Evolving Risks, Structure and Strategies in Retirement Plan Governance

Highlights from the 2016 Willis Towers Watson U.S. Retirement Plan Governance Survey

Executive summary

Investment volatility, benefit costs, regulatory and legislative compliance, and the benefit adequacy of an aging workforce top the list of concerns for defined contribution (DC) and defined benefit (DB) plan sponsors. This is one of the key findings of the 2016 U.S. Retirement Plan Governance Survey, which examines the current and evolving governance practices of over 300 retirement plan sponsors across a range of industries and company size. This research explores four areas critical to effective plan governance: risk management, levels of governance, strategy and the measuring of plan effectiveness.

Three major trends emerge from the survey findings:

- **Employers have a growing concern over retirement benefit adequacy and financial well-being.** Retirement 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. Our findings point to a shift in resources away from fees and expenses toward benefit adequacy and retirement readiness over the next two years. Cost will still be top of mind but to a lesser extent during this period.

31% of sponsors have faced a **government audit** of their plan(s) over the past two years.

- **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, with more than 30% outsourcing manager selection and implementation activities.
- **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.

39% of sponsors say **workers' inability to retire in a timely fashion is a top risk.** And this is the top risk for those that manage only a DC plan.

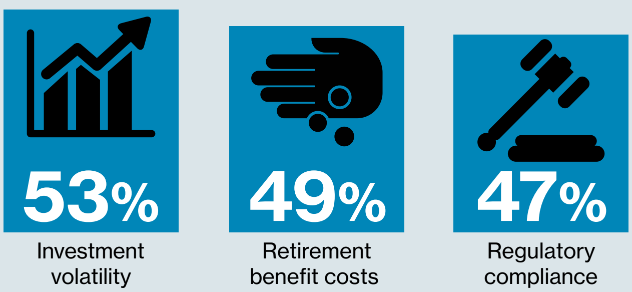
Overall, the survey findings highlight the governance practices essential to managing risks and achieving positive outcomes that deliver value to both plan participants and employers.

Managing risks

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

What's keeping plan sponsors up at night? Sponsors identified the following as their top three retirement plan risks: investment volatility (53%), retirement benefit costs (49%) and regulatory compliance (47%). These were closely followed by workers' inability to retire in a timely fashion, which 39% of sponsors identified as a top risk. The respondents indicated that they expect these risks to remain top of mind over the next two years.

Top three retirement plan risks



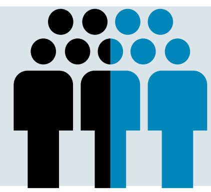
Concerns about risks vary by plan offering:

- As more companies move to DC plans, the ability of workers to retire in a timely fashion becomes critically important, prompting sponsors to prioritize resources that promote retirement readiness. The top risk for those that manage only a DC plan is retirement readiness.
- For employers with DB plans, benefit adequacy is a growing issue among those with inactive plans. De-risking preparedness will increase in importance over the next two years and become the top resource devoted to operational excellence among DB plan sponsors.

Regulatory risks

While regulatory compliance is a top concern of sponsors, our findings reveal that there is room to improve the management of this risk through operational reviews. Only 58% 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 that selected regulatory compliance as their number one risk have conducted operational compliance reviews in the past two years.

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



Levels of governance

Committees: structure and composition

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

Key findings related to committee membership and training:

- Overall, governance committees are comprised on average of 4.7 members, with the chief human resource officer, chief finance officer and treasurer sitting on the majority of committees.
- More than half of members (62%) are formally trained either when they join a committee or on a scheduled basis. Larger organizations are more inclined to train their members on a scheduled basis; almost half of employers with over 25,000 employees fit this criteria.

Plan sponsors that outsource at least one aspect of investment services

26% DC plan sponsors

33% DB plan sponsors

Investment oversight

In the majority of cases, the investment committee makes investment decisions regarding asset allocation, manager selection and implementation regarding investment services with assistance from a third party regardless of plan type. Twenty-six percent of DC plan sponsors fully or partially outsource at least one aspect of their investment services, and 33% of DB plan sponsors do so. Manager selection and implementation activities are the most frequently outsourced. 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.

Retirement plan sponsors that outsource investment functions cite increased governance and enhancing risk management as their main drivers. Administrative functions in DB plans are more commonly outsourced to a third party, while the monitoring of company stock still remains in-house.

Governance strategy

Priorities for today and tomorrow

Given the increasing concern over retirement readiness, more sponsors are expecting to prioritize their resources to help ensure their employees can retire in a timely manner.

Shifting priorities

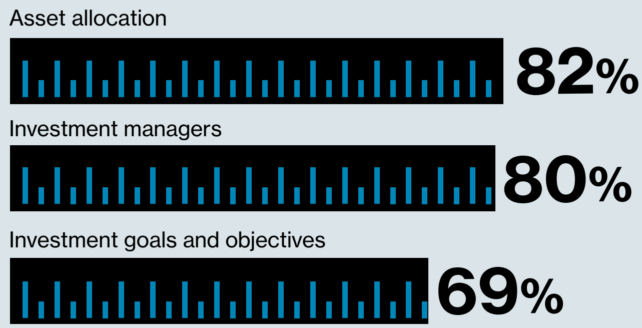
Today: The majority of DC plan sponsors report devoting their top investment resources primarily to **monitoring investment fees (74%)** and **investment manager performance (61%).**

Tomorrow: In the next two years, more sponsors are expected to shift their focus toward **benefit adequacy** and **monitoring participant behavior.**

In terms of operational excellence, the majority of DC plan sponsors (58%) indicated they are allocating their top resources mainly to communications and employee engagement. Over the next two years, this focus will increase even further, with 67% of sponsors expecting to allocate their top resources to this area. Over the same period, the focus on fees and expenses is expected to decrease.

DB plan sponsors reported that their top resource devoted to operational excellence is legal and operational compliance. Over the next two years, de-risking preparedness is expected to become the top resource, with the percentage of sponsors citing de-risking preparedness as their most important resource, increasing from 40% to 49% during this period.

Frequently monitored aspects of DB plans



Measuring effectiveness

- DC plan sponsors reported that they monitor investment managers more than other aspects of their plan. Seventy-eight percent indicated that they monitor investment managers frequently, that is, quarterly or more often. While the majority of sponsors monitor employee participation and contribution rates frequently, only 19% monitor retirement readiness with the same frequency despite the growing concern of DC plan sponsors over benefit adequacy.
- The most monitored aspects of DB plans include investment-related issues such as asset allocation (82%), investment managers (80%), and investment goals and objectives (69%), which are monitored quarterly or more frequently.
- 39% of respondents reported facing moderate to significant barriers to effective governance related to legislative and regulatory complexity to a moderate or greater extent. And 31% said the same regarding lack of time.

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. Consider the following actions:

- *Evaluate your program* to ensure you have a strong governance structure. If you need to enhance your framework, take action now.
- *Be prepared for the potential of DOL and IRS audits,* which are prevalent, by evaluating your governance practices and, if necessary, conducting an operational review.
- *Rethink outsourcing,* especially for your DB program, in light of recent trends.
- *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 manufacturing, health care, technology, financial services, insurance, energy, utilities and retail.

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