Balancing Costs, Risks, and Rewards

The Retirement and Employee Benefits Landscape in 2013

July 2013

A report prepared by CFO Research
in collaboration with
Prudential Financial, Inc.
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Research Sponsor’s Introduction

AS THE ECONOMIC RECOVERY ADVANCES, retirement and employee benefits continue to play an important role in the ability of companies to attract and retain workers. While employers remain committed to providing competitive benefits, they are also exploring and implementing strategies to help balance the associated costs and risks.

Prudential understands firsthand the importance of providing benefits offerings that are both attractive and efficient. We are pleased to again partner with CFO Research to gain insights into how finance executives are thinking about the costs, risks, and rewards of retirement and employee benefits. Below are our perspectives on some of the key findings from this research, which echo the themes we are hearing in conversations with our clients.

**Defined benefit (DB) plan de-risking is top of mind.** The retirement system in the U.S. is undergoing significant change, with companies fundamentally rethinking how DB plans are managed. The market continues to be interested in liability-driven investment strategies, and interest in full pension risk transfer solutions is intensifying, as evidenced by two recent groundbreaking transactions in the U.S.

**Reliance on defined contribution (DC) plans is increasing.** The changing U.S. retirement system is placing much greater emphasis on the role of DC plans in Americans’ retirement security. The next generation of DC plans will help employees more adequately fund their own retirements through the addition of automated features and guaranteed lifetime income solutions, among other enhancements. Nearly two-thirds of finance executives in this study agreed that the presence of a guaranteed income feature would help participants make better investment decisions, such as maintaining their asset allocations during periods of market volatility.

**The role of voluntary benefits is expanding.** Voluntary benefits are increasingly being considered to help companies manage costs, while providing access to the benefits and options that employees value most. Growing healthcare costs are limiting some employers’ ability to offer a full menu of employer-paid benefits. As a result, voluntary benefits—protection and convenience products that employees select and fund themselves—are tools that more companies are considering to help employees achieve the levels of coverage they desire.

Successful retirement and employee benefits programs must meet the needs of both employers and employees. Prudential remains committed to helping companies maintain attractive and cost-effective benefits programs, while utilizing innovative risk management solutions that will enable them to continue to meet today’s promises for decades to come. Thank you for engaging on these important issues.

Charles Lowrey  
Executive Vice President and Chief Operating Officer, U.S. Businesses  
Prudential Financial
Executive Summary

IN FEBRUARY 2013, CFO RESEARCH—in conjunction with Prudential Financial, Inc.—surveyed senior finance executives from a range of midsize and large U.S. companies (“2013 survey”). CFO Research and Prudential carried out similar studies in 2009, 2010, and 2012. As in the previous studies, the 2013 survey targeted companies that have defined benefit (DB) plans with $250 million or more in assets. This year, the survey focused on the strategies employers are evaluating as they balance the costs, risks, and rewards of providing retirement, healthcare, and other employee benefits.

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

- Respondents report that their companies continue to de-emphasize DB plans in favor of DC plans. Finance executives are more actively considering their options for managing the remaining risk in their DB plans. Liability-driven investing is increasingly being viewed as part of the glide path of pension de-risking. Pension risk transfer solutions also continue to garner attention, with nearly 4 in 10 respondents saying that they are at least somewhat likely to transfer DB plan risk to a third party within the next two years. Relatively few companies indicate that they are waiting for additional options to become available before they consider transferring their DB plan risk.

- Respondents express concern about employees’ ability to ensure adequate funding for their retirement. They say they are considering the options available for enhancing DC plan offerings, including the addition of lifetime income guarantees to target-date funds. They affirm that the guarantees of principal and investment returns offered by stable value products are highly valued by DC plan participants.

- Nearly all respondents in this year’s survey agree that employee benefits are critical for attracting and retaining employees. The rising cost of healthcare continues to be a top concern, but almost all respondents agree that providing a balanced mix of health insurance, retirement, and group benefits, including voluntary benefits, is important to their companies’ success.

Respondents agree that providing a balanced mix of health insurance, retirement, and group benefits is important to their companies’ success.
About this Report

CFO Research gathered a total of 181 complete survey responses from senior finance executives working in a broad cross-section of company segments, as follows:

**DB PLAN ASSETS**

- $250M-$500M: 18%
- >$500M-$1B: 23%
- >$1B-$5B: 22%
- >$5B: 37%

**ANNUAL REVENUE**

- $500M or less: 2%
- >$500M-$1B: 17%
- >$1B-$5B: 32%
- >$5B: 50%

**TITLES**

- Director of finance: 34%
- VP of finance: 16%
- Controller: 14%
- Chief financial officer: 14%
- Treasurer: 7%
- EVP or SVP of finance: 6%
- Chief risk officer: 3%
- Senior benefits manager or director: 2%
- CEO, president, or managing director: 1%
- Other senior finance executive: 4%

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

Respondents work for companies in nearly every industry. Financial services (including real estate and insurance) and manufacturing represent the two largest segments—28% and 14%, respectively, of the total.
Managing Risks in DB Plans

OVERALL, FINANCE EXECUTIVES REPORT THAT their companies are continuing to de-emphasize DB plans, with 36% noting that they have already closed DB plans to new entrants, and an additional 27% saying their companies are likely to do so within two years. (See Figure 1.) Nearly one-quarter of respondents (23%) have frozen or terminated DB plans, and an additional 28% are considering doing so. As an unsteady economic recovery continues to engender wariness, companies are following a gradual path to de-risking their DB plan, working to first close their plans, then shrink their DB funding gap, then employ liability-driven investment (LDI) strategies, and finally transfer risk to third parties.

Finance executives recognize the need to continue to manage financial risk within their DB plans, whether those are active or frozen. In particular, the prospect of increasing longevity—that is, longer average life expectancy—is starting to influence more decisions. For example, the Society of Actuaries is currently developing a new mortality standard that may be adopted by the Treasury Department for pension valuations beginning as early as 2015. In this year’s survey, nearly half of the respondents (46%) indicate that these new mortality standards will affect their company’s management of its DB plan, while an additional 28% say that they are still unsure what the impact of the new mortality standards will be. Most respondents (58%) also confirm that they have modeled future DB contributions to account for increasing longevity.

LDI strategies continue to attract interest as one means of managing DB plan risk. Two-thirds of respondents (65%) confirm that some portion of their DB plan assets are currently invested in LDI strategies. In a separate question, more than half of respondents (54%) say that they are at least somewhat likely to employ LDI strategies further (either adopting a new LDI strategy or investing more of their assets in LDI) over the next two years. One-third of respondents (33%) view LDI as an initial step toward full DB risk transfer.

Finance executives acknowledge the advantages and disadvantages of offering lump-sum distributions to participants as a means of...
transferring DB plan risk. About two-thirds of respondents (65%) say that lump-sum distributions can be effective in reducing the size, exposure, and volatility of pension obligations. However, more than 40% of finance executives view lump-sum distributions as inconsistent with their benefit policy to provide retirement income.

This year’s survey indicates that pension risk transfer continues to be an emerging option. In pension risk transfer solutions, companies purchase annuities for some or all of the obligations in a DB plan, allowing insurance companies to take over the liability, administration, and distribution of benefits. Although only a small number of respondents (6%) say that their companies have already transferred DB plan risk to a third-party insurer, approximately 40% of finance executives indicate that they will seriously consider doing so within the next two years. Nearly half of survey respondents (47%) agree that pension risk transfer solutions would allow them to focus more on their core business, rather than on managing pension obligations. (See Figure 2.) Many respondents say that obligations from their company’s DB plan place some constraints on their company’s performance. (See Figure 3.)

Increased board of director and senior management focus on eliminating DB plan risk is most likely to encourage companies to transfer DB plan risk to a third-party insurer. Timing considerations are also likely to influence the adoption of pension risk transfer solutions. As one respondent writes in the survey, “We are researching these options, but have not made a decision yet.” Nearly equal numbers of respondents indicate that their companies would be more likely to consider risk transfer once their funding levels improve (27%); if interest rates rise, making the transactions more feasible as accounting liabilities are reduced (25%); and if the transactions can be accomplished without using the company’s cash (26%).

Finance executives expect to make their own evaluations of the feasibility of risk transfer solutions. Although 46% of respondents agree that the cost to shareholders is a significant concern in adopting DB risk transfer solutions (compared with only 17% who disagree), only a quarter of respondents (25%) say that transferring DB risk to an insurer is too expensive for them to consider. Relatively few companies (20%) indicate that they are waiting for more choices for risk transfer solutions to become available before they consider transferring their DB plan risk to a third party.

Approximately 40% of finance executives indicate that they will seriously consider transferring DB plan risk to a third-party insurer within the next two years.
Enhancing DC Plans to Improve Retirement Outcomes

Our surveys over the past several years have documented a movement away from traditional DB plans, in favor of DC plans, in which individual employees have responsibility for enrollment, savings, and investment decisions, as well as for creating retirement income from plan accumulations.

Most respondents in this year’s survey (65%) believe that a significant portion of their employees will have to delay retirement due to inadequate retirement savings. (See Figure 4.) This highlights the need for DC plan investment options and other features to help employees achieve better outcomes.

Companies continue to evaluate ways to enhance DC plans to ensure more security for employees in their retirement planning.

An expanded range of solutions can be implemented to help dampen volatility in retirement investments or reduce individual investment risk. For example, a majority of survey respondents (65%) indicate that their companies’ retirement plan participants appreciate the stability of returns and safety of principal offered by stable value products.

Target-date funds, which automatically rebalance investment portfolios as an individual nears or enters retirement, have been increasing in popularity over the years. But in this year’s survey, a majority of respondents say that target-date funds should be enhanced in order to provide more protection against market volatility (60%), and that these enhancements need to include the option of providing participants with guaranteed lifetime income (63%). (See Figure 5.)
Guaranteed income in the form of an annuity can go a long way toward easing investment jitters among plan participants, which are brought about by swings in equity markets. In fact, most respondents in this year’s survey (61%) 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 an option that includes a guaranteed income feature. (See Figure 6.)

Nearly half of the respondents in this year’s survey (45%) indicate that their companies are at least somewhat likely to offer guaranteed lifetime income products over the next two years, with an additional 11% confirming that their companies already do. The survey also shows that reluctance to consider these kinds of products is on the decline. Only about one-quarter of respondents this year (26%) say that their companies are not at all likely to offer such products, while more than a third (37%) were similarly disinclined in 2012.
Providing a Robust Range of Employee Benefits

PURSUING BALANCE IN INSURANCE BENEFITS—health, disability, life, property, etc.—is translating into interest in providing employees with the discretion to choose the benefits they value most. Overall, nearly three-quarters of survey respondents (74%) agree with the statement that the use of voluntary benefits (i.e., benefits that employees select and fund) is a cost-effective way to increase employee satisfaction with benefits. This interest in the use of voluntary benefits represents a substantial increase over the 2012 survey results, in which 56% of respondents agreed. (See Figure 7.)

In the current survey, one in six companies (16%) have already expanded their voluntary benefits programs, and another 60% of respondents this year say that their companies are at least somewhat likely to expand the range of voluntary benefits over the next two years.

This shift toward greater use of voluntary benefits makes sense, in part, because of the prominence that healthcare costs continue to have in benefits planning. Increasing costs for healthcare remains the top benefits concern for finance executives by a wide margin. In this year’s survey, the largest number of respondents (71%) select “controlling the employer cost for company-provided healthcare benefits” as one of their companies’ top employee-benefits priorities for the next year. (See Figure 8, page 9.)

Most respondents (74%) agree that the use of voluntary benefits is a cost-effective way to increase employee satisfaction with benefits.

FIGURE 7. To what extent do you agree with the following statement about your company’s employee benefits strategy overall?

“Offering more voluntary benefits is a cost-effective way to increase employee satisfaction with benefits.”

<table>
<thead>
<tr>
<th>Year</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Neutral</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>56%</td>
<td>12%</td>
<td>27%</td>
<td>11%</td>
<td>12%</td>
<td>44%</td>
</tr>
<tr>
<td>2013</td>
<td>58%</td>
<td>16%</td>
<td>20%</td>
<td>20%</td>
<td>6%</td>
<td>1%</td>
</tr>
</tbody>
</table>
Companies continue to ask their employees to shoulder more responsibility for their healthcare costs. More than one-quarter of respondents (28%) confirm that their companies have already shifted a large portion of costs for healthcare coverage to employees, one-third (34%) say that their companies are very likely to do so within the next two years, and an additional quarter (26%) say that their companies are somewhat likely to do so. (See Figure 9.)

But finance executives are not necessarily viewing healthcare as a zero-sum game. As shown in Figure 8, the benefits-program priority selected second most frequently (by 35% of respondents) is “minimizing the impact on employees for the increasing cost of healthcare benefits.” Of the respondents who select this as a priority, three-quarters (77%) also say that controlling the employer cost of healthcare is a priority.

Asking employees to take on more responsibility for costs may be seen as necessary if companies are going to maintain their coverage levels. This year’s survey results indicate that a fair number of companies are not categorically looking to make dramatic cuts in their healthcare offerings. Only 15% of respondents indicate they have substantially reduced employer-paid healthcare benefits provided to employees, and about one-fifth (19%) think their companies are very likely to go down this path within the next two years. In fact, the largest number of respondents (31%) say that their companies are not likely to make substantial reductions in employer-paid health benefits. (See Figure 9.)

To preserve the best balance between costs and coverages, many companies are selectively considering the most effective use of voluntary benefits. About half of respondents (52%) say that their companies are at least somewhat likely to expand the range of voluntary benefits that offer protection to employees, and an additional 25% of respondents say that their companies have already taken this step. (See Figure 10, page 10.) These kinds of protection-oriented benefits include

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

<table>
<thead>
<tr>
<th>Priority</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Controlling the employer cost for company-provided healthcare benefits</td>
<td>71%</td>
</tr>
<tr>
<td>Minimizing the impact on employees for the increasing cost of healthcare benefits</td>
<td>35%</td>
</tr>
<tr>
<td>Reducing the cost of employee benefits other than healthcare benefits</td>
<td>28%</td>
</tr>
<tr>
<td>Increasing employee satisfaction with the company’s benefits plan</td>
<td>28%</td>
</tr>
</tbody>
</table>

Note: Top results shown. Respondents were asked to select up to three responses.

**FIGURE 9. How likely is your company to make the following changes to its health insurance offerings within the next two years?**

<table>
<thead>
<tr>
<th>Change</th>
<th>Likelihood</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shift a larger portion of costs for healthcare coverage to employees</td>
<td>64%</td>
<td>30%</td>
</tr>
<tr>
<td>Substantially reduce employer-paid healthcare benefits provided to employees</td>
<td>31%</td>
<td>19%</td>
</tr>
</tbody>
</table>

88% have already taken this step or are likely to do so

15% 19% 30% 31% 5%

15% 19% 30% 31% 5%

 Already completed Very likely Somewhat likely Not likely Don’t know/Does not apply
products for such things as life, disability, critical illness, or accident insurance. In fact, a majority of respondents (61%) agree that offering voluntary benefits such as group life insurance and similar types of insurance is the best way to provide employees with access to these products.

Respondents are not as likely to explore the use of voluntary benefits in other areas—for example, offering convenience products such as auto insurance, or providing elective life insurance to retirees. However, more than half of the respondents say they will at least consider these areas. (See Figure 10.) As a supplementary measure, 52% of respondents say that their companies are at least somewhat likely to allow their employees to select their own mix of company-paid protection benefits within the next two years.
IN THIS YEAR’S SURVEY OF THE EMPLOYEE benefits landscape, we find that finance executives’ commitment to ensuring employee satisfaction with benefits remains as strong as ever—and, in fact, appears to have intensified since a year ago. This year, nine out of ten respondents agree that employee satisfaction with benefits is important for their companies’ success. (See Figure 11.) This represents a noticeable increase from the 76% who agreed with that statement in the 2012 survey.

Nearly all respondents in this year’s survey (94%) agree that employee benefits are critical to attracting and retaining employees. An unusually high number of finance executives—nearly half, at 48%, which is up from 33% in the 2012 survey—strongly agree with this statement, indicating the importance they place on designing and managing benefits offerings. (See Figure 11.)

But as the effects of a global recession linger, finance executives also remain sensitive to the impact that their companies’ benefits programs have on the business. Rising costs—especially for healthcare—and ongoing changes in the benefits landscape increase the financial risk of benefits offerings, at a time when many companies are doing all they can to dampen risk.

Fortunately, this year’s survey shows that the options available to companies to help them manage benefits offerings also continue to evolve. Almost all respondents (93%) agree that providing a balanced mix of health insurance, retirement, and group benefits is important to their companies. (See Figure 12.) They continue to explore different options—including emerging options—that will allow them to continue to reap the rewards of offering attractive benefits packages while better managing the costs and risks of their offerings.

**FIGURE 11.** To what extent do you agree with each of these statements about your company’s employee benefits strategy overall?

- “Employee satisfaction with benefits is important for my company’s success.”
  - 31% STRONGLY AGREE
  - 59% AGREE
  - 8% NEUTRAL
  - 1% DISAGREE
  - 1% STRONGLY DISAGREE

- “Employee benefits are critical to attracting and retaining employees.”
  - 48% STRONGLY AGREE
  - 46% AGREE
  - 1% NEUTRAL
  - 1% DISAGREE
  - 4% STRONGLY DISAGREE

**FIGURE 12.** To what extent do you agree with the following statement about your company’s employee benefits strategy overall?

- “Providing a balanced mix of health insurance, retirement, and group benefits is important to my company.”
  - 32% STRONGLY AGREE
  - 61% AGREE
  - 5% NEUTRAL
  - 2% DISAGREE
  - 1% STRONGLY DISAGREE
Key Takeaways

**DB Plans**
- Finance executives recognize the risks posed by the increasing longevity of DB plan participants.
- Companies continue to close and freeze some or all of their existing DB plans.
- Many companies have adopted LDI strategies for their DB plans, and finance executives are evaluating ways to further de-risk their plans. Pension risk transfer solutions are one way to accomplish this goal, and nearly 4 in 10 finance executives indicate that they are at least somewhat likely to transfer DB plan risk to a third party in the next two years.

**DC Plans**
- In the face of workplace retirement plan trends—including ongoing changes to DB plans and rising doubts about the adequacy of employees’ retirement savings—finance executives are evaluating enhancements to their companies’ DC plans. The goal is to provide employees with the means to enhance their retirement security.
- Finance executives indicate that participants appreciate the stability of returns and safety of principal offered by stable value funds, and many executives indicate that their companies are exploring the addition of guaranteed lifetime income investments in their DC plans.

**Employee Benefits**
- Traditional balances between employer and employee responsibilities continue to shift, with companies seeking to distribute the costs and risks of their benefits programs while also providing employees with the ability to make their own choices.
- Expanded use of voluntary benefits programs can play a critical role in achieving this balance.

Through solutions to manage risks, share costs, and enhance retirement outcomes, finance executives are helping their companies to continue to enjoy the rewards of offering attractive benefits packages.