services**



Why do plan sponsors outsource investment services?

Increased governance and better risk management are prompting sponsors to outsource investment services *(Figure 5)*. Eighty-five percent of DC plan sponsors and 69% of DB plan sponsors that outsource at least one aspect of investment services cite increased governance as a key reason for outsourcing. Moreover, increased governance is the number one reason sponsors outsource regardless of plan type. In addition, 61% of DC plan sponsors and 54% of DB plan sponsors that outsource at least one aspect of investment services, indicate that they opted to outsource to enhance risk management.

While not an issue for DC plans, the ability to implement dynamic de-risking was a factor in DB investment outsourcing. Twenty-eight percent of DB plan sponsors report that they outsource investment services for this reason.

For those that do not currently outsource, over 70% cite adequate internal expertise and loss of control as the main reasons they don't outsource. Moreover, the vast majority of organizations that don't outsource investment services are not considering it in the near future because most are comfortable with their internal expertise.

Outsourcing of stock monitoring and administrative functions

The monitoring of employer stock is not outsourced by the majority of organizations largely due to the high cost of an independent fiduciary. Among those that maintain employer stock as an investment choice in their retirement plans, 57% of sponsors monitor employer stock in DC plans in-house and 50% do so for the employer stock in their DB plans.

Administrative functions in DB plans are more commonly outsourced to a third party than investment functions. Only 26% of DB plan sponsors handle administrative functions internally, while 69% outsource these functions to a third party. A small minority of sponsors (5%) handle some administrative functions internally and some are outsourced. DB sponsors with separate committees for investment and administration functions are slightly more inclined to handle administration functions in-house than those with one committee for administration and investments (29% versus 21%).

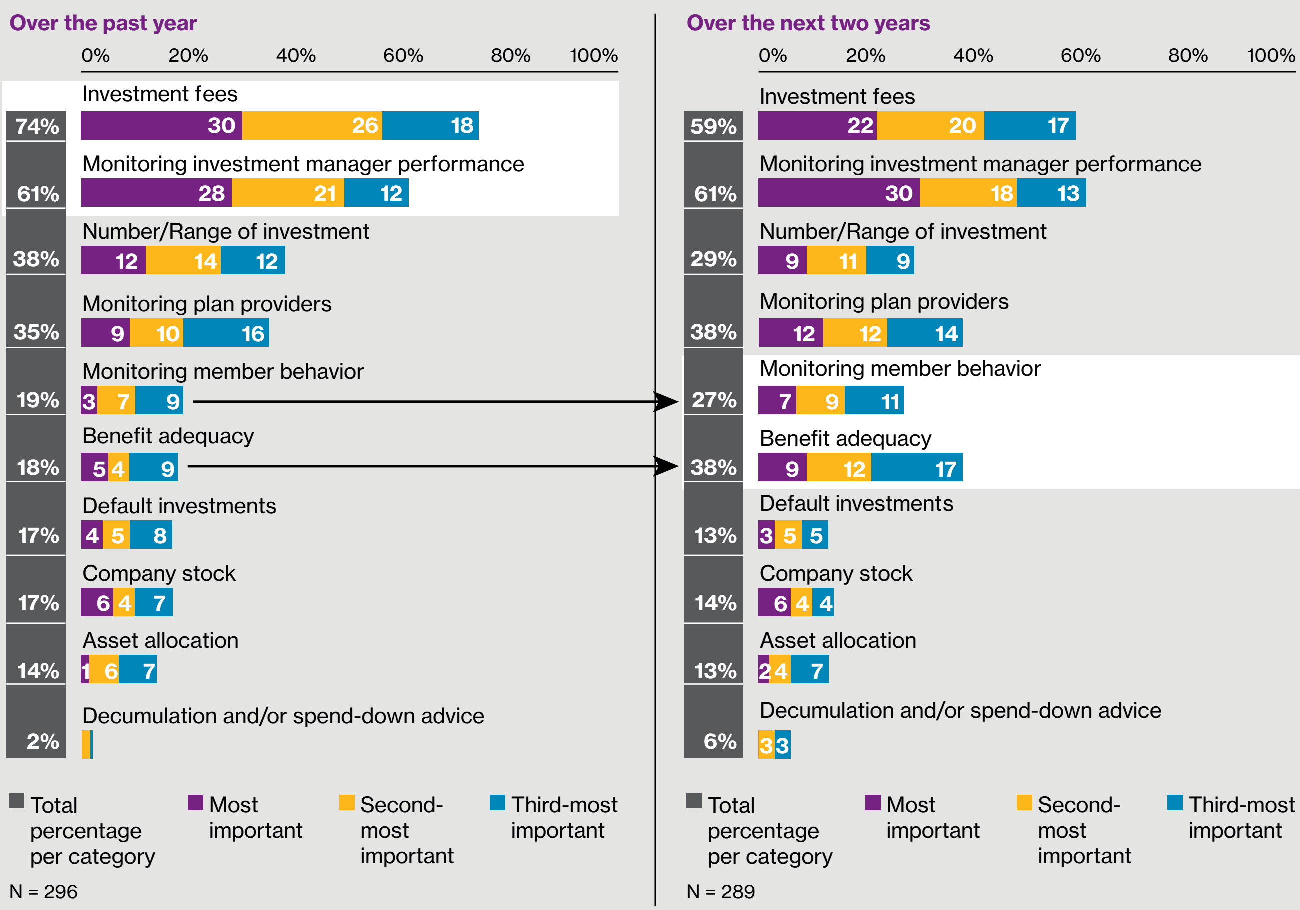
Governance strategy – priorities for today and tomorrow

Investment governance

Today, the majority of DC sponsors report that they devote investment resources to monitoring fees (74%) and investment managers (61%). While over the next two years resources allocated to these issues are expected to continue being significant, we expect to see a greater focus on benefit adequacy and monitoring participant behavior *(Figure 6).*

This shift reflects the increasing concern over retirement readiness and the fact that more DC plan sponsors are expecting to prioritize their resources to help ensure their employees can retire in a timely manner. In fact, the percentage of DC plan sponsors that prioritize benefit adequacy is expected to roughly double in the next two years, increasing from 18% to 38%. Our findings also indicate that in two years it is expected that benefit adequacy will be one of the top three areas in investment governance to which sponsors devote resources. And during the same two-year period, the percentage of these sponsors devoting resources mainly to monitoring participant behavior is expected to increase from 19% to 27%.

Figure 6. **DC sponsors now largely devote resources to monitoring fees and investment managers but expect to shift in the next two years to focus on benefit adequacy and member behavior**



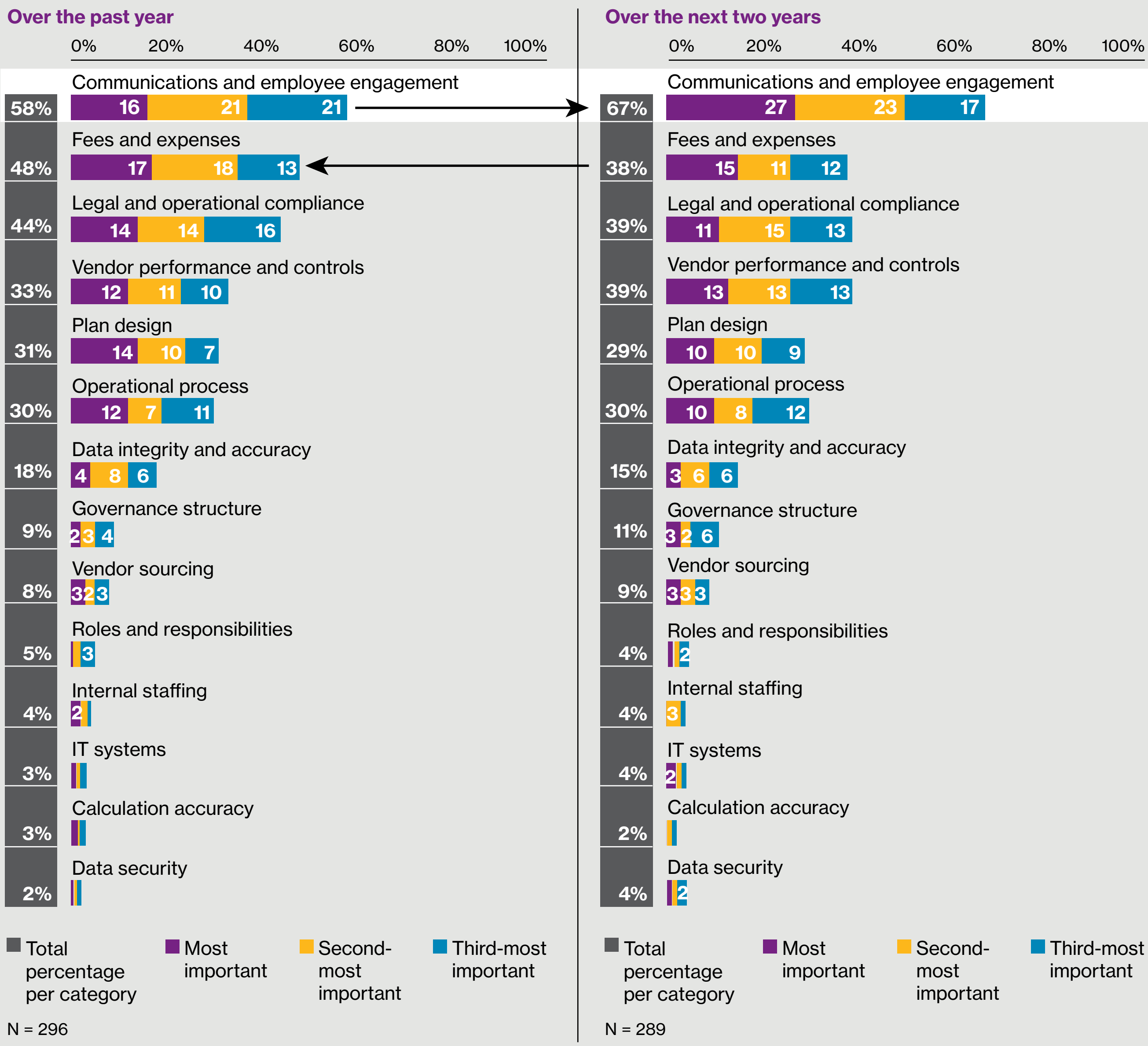
Regarding investment governance, DB plan sponsors are not anticipating a similar shift in priorities as DC plan sponsors. The majority of DB sponsors report devoting resources mainly to monitoring investment manager performance (79%) and asset allocation (74%). The focus on these priorities is not expected to change over the next two years. During the same period, we can expect plan sponsors to focus on the number and types of investments (50%), and the monitoring of plan providers (49%).

Operational excellence

The majority of DC plan sponsors (58%) indicated that they are allocating resources mainly to communications and employee engagement *(Figure 7).* Over the next two years, this focus will increase even further, with 67% of sponsors expecting to allocate primary resources to this area. During the same period, the percentage of DC plan sponsors devoting resources to fees and expenses is expected to decrease from 48% to 38%.

On the other hand, DB plan sponsors reported that their top resource devoted to operational excellence was legal and operational compliance. Over the next two years, the percentage of sponsors devoting resources mainly to this area is expected to decrease slightly from 46% to 43%. At the same time, de-risking preparedness is expected to become the top resource devoted to DB operational excellence, with the percentage of DB plan sponsors allocating resources to de-risking preparedness increasing from 40% to 49% in the next two years. We see a difference between active DB sponsors and those that no longer offer a pension to new hires. Thirty-two percent of sponsors that offer a DB plan to new hires report de-risking preparedness as top priority over the next two years, compared to 56% of respondents that no longer offer a pension.

Figure 7. **The majority of DC plan sponsors are allocating resources to communications and employee engagement**



Measuring effectiveness

Monitoring practices

Our research uncovered the following key findings related to monitoring practices of DC plan sponsors:

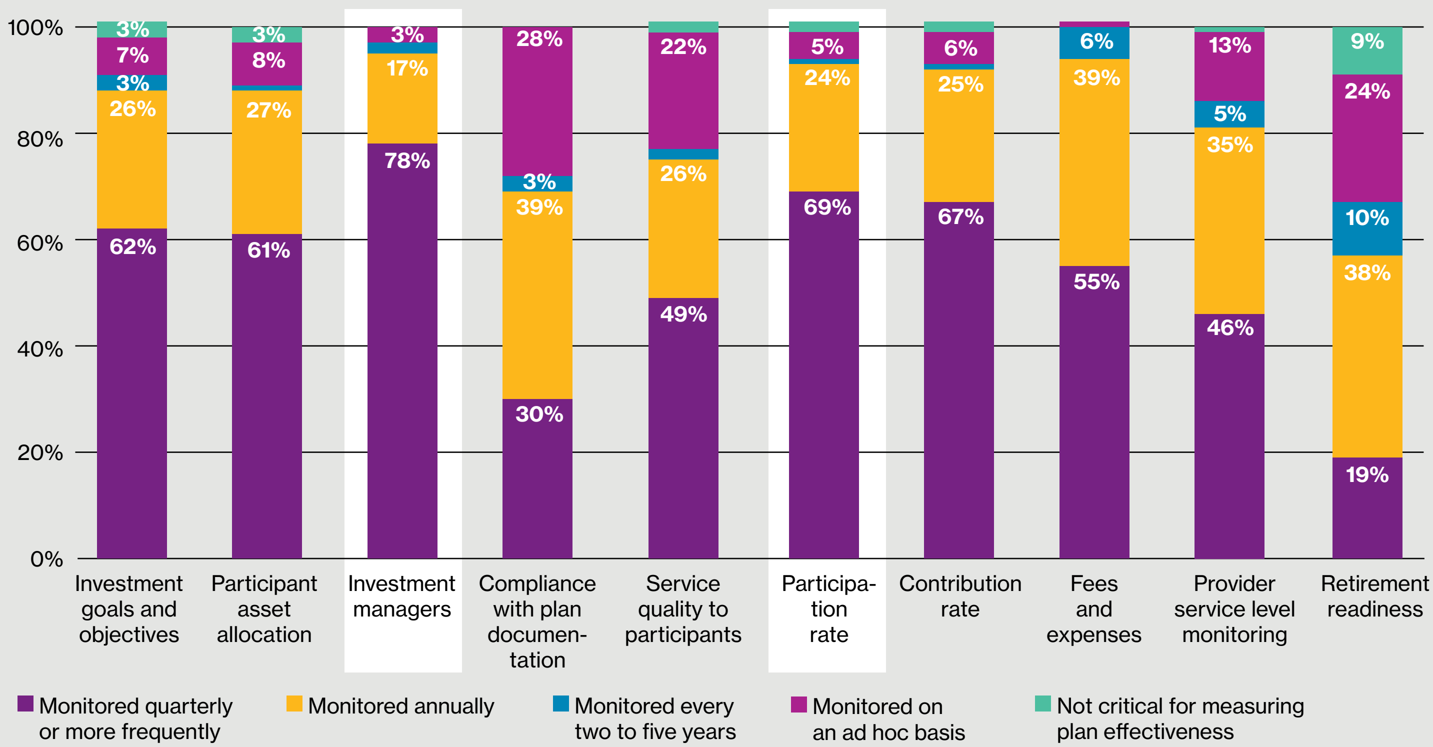
- DC plan sponsors monitor investment managers more than other aspects of their plan *(Figure 8)*. Seventy-eight percent indicated that they monitor investment managers frequently, that is, quarterly or more often. These sponsors also reported monitoring participation rates (69%) and contribution rates (67%) frequently. Over half of DC plan sponsors say they monitor investment goals and objectives, participant asset allocation, and fees and expenses on a frequent basis.

DC plan sponsors monitor investment managers more than other aspects of their plan.

- While the majority monitor employee contribution and participation rates, only 19% of DC plan sponsors monitor retirement readiness frequently. Another 38% monitor this aspect of their plan annually. Almost a quarter (24%) monitor retirement readiness on an ad hoc basis. And roughly 10% say this aspect is not critical to measuring plan effectiveness.

These findings suggest that sponsors have an opportunity to improve the governance of DC plans by increasing the frequency with which they monitor retirement readiness, as specific metrics on readiness would offer sponsors insight on the overall effectiveness of their plan.

Figure 8. **DC plan sponsors monitor investment managers more than other aspects of their plan**



N = 301
Note: Due to rounding some categories might not sum to 100%.

DB plan sponsors focus on monitoring investment-related issues:

- The most monitored aspects of DB plans include plan asset allocation (82%), investment managers (80%), and investment goals and objectives (69%), which are monitored quarterly or more frequently *(Figure 9).*
- Over half monitor funded status (65%), as well as fees and expenses (53%) on a frequent basis.
- DB plan sponsors are less concerned with their plan documentation compliance relative to investment-related issues. Less than a third (31%) monitor this aspect of their plan frequently; 35% monitor it annually, and another 30% do so on an ad hoc basis.

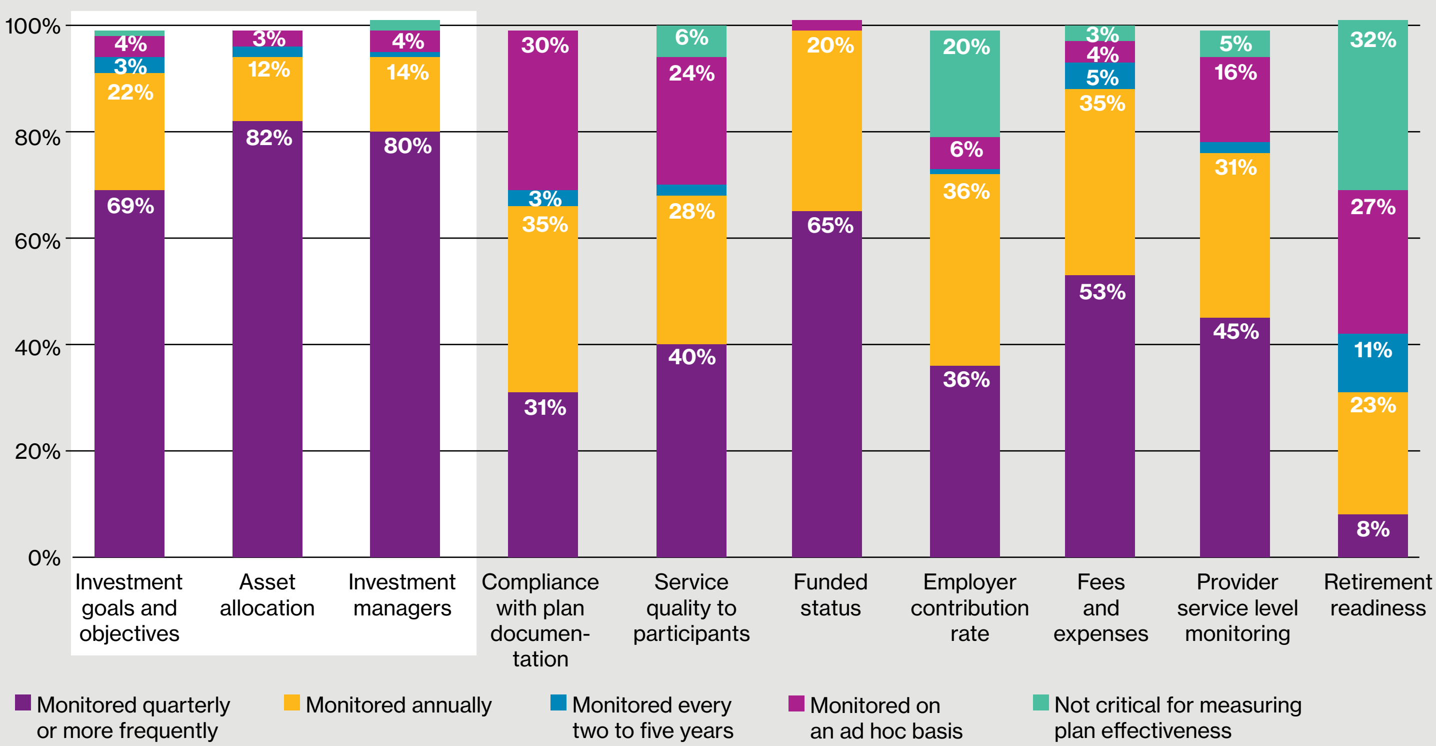
Barriers to governance

Thirty-nine percent of respondents reported facing moderate to significant barriers to effective governance related to legislative and regulatory complexity. And 31% said the same regarding lack of time *(Figure 10).* Those that indicated that lack of time was a barrier to better governance typically measured items less often that those that did not have this issue.

Documentation responsibilities

In most cases, organizations with separate committees for administration and investment use more tools to document responsibility related to governance when compared to those that have just one committee. More than 90% of organizations use minutes, investment policy and agendas.

Figure 9. **The most monitored aspects of DB plans are participant asset allocation, investment managers, and investment goals and objectives**



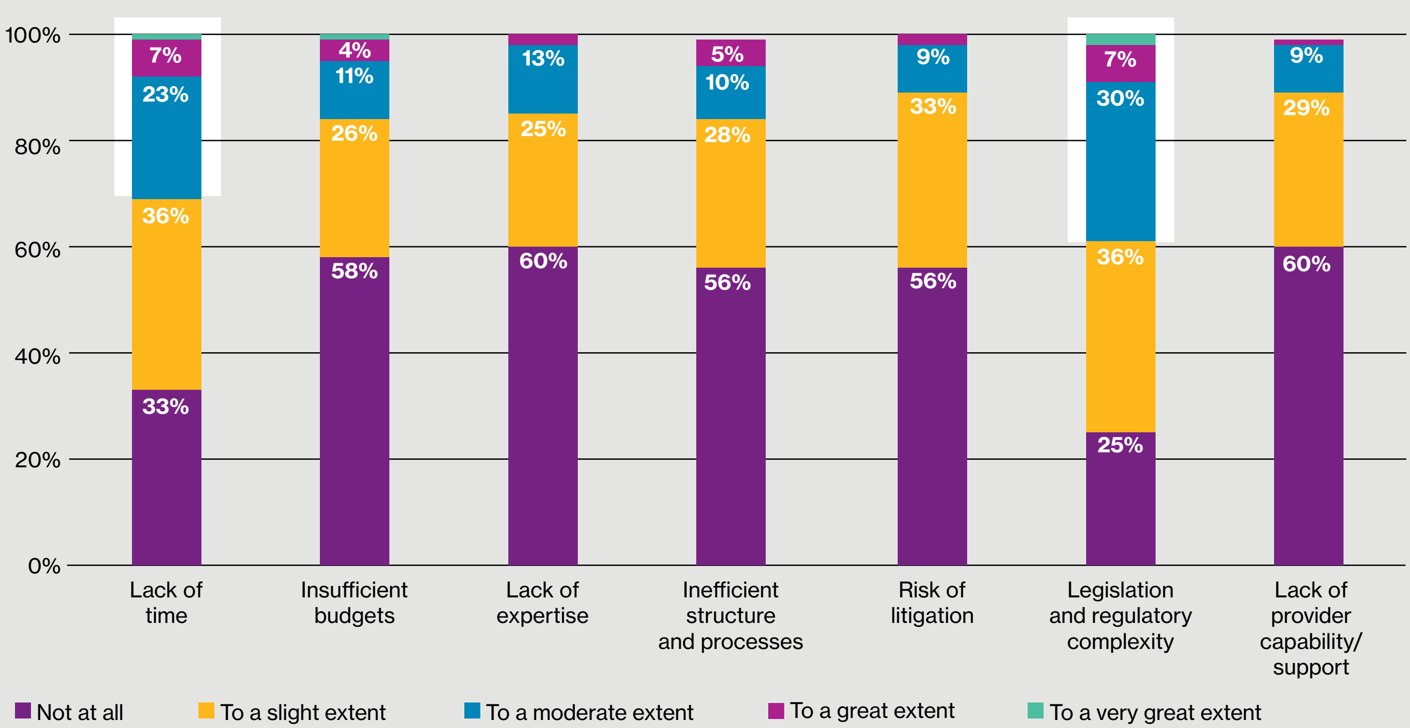
N = 224
Note: Due to rounding some categories might not sum to 100%.

Are measuring practices in line with risk perceptions?

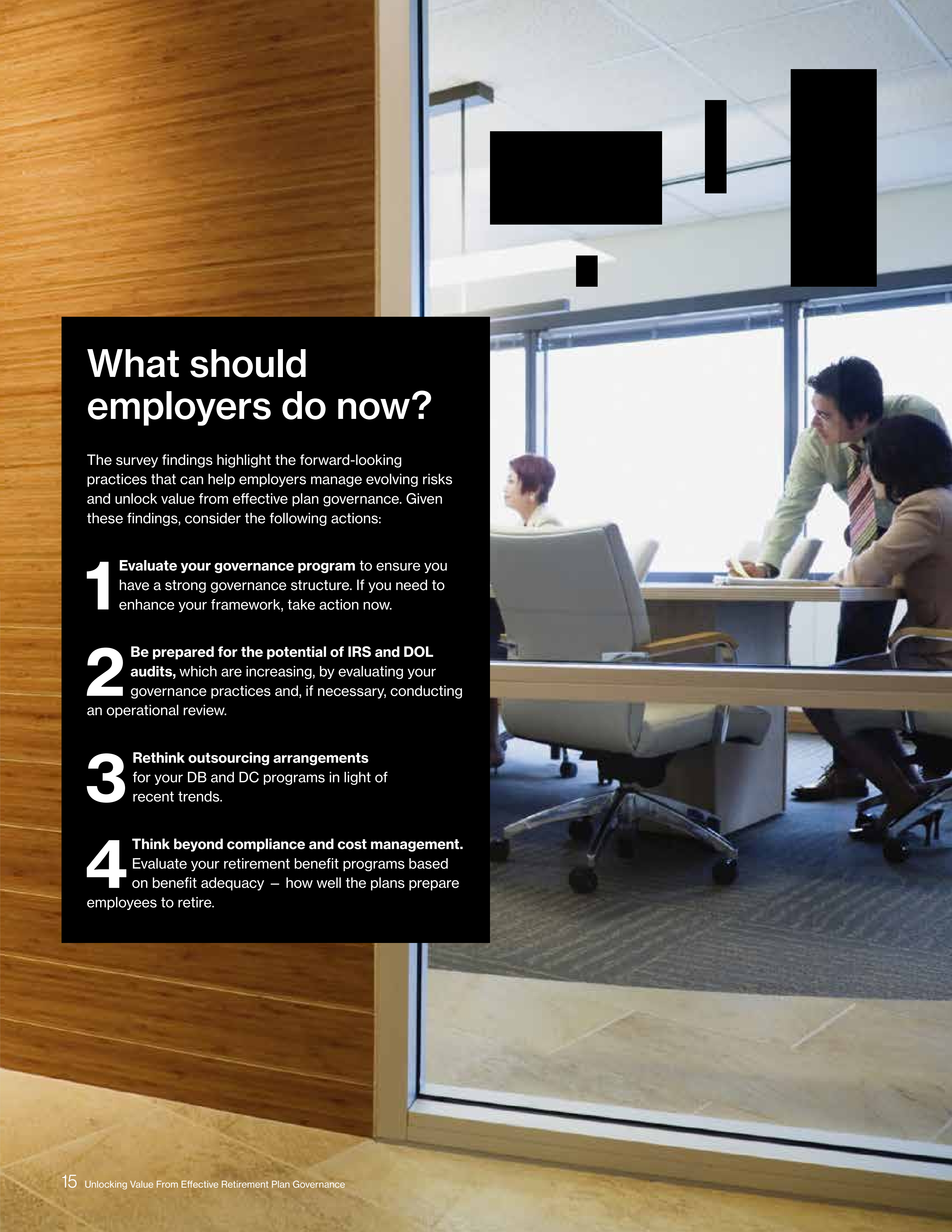
- Overall, sponsors are closely monitoring aspects of the top risks – especially investment volatility and retirement benefit costs – fairly frequently.
- There is room to improve the monitoring of compliance with plan documentation. Even among organizations that selected regulatory compliance as a top three risk, only 33% of DC plan sponsors and 28% of DB plan sponsors say that they monitor compliance with plan documentation frequently. A map of governance roles and responsibilities that includes a calendar of key dates and events can help employers stay proactively aware of where they stand.

A map of governance roles and responsibilities that includes a calendar of key dates and events can help employers stay proactively aware of where they stand.

Figure 10. **Barriers to governance include legislative and regulatory complexity, and lack of time**



N = 301
Note: Due to rounding some categories might not sum to 100%.



What should employers do now?

The survey findings highlight the forward-looking practices that can help employers manage evolving risks and unlock value from effective plan governance. Given these findings, consider the following actions:

1. **Evaluate your governance program** to ensure you have a strong governance structure. If you need to enhance your framework, take action now.

2. **Be prepared for the potential of IRS and DOL audits,** which are increasing, by evaluating your governance practices and, if necessary, conducting an operational review.

3. **Rethink outsourcing arrangements** for your DB and DC programs in light of recent trends.

4. **Think beyond compliance and cost management.** Evaluate your retirement benefit programs based on benefit adequacy – how well the plans prepare employees to retire.

About the survey

The Willis Towers Watson U.S. Retirement Plan Governance Survey, fielded in February and March 2016, examines current and evolving practices in four key areas of governance: risk, structure, strategy and measuring effectiveness. The survey participants comprise over 300 retirement sponsors representing a range of industries including Energy, Financial Services, Health Care, Insurance, Manufacturing, Retail, Technology and Utilities *(Figure 11).*

Figure 11. **Survey demographics**

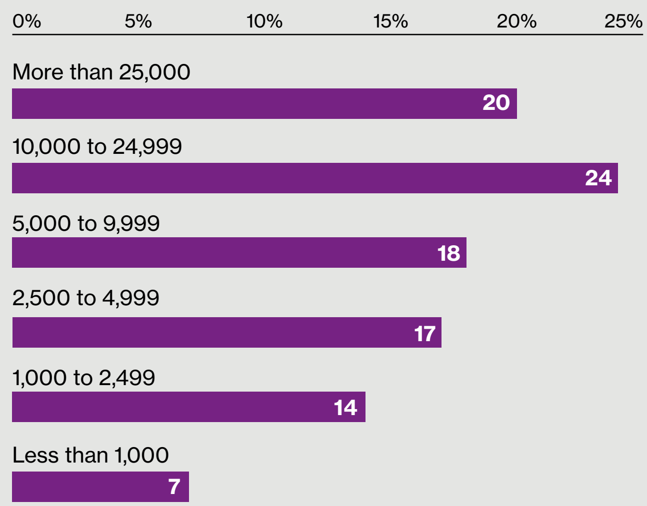
Type of plan

DB	**77%**
DC	**99%**
Non-tax-qualified retirement	**64%**
Retiree health care	**63%**
Health and welfare	**92%**
Other	**8%**

Status of your largest DB non-bargaining pension plan

Open	**27%**
Closed to new hires	**23%**
Partially frozen	**8%**
Frozen	**35%**
Frozen, in the process of plan termination	**4%**
We do not sponsor a non-bargaining pension (union only)	**3%**

Employees in the U.S.



About Willis Towers Watson

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