

**2014**

# **Managing Financial Risk in Retirement and Benefits Programs**

**Translating Awareness  
into Action**



A report prepared by CFO Research  
in collaboration with  
Prudential Financial, Inc.





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# Research Sponsor's Introduction

THIS REPORT MARKS THE FIFTH YEAR PRUDENTIAL has partnered with CFO Research to gain insights into how finance executives are thinking about their companies' retirement and employee benefit programs. Our research findings point to an increasing outcome orientation among U.S. companies: a desire for more certainty with respect to managing defined benefit (DB) plan risks, an understanding of the need for more DB-like outcomes from defined contribution (DC) plans, and a desire to enhance the financial wellness of employees while managing benefits costs. These findings are highly consistent with what we are hearing in conversations with our own institutional clients.

**DB plans** – With improvements in the capital markets, there has been significant improvement in the funded status of defined benefit plans. However, plan sponsors are now facing larger PBGC premiums and the upcoming adoption of new mortality assumptions, which will significantly increase DB plan liabilities. Numerous employers have reduced risk by closing their DB plans to new hires, freezing their plans, and/or adopting liability-driven investment strategies. Moreover, the last two years have seen a resurgence of annuity buy-out transactions – which eliminate DB plan risks by transferring them to a third party.

**DC plans** – While 401(k) balances have generally recovered from the lows experienced five years ago, most employees still need to be saving more. As coverage shifts from DB plans to DC plans for many private sector employees, companies are looking at ways to improve employees' efforts to save enough for retirement and to create secure retirement

income from DC plans. The result is an expansion in the use of automatic enrollment, automatic escalation of contributions, and qualified default investment alternatives – such as target-date funds. Stable value products are recognized for the guarantees they provide to plan participants, and there is an increasing appetite among plan sponsors to consider lifetime income products for DC plans.

**Employee benefits programs** – Finance executives are refining their approach to employee benefit offerings as these programs continue to evolve and as the implications of healthcare reform continue to unfold. Similar to the shift we have seen in retirement plans, other employee benefit programs are moving to a DC-like model as well. This model allows the employer to allocate a certain amount of money toward employee benefits, giving employees greater choice while controlling costs for employers. In parallel, companies are making more voluntary products available to employees to enhance overall benefits offerings.

The landscape of retirement and employee benefits will continue to be very dynamic. We expect that companies will increasingly look for ways to manage the risks associated with these offerings, while helping employees manage their own risks on the path to financial wellness and retirement security.

Thank you for taking the time to engage on these important issues.

**Steve Pelletier**

Executive Vice President and Chief Operating Officer, U.S. Businesses

# Executive Summary

IN FEBRUARY 2014, CFO RESEARCH—IN conjunction with Prudential Financial, Inc.—surveyed senior finance executives from a range of midsize and large U.S. companies (“2014 survey”). CFO Research and Prudential have carried out similar studies for the past five years, allowing us to track long-term trends in the evolution of retirement and benefits strategies. As in the previous studies, the 2014 survey targeted companies that have defined benefit (DB) plans with \$250 million or more in assets. This year, the survey focused on finance executives’ increasing interest in pension de-risking strategies, as financial performance and funded status both improve. We also explored the different options that companies are considering to enhance defined contribution (DC) plans and achieve a better balance in other employee benefits offerings.

Some of the key findings from this year’s report are as follows:

■ Overall, finance executives feel that their companies are in a better financial position to consider a range of options for managing pension risk; many companies have experienced an improvement in funded status as a result of equity market improvements combined with increasing discount rates. Executives are now able to weigh the relative advantages and disadvantages of plan restructuring alternatives that can lead to the ultimate disposition of their pension liabilities. They show a growing awareness of, and interest in, DB plan liability transfer solutions, as well as increased interest in liability-driven investment (LDI) strategies for their DB plan portfolios.

■ Many finance executives in this year’s survey perceive a trend toward employees extending their careers beyond historical retirement ages. In the face of this, companies are also considering expanding offerings in defined contribution (DC) plans to enhance security and reduce volatility in their employees’ retirement investment strategies. Automatic enrollments, stable value funds, and guaranteed income products are receiving more attention, and executives continue to consider ways to enhance target-date funds to reduce risk and provide retirement income. Awareness of the benefits of guaranteed income products, in particular, has gained ground among finance executives over the last several years.

■ Controlling the employer’s cost for company-provided healthcare benefits remains the number-one benefits priority, but other benefits concerns are gaining more attention, as well. Interest in expanding the use of voluntary benefits, for both protection coverage and convenience services, remains strong. Finance executives also continue to explore ways in which either third-party providers or employees themselves can take more responsibility for managing employee benefits. Respondents in this year’s survey are examining newly established private health insurance exchanges, although relatively few are taking advantage of them yet. Most companies are not likely to consider switching employees out of company-provided health coverage completely and into public insurance exchanges.

Finance executives feel that their companies are in a better financial position to consider a range of options for managing pension risk.

# About this Report

CFO Research gathered a total of 182 complete survey responses from senior finance executives working in a broad cross-section of company segments, as follows:

## DB PLAN ASSETS

\$5B+	34%
\$1B-\$5B	29%
\$500M-\$1B	20%
\$250M-\$500M	17%

## ANNUAL REVENUE

\$5B+	51%
\$1B-\$5B	33%
\$500M-\$1B	14%
<\$500M	2%

## TITLES

Director of finance	29%
Controller	18%
Chief financial officer	13%
VP of finance	13%
Treasurer	6%
EVP or SVP of finance	3%
Other senior finance executive	9%
CEO, president, or managing director	2%
Chief risk officer	2%
Senior benefits manager or director	4%
Other benefits executive	1%

Note: Percentages may not total 100 percent, due to rounding.

Respondents work for companies in nearly every industry, with the largest segments representing financial services (including real estate and insurance) (31%), manufacturing (including auto and industrial manufacturing) (14%), and chemical, energy, and utilities companies (12%).

# Following a Path to De-Risking in DB Plans

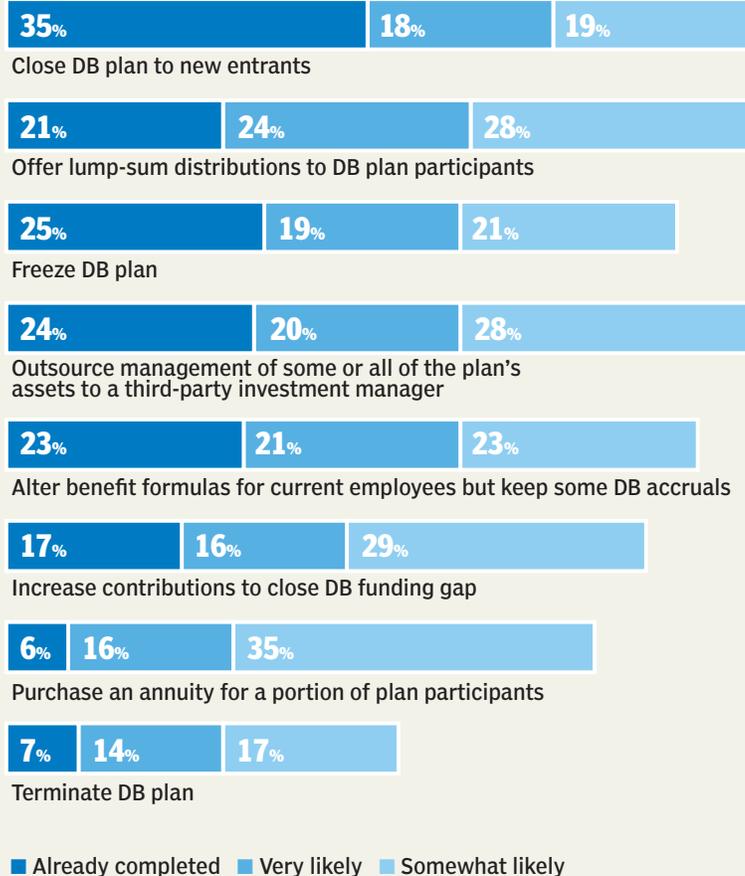
IN THIS YEAR'S SURVEY, THE RESULTS SHOW that companies with DB plans are at different stages in their strategies for de-risking. Overall, however, finance executives at the companies surveyed indicate that they are getting ready to move forward. Thirty-five percent (35%) of the companies in the 2014 survey—all of which have DB plans—have already closed their plans to new entrants, and one-quarter (25%) have frozen them. Responses are split equally between those who say that their companies are somewhat likely (19%) to close DB plans within the next two years, and those who characterize themselves as very likely to do so (18%). Approximately the same number of respondents say that they are either somewhat likely (21%) or very likely (19%) to freeze DB plans over the next two years. (See Figure 1.)

Finance executives are becoming more sensitive to the constraints that DB plan liabilities can place on the business. (See Figure 2, next page.) Half of the respondents (50%) believe that the volatility of their DB plan assets impacts earnings, while moderately lower numbers of respondents say that DB plan obligations place constraints on balance sheet leverage (44%) and cash (43%). Nearly as many (39%) are concerned about constraints on their companies' ability to invest in growth opportunities. This may be a timely finding, as corporate leaders look for ways to resume growth in a stubbornly sluggish economic recovery.

Particularly when compared with results from earlier surveys, finance executives

are increasingly interested in the role that DB liability transfer strategies can play in managing financial risk. In these types of solutions, companies purchase annuities for some or all of the obligations in a DB plan, and insurance companies take over the administration and distribution of benefits.

**FIGURE 1.** In your opinion, how likely is your company to make the following changes to its DB plan over the next two years?

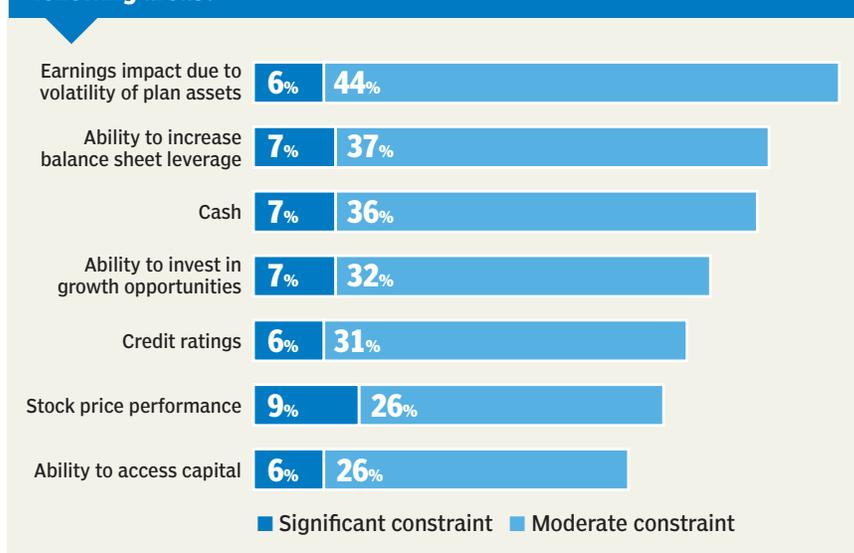


This year, more than half of the respondents (53%) report that their companies either have already transferred DB plan liabilities to a third-party insurer (5%), or are likely to do so within two years (9% very likely and 39% somewhat likely). While the percentage of companies saying they have executed liability transfer strategies remains the same as in 2010, the percentage of companies open to examining the issue has increased over the years. (See Figure 3.)

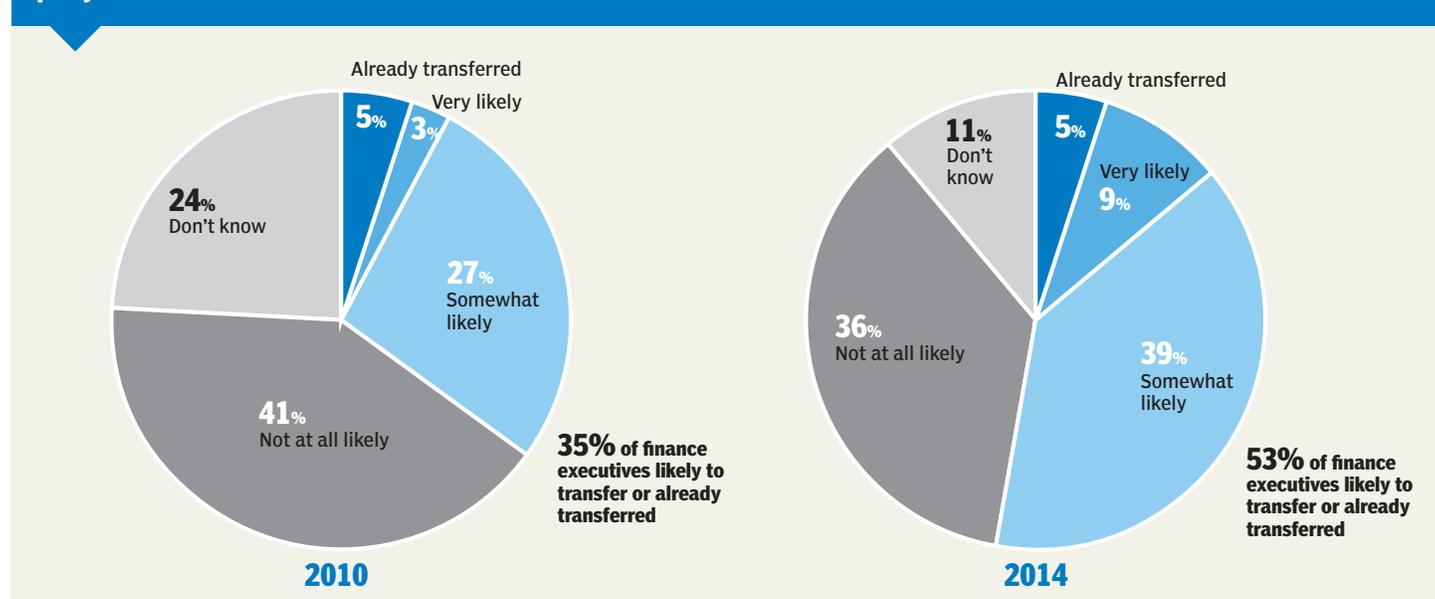
The level of discussion about these types of solutions is increasing, as well. Three-quarters of this year's respondents (76%) note that their companies have discussed DB liability transfer solutions either internally, with their pension committees or at the board level, or externally, with consultants, actuarial and accounting firms, or other advisors. Half of the respondents (51%) say that transferring DB risk to a third party would allow them to focus more attention on managing their own businesses, and nearly four out of ten (39%) are optimistic

Finance executives are becoming more sensitive to the constraints that DB plan liabilities can place on the business.

**FIGURE 2.** To what extent do the obligations from your company's DB plan constrain your company's financial performance in the following areas?



**FIGURE 3.** Within the next two years, how likely is your company to transfer liabilities from your DB plan to a third-party insurer?



that recent improvements in their funded status can move them closer to this goal. (See Figure 4.)

Liability-driven investment (LDI) strategies are becoming increasingly important in helping finance executives move their companies toward their ultimate goals for their DB plans. Seventy-two percent (72%) of respondents confirm that some portion of their DB assets are currently invested in LDI strategies. As shown in Figure 4, LDI is seen as an initial step towards full DB liability transfer by 44% of the respondents.

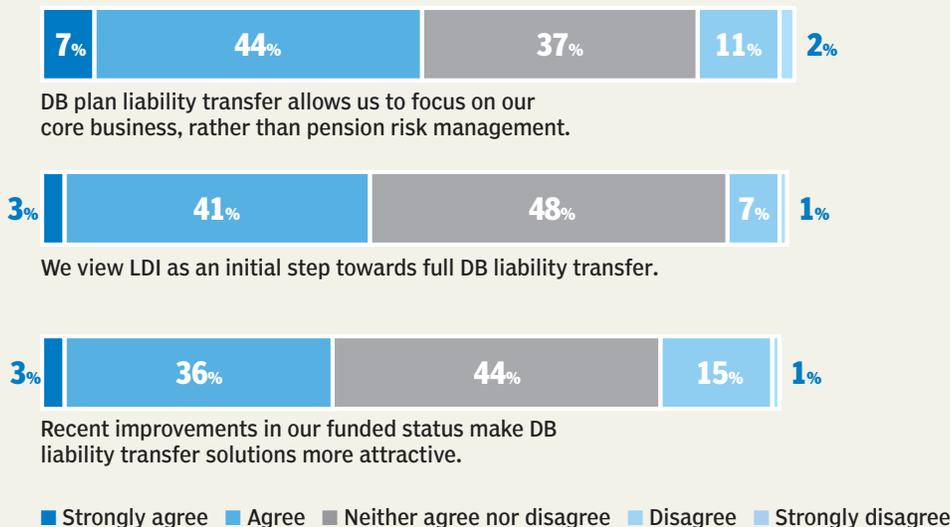
Finance executives in the survey are also giving more consideration to lump-sum distributions as they look for ways to reduce the financial risk of DB plan liabilities. One out of five respondents (21%) has already employed this tactic, while 52% say that they are likely to offer a lump-sum distribution within two years. (See Figure 1, previously.)

Finance executives continue to track the effects that increasing longevity—that is, longer average life expectancy—may have on decisions for managing DB plan liabilities. Nearly two-thirds (64%) of respondents' companies have modeled future DB contributions to account for increasing longevity, and 57% of companies have either conducted a review of participant mortality experience within the past 12 months, or are planning a review within the next 12 months.

Finance executives continue to track the effects that increasing longevity may have on decisions for managing DB plan liabilities.



**FIGURE 4.** To what extent do you agree with the following statements about reducing DB risk at your company?



# Enhancing DC Plans to Offer More Stability

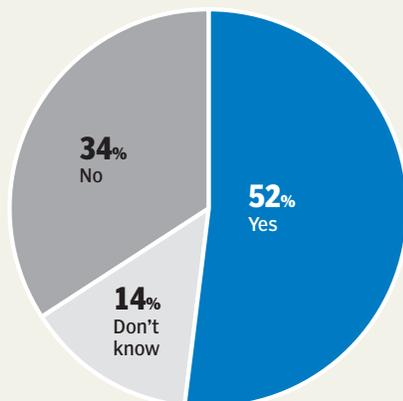
MANY EMPLOYEES ARE NOW RELYING MORE on defined contribution (DC) plans for their retirement planning, and so finance executives continue to evaluate ways to enhance these plans to achieve better outcomes for participants. Respondents to this year's survey recognize employee retirement decisions as a business management issue, as well as an individual decision. Among the finance executives answering separate questions about changes over time in average retirement age, half (52%) believe that a significant portion of their companies' employees will have to delay retirement due to inadequate savings. A somewhat larger segment (59%) have seen an increase in their employees' average retirement age over the past five years, and practically the same number (61%) expect the average to continue to rise over the next five years. (See Figure 5.)

Seven out of ten respondents (69%) indicate that, if employees delay retirement due to financial or personal issues, their companies will need to actively manage the impacts on the business. Controlling workforce costs is the top concern, selected by 41% of respondents. Other concerns are split relatively evenly among forecasting and managing staffing needs (27%), retaining talent (26%), and maintaining employee morale (21%). (See Figure 6, next page.)

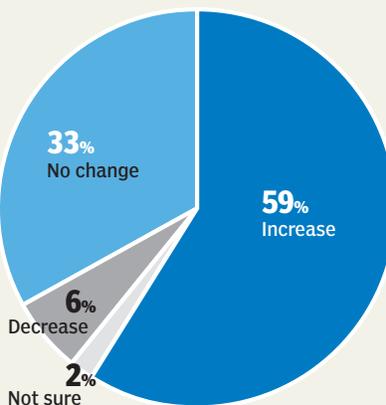
As a result, finance executives exhibit a growing interest in DC plan options that can support the security and stability of their employees' retirement resources. Mechanisms such as automatic enrollment, stable value funds, and guaranteed income products are attracting more consideration as companies

**FIGURE 5.** What kinds of changes are you seeing in retirement decisions among your company's employees?

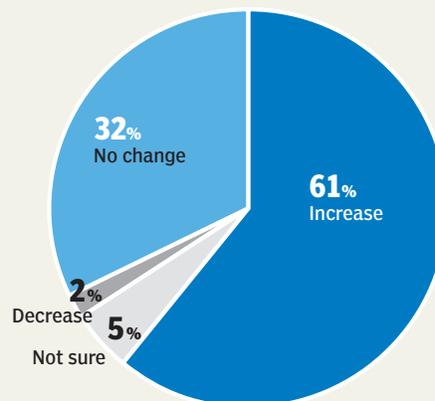
Do you believe that a significant portion of your company's employees will have to **delay retirement due to inadequate retirement savings**?



In your opinion, how has the **average retirement age** of your company's employees changed from five years ago?



What kinds of changes would you expect in the average retirement age of your company's employees within the **next five years**?



tailor features of their DC plans.

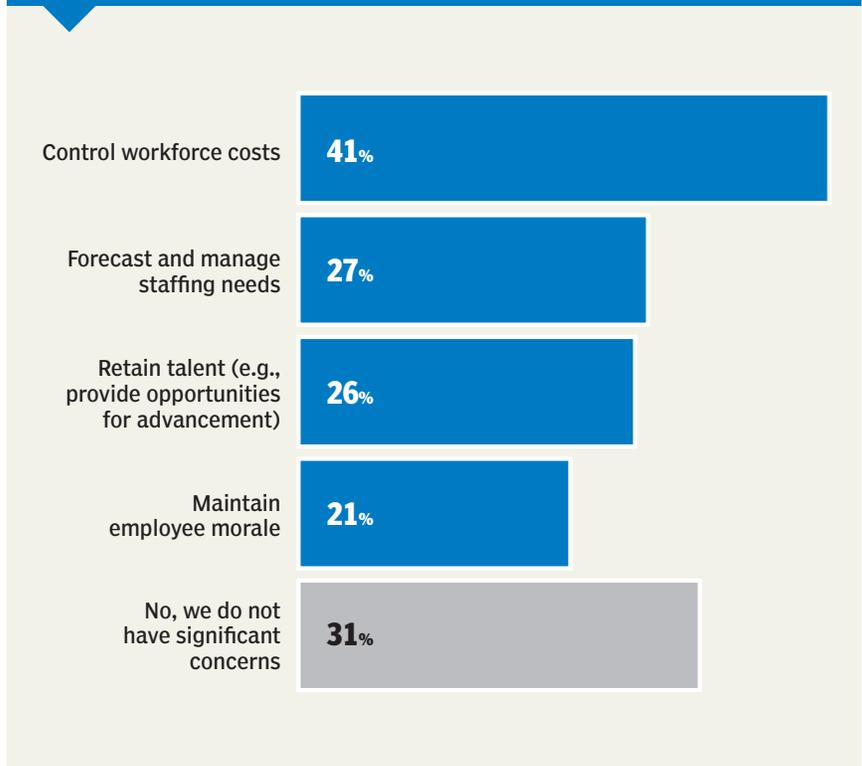
Approximately four out of ten of the companies surveyed (39%) already provide automatic enrollment of employees for their DC plans, and another 35% say it is likely their companies will implement automatic enrollment within two years. A similar number of companies have either adopted employer-match contribution formulas to encourage higher savings rates among employees (40%), or are likely to do so (36%).

In addition, a majority of respondents (61%) agree that the participants in their companies' DC plans value the stability of returns and safety of principal offered by stable value products. A little more than half of the respondents agree that providing downside risk protection would help DC plan participants stay invested in the stock market (53%), and as many agree that participants in DC plans will make better behavioral decisions (e.g., not getting out of investments at the wrong time) if they are invested in options that include a guaranteed income feature.

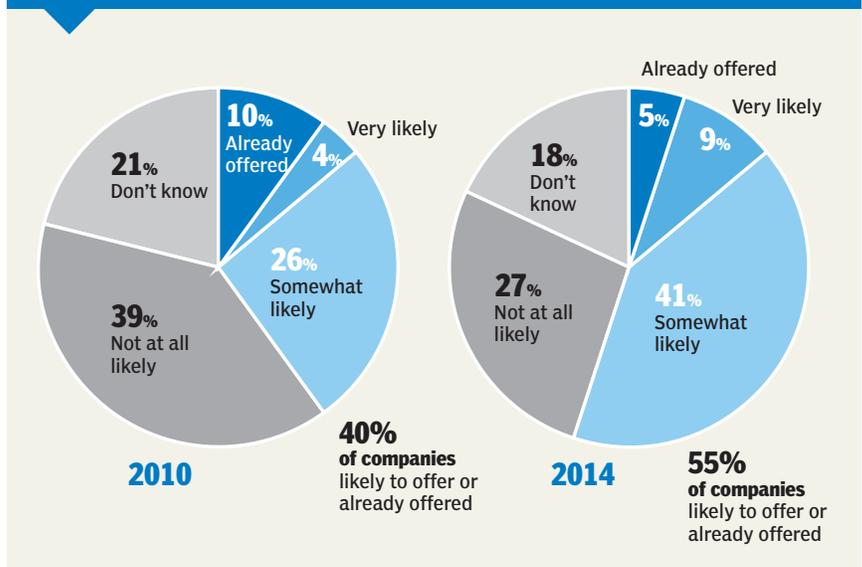
Correspondingly, more than half of the respondents (55%) report either that their companies already offer guaranteed income products in their DC plans (5%), or are likely to do so within the next two years (50%). Compared to finance executives surveyed in 2010, this result demonstrates an increasing acceptance of these types of products within DC investment portfolios. (See Figure 7.)

Slightly fewer than half of the respondents agree that target-date funds (which automatically rebalance investment portfolios as an individual nears or enters retirement) need to be enhanced to include the option of providing DC plan participants with guaranteed lifetime income (47%), as well as to provide more protection against market volatility (46%).

**FIGURE 6.** Are you concerned that employee decisions to delay retirement will make it more difficult for your company to accomplish the following objectives?



**FIGURE 7.** Within the next two years, how likely is your company to offer guaranteed lifetime income products for your DC plan?



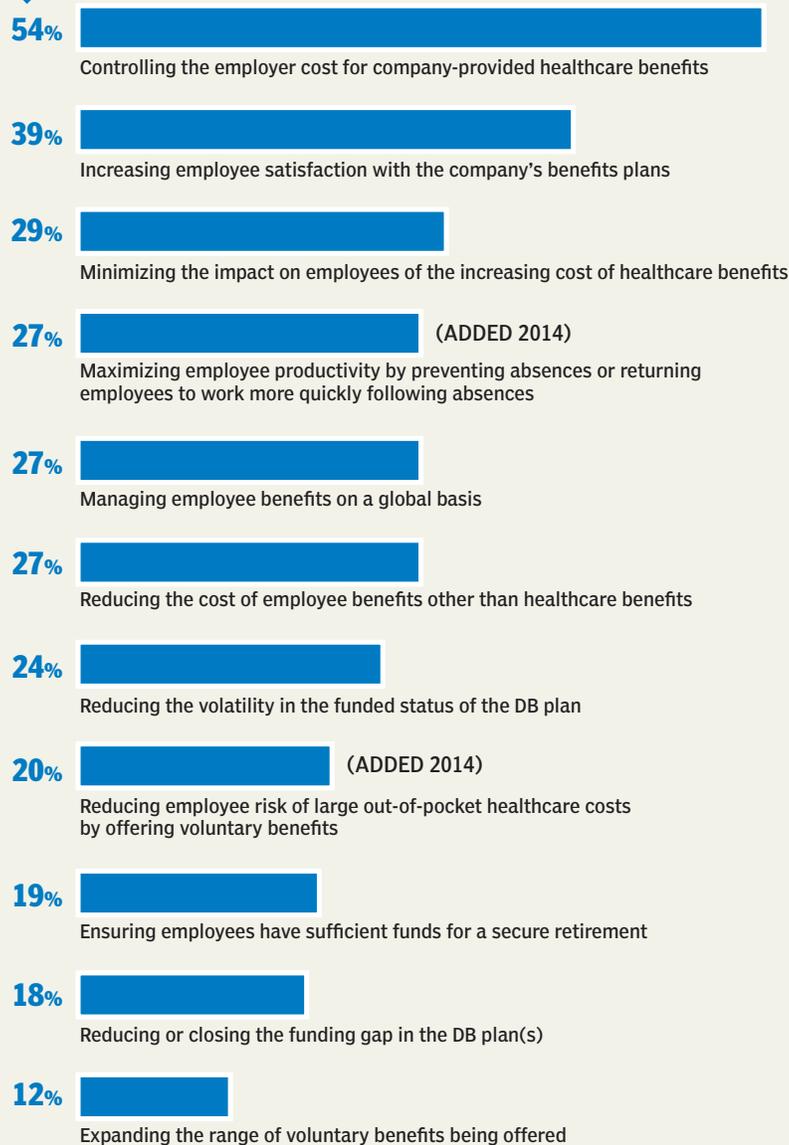
# Adapting Offerings to a Changing Benefits Environment

FINANCE EXECUTIVES CONTINUE TO VIEW benefits offerings as an important part of human capital management, with approximately three-quarters of respondents agreeing that employee satisfaction with benefits is important for their companies' success (76%), and that employee benefits are critical to attracting and retaining employees (77%). However, the steadily increasing cost of benefits programs remains a concern for finance executives, and they continue to seek the most value for their benefit expense.

Controlling the employer's cost for company-provided healthcare benefits remains the number-one benefits priority, selected by 54% of respondents. At the same time, increasing employee satisfaction with company benefits plans remains in place as the second-highest priority. (See Figure 8.) Three-quarters of this year's respondents (76%) also agree that providing a balanced mix of health insurance, retirement, and group benefits is important to their companies.

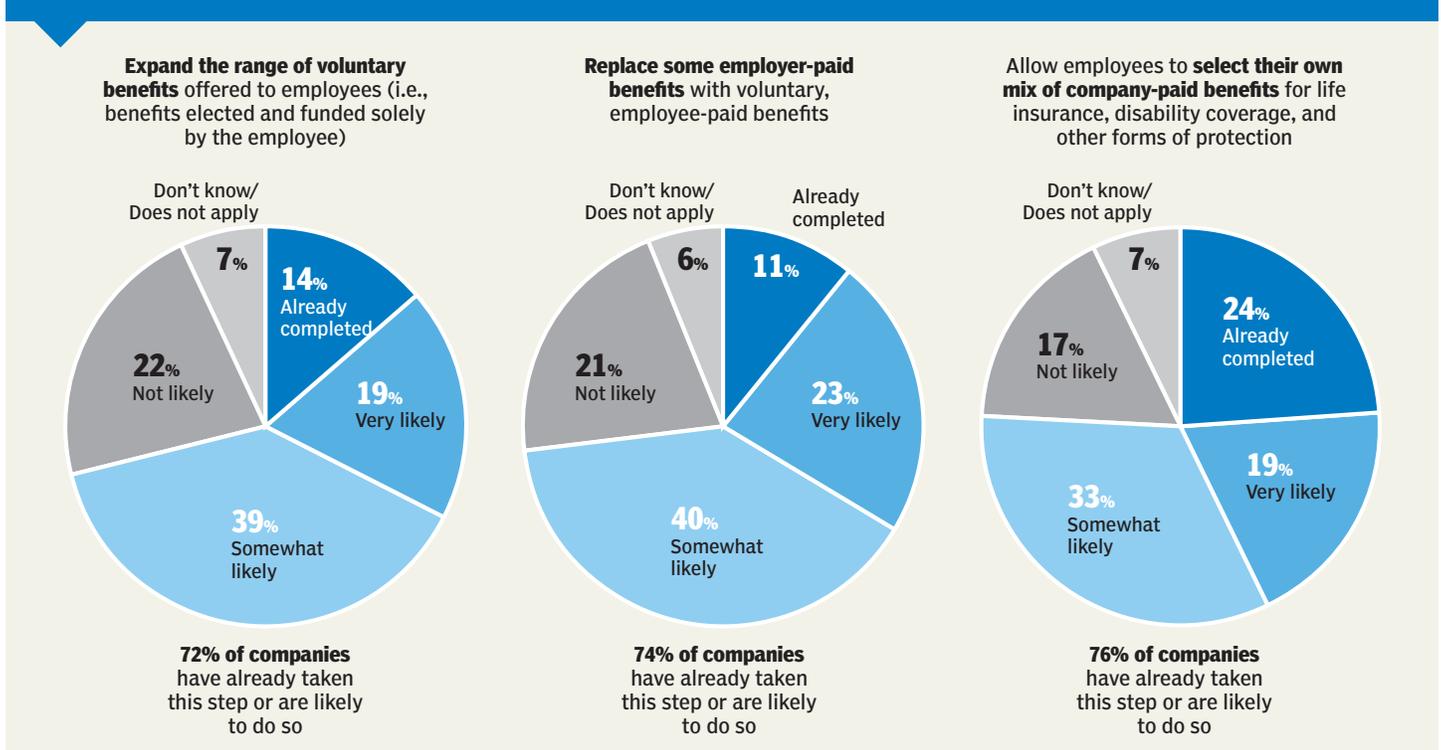
Seven out of ten respondents (70%) believe that offering voluntary benefits is one way to increase employee satisfaction with benefits while remaining cost-effective. About the same percentage (72%) say their companies are continuing to move towards greater use of voluntary benefits—more than half (58%) are likely to expand the range of voluntary benefits, and another 14% of respondents report that their companies have already done so. Similarly, 23% are very likely, and 40% are somewhat likely, to replace some employer-paid benefits

**FIGURE 8.** Which of the following are your company's top priorities for its employee benefits programs over the next year?



NOTE: RESPONDENTS WERE ASKED TO SELECT UP TO THREE RESPONSES

**FIGURE 9.** How likely is your company to offer more voluntary benefits in the following ways within the next two years?



with voluntary, employee-paid benefits, with an additional 11% reporting that their companies have already done so. A quarter of respondents (24%) say that their employees already choose their own mix of company-paid benefits for life insurance, disability coverage, and other forms of protection, and about half of the companies (52%) expect to move in that direction over the next two years. (See Figure 9).

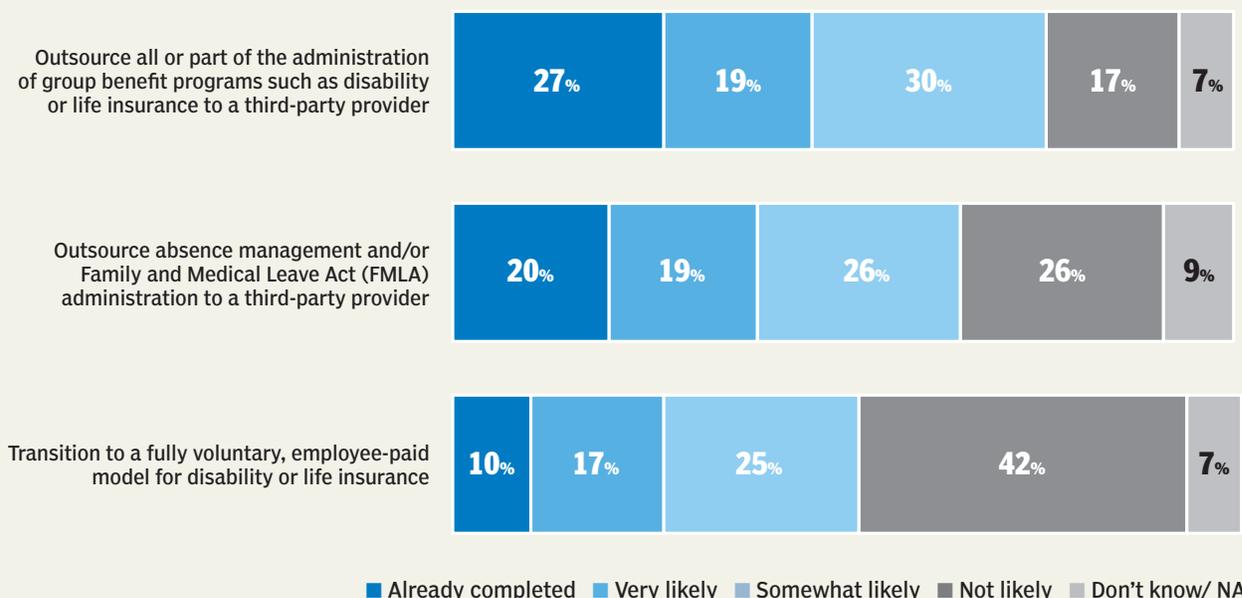
Outsourcing offers another path to efficient benefits administration. Twenty-seven percent (27%) of respondents report that their companies have outsourced administration of benefits such as disability or life insurance, and another 49% say their companies are likely to do so within the next two years. One in five (20%) have already outsourced management of the Family and Medical Leave Act (FMLA), with another

45% saying their companies are likely to outsource in the future. (See Figure 10, next page.)

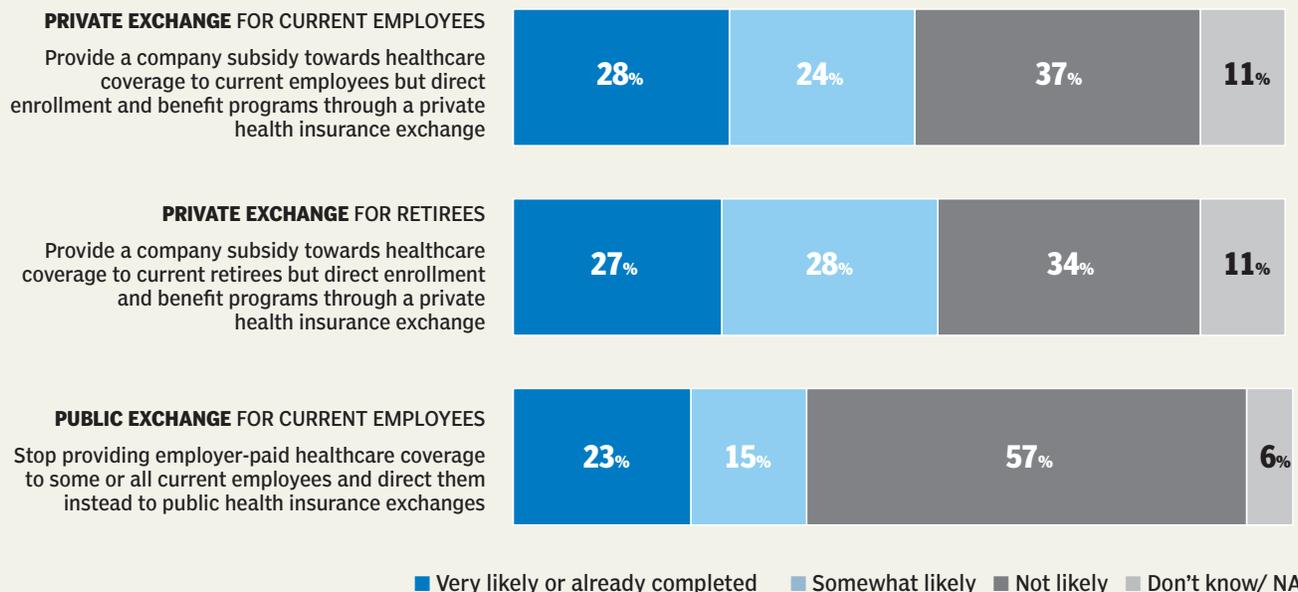
To help meet the challenge of the rapidly rising expense of providing healthcare coverage, 80% of respondents have either shifted more healthcare costs to employees (22%), or think their companies are likely to do so (58%). The majority of respondents (57%) say they are unlikely to stop providing employer-paid health coverage altogether, in favor of directing employees to the new public exchanges that are now available for health insurance. However, 28% of respondents appear to be giving serious consideration to altering their current healthcare offering and instead providing subsidies for employees to use private health insurance exchanges. (See Figure 11, next page.)

Finance executives continue to seek the most value for their benefit expense.

**FIGURE 10.** How likely is your company to alter the structure of its benefit plans in the following ways within the next two years?



**FIGURE 11.** How likely is your company to make the following changes to its health insurance offerings within the next two years?



# Transitioning from Awareness to Action in Retirement and Benefits Programs

IN SUMMARY, THE 2014 SURVEY FINDS THAT finance executives are closely examining a variety of solutions that can help them enhance benefits offerings while still allowing them to manage the financial risk of the programs.

For their DB plans, more finance executives, as well as the boards they report to, are examining the feasibility and benefits of liability transfer—that is, purchasing annuities at some point in the future to transfer some or all of their companies' DB plan liabilities to a third-party insurer. Many see the adoption or expansion of liability-driven investment (LDI) strategies as a means of dampening the volatility of DB plan investments, either as an initial step toward the ultimate transfer of liabilities, or as a sound risk-management strategy in itself.

In the face of a perceived upward trend in retirement ages, finance executives are also considering ways to enhance DC plans to deliver better outcomes for their employees. Including options such as stable value funds and guaranteed income products in DC portfolios can help employees better cope with an uncertain stock market. Over the five years the Prudential/CFO Research survey has been fielded, finance executives have exhibited a growing appreciation of these kinds of offerings.

They also show an ongoing interest in the expanded use of voluntary benefits, which allow employees to select the types of benefits they deem most important. Finance executives continue to explore options for dealing with the steeply rising costs of healthcare, in particular. With the advent of both private and public health insurance exchanges, executives are given another resource to evaluate in their efforts to optimally balance corporate expense and employee benefits.

Finance executives are examining solutions that can help them enhance benefits offerings while still allowing them to manage the financial risk of the programs.





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