



# SURVEY FINDINGS: Hot Topics In Retirement 2007

## **About This Survey**

Employers today are faced with numerous and difficult choices when it comes to the retirement benefits they provide to workers. Further, the financial and legislative environments continue to change with the new Pension Protection Act of 2006 (PPA), FAS rules around accounting for pensions, and the U.S. Department of Labor (DOL) regulations on Qualified Default Investment Alternatives (QDIAs). Employers are evaluating their plans in light of these new rules and their own business environments. This review leads to choices that can have a significant impact on company financials, employee engagement and satisfaction, effective workforce management, employee retirement income security, the ability to attract and recruit new workers, and even workforce productivity.

In November/December 2006, Hewitt Associates surveyed human resources professionals to learn their likely areas of focus and action over the next year regarding the design, management, and delivery of their defined contribution and defined benefit plans for their active, salaried U.S. employees. Responses from 146 employers provide a preview of the changes likely to take place in the retirement landscape over the next year. Plan sponsors can use this information to gather context and perspective as they address the challenges posed by today's unique environment.

***Note:** Percentages in this report are rounded to the nearest whole number. Therefore, totals may not equal exactly 100%. While the focus of the survey instrument and survey samples has changed from year to year, there are still a number of areas where useful comparisons and trends across time can be examined.*

## Survey Highlights

### Across All Plans

Retirement plans continue to be an important focus of employers going into 2007. Given recent legislation (the Pension Protection Act of 2006) and the need to offer competitive benefits to attract new employees, many plan sponsors are preparing for plan changes in the coming year. The most frequently cited initiatives across all retirement programs are measuring the total benefit cost of the program, measuring the competitive position, and assessing the plan design.

The confidence level of employers with respect to various retirement issues has not changed dramatically since last year, with employers being most confident about their ability to manage the competitive position of the plan and the likelihood of employees retiring with sufficient assets. The area of least confidence continues to be employees taking accountability for their own future, which is encouraging the trends of increased automation and communication. Employers also lack confidence in their management of appropriate policies designed to influence the patterns of employee departures, indicating a possible need for increased workforce planning.

#### Key Findings

- 90% of plan sponsors are likely to measure the total cost of their retirement program.
- 73% of respondents are likely to measure the competitiveness of their program.
- 64% of respondents are likely to assess their retirement plan design.
- 52% of respondents are confident in their ability to manage the competitive position, but only 5% are confident in their ability to manage employees taking accountability for their future.

### Defined Contribution Plans

The provisions of the PPA seem to have accelerated the already rapid shift toward automation in defined contribution plans. In fact, if the employers who are very likely to implement automatic enrollment for new employees move forward, at the end of 2007 it appears that prevalence of automatic enrollment may surpass the 50% mark. This is not surprising, since many of the barriers reported in last year's survey have been eliminated.

#### Key Findings

- 36% of respondents already offer automatic enrollment to new employees, with more than half of the remainder very or somewhat likely to implement it this year.
- 12% of respondents already offer Roth 401(k) accounts, with 32% of the remaining respondents very likely or somewhat likely to implement in 2007.
- 77% of respondents are very or somewhat likely to review fund expenses, revenue sharing, and disclosure of these to participants.

Automatic contribution escalation is not far behind. Further, the PPA is also encouraging a swift change from more conservative default investments, like stable value funds, to more diversified alternatives, like target maturity funds. Two-thirds of plans with automatic enrollment are making a change to the default investment, either to comply with the qualified default investment alternative provisions of the PPA, or to simply improve results for participants.

Adoption of the Roth 401(k) provision is increasing, although at a slower pace. While the EGTRRA permanence provision of the PPA makes Roth 401(k) more appealing, many employers are seeking more evidence that employees will take advantage of the offer before implementing it.

Employers are also likely to spend significant energy on their investment fund offerings during 2007, with an emphasis on reviewing fund expenses, analyzing which funds and what types are offered, and finding ways to reduce the cost of funds. Plan sponsors are partly reacting to recent lawsuits filed against employers for claimed violations in this area and increased attention by government agencies on plan fees and disclosures. There is also an avid interest in adding premixed or target maturity funds to plan offerings among those employers who do not already offer them. These funds are viewed as a strong way to enhance diversification and simplify investments for participants.

### **Defined Benefit Plans**

The shift from defined benefit plans to defined contribution plans as the primary retirement vehicle continues, although the pace of the change is not as rapid as many plan sponsors might perceive, and has declined based on the results of last year's survey. In fact, 42% of respondents still sponsor a defined benefit plan open to new entrants, with only 25% of those very likely to make any change to their plan over the next year. Four percent of plan sponsors are very likely to freeze the plan, and only 6% are very likely to close their plan. In spite of the challenges posed by new legislation and accounting rules and a continued low interest rate environment, most pension plan sponsors are staying the course with respect to their pension plan.

That does not mean, however, that plans sponsors are complacent about addressing the challenges of sponsoring a defined benefit plan in the current environment. Plan design is only one of three levers

#### **Key Findings**

- Only 25% of respondents with open defined benefit plans are very likely to make a change to their plan in 2007.
- Of those very likely to make a change, most will likely change the design, but continue to offer a plan to current and new employees.
- 81% of respondents with a pension plan are likely to perform funding and accounting projection and 73% are likely to review funding strategy.
- 46% of respondents are likely to adjust the overall asset allocation.

employers can use to manage cost and volatility of defined benefit plans. During 2007, plan sponsors—both with open plans and with closed and frozen plans—are likely to focus attention on the other two levers: funding policy and asset allocation.

#### **Conclusions**

This year will be a significant year for retirement plans. Plan sponsors will be carefully assessing the opportunities and challenges offered by the PPA, watching trends, reviewing newer features, and taking action accordingly to maintain the competitiveness and compliance of their plan. It is evident that plan sponsors cannot afford to sit still during this time of retirement program evolution.

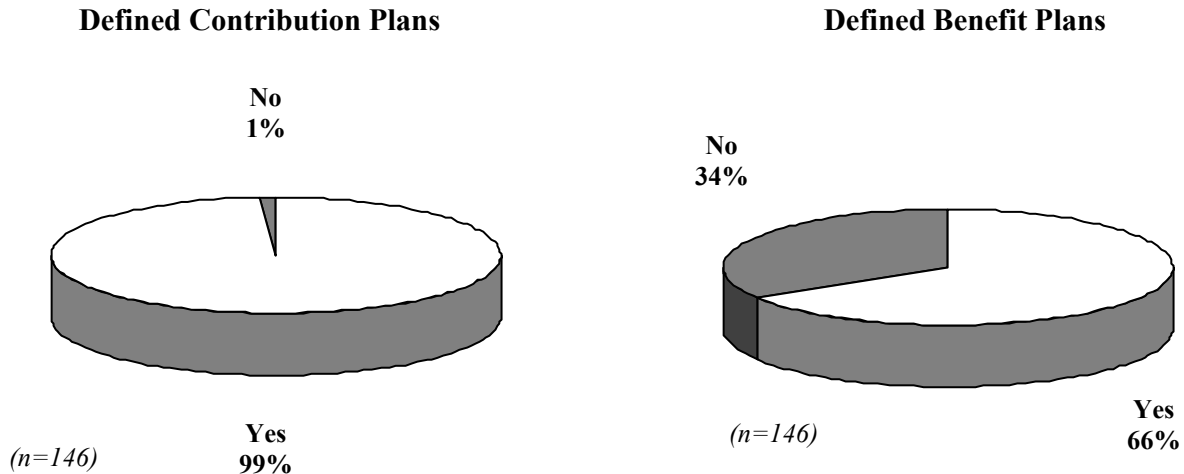
This appears to be a turning point for 401(k) plan automation, with required employee involvement potentially becoming less critical in the savings process. Participants might be led to conclude that they can make as few decisions in their 401(k) plans as they make in defined benefit plans and still meet their retirement goals. This could be challenging and lead to issues with plan awareness and appreciation.

While new defined benefit plans are not being added, they remain a benefit for a significant number of employees. Plan sponsors are constantly assessing the continued appropriateness of their plan design, funding policy, and investment policy, and a significant portion of them are concluding that the efficiency of pension plans, the tools available to manage them, and the needs and preferences of the workforce still render defined benefit plans a valuable and worthwhile benefit.

## Survey Findings: Overview of Retirement Plans

Almost all respondents participating in this survey provide their employees with a defined contribution plan, while two-thirds of respondents provide some form of defined benefit (traditional or hybrid) plan.

### Retirement Plans Offered



Among the 66% of employers participating in this survey and offering a defined benefit plan to their employees, 46% provide a traditional plan and the remaining 20% provide a hybrid plan. Both types of plans were categorized into one of three statuses:

- Open plans, sponsored by 65% of respondents, allow new hires to participate in the plan.
- Closed plans, comprising 31% of respondents' pension plans, allow current eligible employees to accrue benefit service, but new hires are not eligible to participate in the plans.
- Frozen plans, accrue no benefit service for any employees. Four percent of respondents sponsor a frozen plan.

### Defined Benefit Plan Status

	Percent of Employers
Open plan	65%
Closed plan	31%
Frozen plan	4%

(n=96)

Survey respondents are most confident in their ability to effectively manage the competitive position of the plan. They are least confident in their ability to effectively manage employees' taking accountability for their future. However, from 2006 to 2007, there was an increase of confidence in employers' ability to manage the likelihood of employees retiring with sufficient retirement assets. Given the evolving

retirement landscape, many employers implemented design changes in 2006, including more automation in their defined contribution plans, and thus, may have increased their level of confidence in employee savings behavior. Plan automation is discussed in more detail later in the survey.

Not surprisingly, defined benefit plan sponsors are much more confident in their ability to manage the likelihood of employees retiring with sufficient retirement assets (33%) than sponsors with only defined contribution plans (13%).

### **Confidence Level of Employers Effectively Managing Retirement Program Issues**

	<b>Not Confident at All 1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Very Confident 6</b>
Competitive position of the plan ( <i>n=141</i> )	0%	3%	15%	30%	36%	16%
Likelihood of employees retiring with sufficient retirement assets ( <i>n=142</i> )	4%	14%	39%	21%	17%	6%
Employees' understanding of future retirement benefits ( <i>n=142</i> )	4%	19%	46%	21%	9%	1%
The aging of the workforce and the impact retirements could have on our business in the next 5 to 10 years ( <i>n=139</i> )	4%	27%	40%	19%	9%	1%
Employee/retiree reactions to change if applicable ( <i>n=123</i> )	2%	11%	41%	36%	9%	1%
The influence of diversity and inclusion on retirement benefit effectiveness ( <i>n=138</i> )	3%	18%	43%	26%	9%	1%
Appropriate policies and procedures designed to influence the patterns of employee departures from the workforce (e.g., phased retirement, early retirement subsidies) ( <i>n=138</i> )	7%	25%	42%	22%	4%	1%
Employees taking accountability for their own future ( <i>n=140</i> )	7%	26%	40%	21%	5%	0%

In terms of retirement initiatives employers are likely to undertake in 2007, nine out of ten employers state they are very likely or somewhat likely to measure the total benefit cost of their retirement programs. Measuring the competitive position of retirement plans is another initiative that is going to be undertaken by nearly three-quarters of employers, while 64% plan to assess the appropriateness of their current retirement program design.

It appears that many plan sponsors are carefully monitoring the cost of the benefits provided to their employees while also evaluating plan structure and design and ensuring their programs remain at the appropriate competitive position. After plan sponsors perform such a review in their current and evolving business context, it is likely there will be more plan changes in 2007 and into 2008.

### Likely Initiatives on Retirement Plans in 2007

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Measure the total benefit cost of the retirement program ( <i>n</i> =139)	50%	40%	7%	3%
Measure the competitive position of the retirement program ( <i>n</i> =140)	39%	34%	18%	10%
Assess the appropriateness of your current retirement program design ( <i>n</i> =140)	35%	29%	17%	19%
Analyze the influence of your current and emerging demographics on retirement designs, policies, and practices (focusing on diversity and inclusion) ( <i>n</i> =139)	19%	36%	35%	10%
Measure/project the expected income adequacy of your employee population ( <i>n</i> =138)	20%	33%	28%	19%
Evaluate phased retirement alternatives ( <i>n</i> =138)	15%	32%	33%	20%
Collect data on employee preferences regarding the retirement program ( <i>n</i> =138)	10%	25%	41%	25%

### Defined Contribution Plans

#### Likely Changes to Defined Contribution Plans in 2007

Employers were asked what areas they would focus on and what possible actions they would take with respect to their defined contribution plan in 2007. The areas/actions asked about in the survey, ranked from most likely to least likely, are:

- Automatic enrollment;
- Automatic rebalancing;
- Contribution escalation;
- Roth 401(k);
- Annuities;
- 401(k) disability insurance; and
- Individual insurance products.

Automatic enrollment and automatic rebalancing were ranked as the top two areas of focus in both 2006 and 2007. Contribution escalation also remains a priority.

## Automatic Enrollment

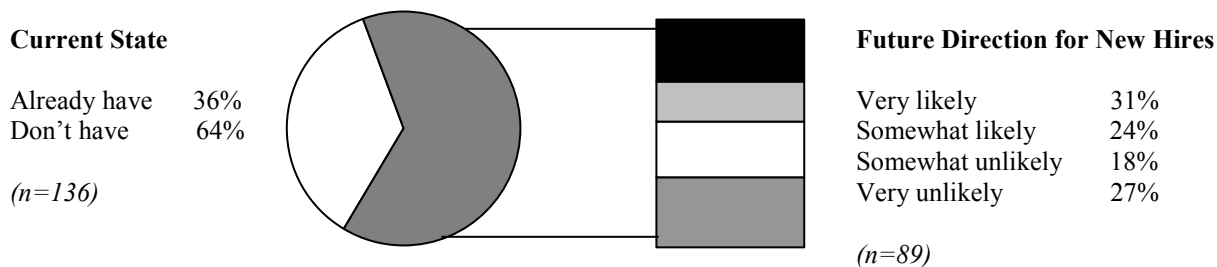
Automatic enrollment has been one of the hottest retirement topics in recent years, and this will continue into 2007. With the encouragement from the PPA, we are likely to see more plan sponsors adopting automatic enrollment and/or improving their automatic enrollment defaults.

Thirty-six percent of respondents participating in this survey have adopted automatic enrollment (up from 24% in 2006). All of these plans automatically enroll new hires in the plan, while 15% also defaulted existing nonparticipants when, or at some point after, they adopted automatic enrollment.

Of the remaining employers that do not currently use automatic enrollment, 55% said that they are very likely or somewhat likely to offer automatic enrollment for new hires in 2007 and 26% indicated they may offer it to current nonparticipants as well. Increasingly, plan sponsors are acknowledging that the automatic enrollment feature is not exclusive to new hires, as sweeping all employees into the plan can have a much larger impact.

Interestingly, respondents who offer an open defined benefit plan are significantly more likely to implement automatic enrollment than respondents with only a defined contribution plan. Perhaps this is reflective of the defined benefit plan sponsors' inclination to be more focused on employees' ability to retire with sufficient assets. In addition, 47% with a closed or frozen defined benefit plan have already implemented automatic enrollment, compared to 28% of sponsors who have only a defined contribution plan. Automatic enrollment may at times be used to ensure employee and/or matching dollars replace lost defined benefit dollars for new employees.

## Automatic Enrollment



Among the employers that already offer automatic enrollment as a plan feature, the most common likely upcoming changes cited regarding the way that automatic enrollment will be offered in 2007 were closely in line with new rules that were part of PPA. In particular, plan sponsors are most likely to change the default investment fund to a QDIA, comply with 2008 safe harbor requirements to avoid ADP/ACP testing, and implement a withdrawal option for participants to withdraw their contributions within 90 days.

By far the most noticeable change is the movement toward more appropriate defaults. While research has proven that automatic enrollment has a very positive impact on participation rates, it is also evident that the quality of participation is greatly influenced by the choice in default contribution rates and default investments. Defaulted participants have a strong tendency to remain at the defaults due to inertia. Trends in making automatic enrollment successful suggest plan sponsors choose a higher default contribution rate at or above the match threshold, coupled with automatic contribution escalation and the use of diversified investment options such as target maturity funds.

### **Likely Changes to Automatic Enrollment in 2007**

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43%	Change default investment fund to a qualified default investment alternative (QDIA)
29%	Comply with 2008 automatic enrollment safe harbor requirements to avoid ADP/ACP testing
29%	Implement a withdrawal option for participants who are automatically enrolled and would like to withdraw their contributions within 90 days
24%	Change default investment fund from stable value to a balanced or premixed/lifecycle fund but not a QDIA
19%	Increase default contribution rate
19%	Apply automatic enrollment to additional classifications of employees
0%	Decrease default contribution rate
0%	Eliminate automatic enrollment

*(n=21; multiple responses)*

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Among the employers that are *unlikely* to offer automatic enrollment in 2007, 42% of respondents cited the increased cost of the employer match as a reason. The next most common reason (cited by 33% of respondents) was the employer's concern over the fiduciary exposure automatic enrollment would bring. Although the PPA addressed fiduciary protection, it has not eliminated all of the employer concerns. While these concerns were also expressed in 2006, they have not deterred many employers from adopting this feature.

### **Barriers to Adding Automatic Enrollment in 2007**

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42%	Cost of match
33%	Concern over fiduciary exposure
30%	Preference for active enrollment within the plan
28%	Internal focus on other priorities
28%	Cost/burden of administering an increased number of small balances
25%	Other (e.g., company culture; employees do not like change)

*(n=69; multiple responses)*

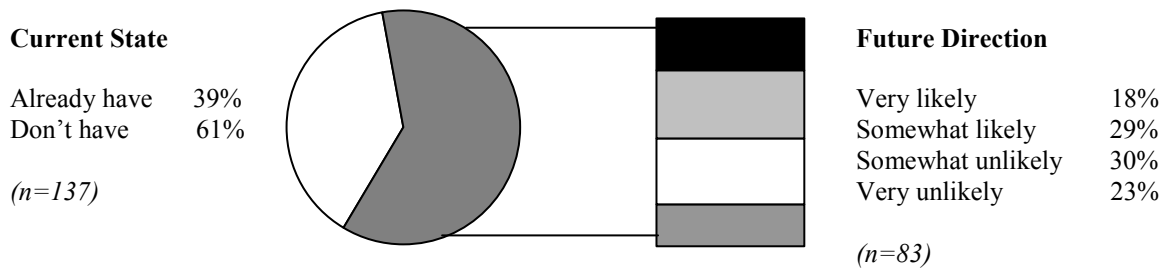
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### Automatic Rebalancing

Thirty-nine percent of respondents said they offer automatic rebalancing, an increase from 27% in 2006. Of the remainder, 47% said they are very likely or somewhat likely to offer automatic rebalancing in 2007.

The need for automatic rebalancing has been established in defined contribution plans. Hewitt’s research report, *How Well Are Employees Saving and Investing in 401(k) Plans*, shows that on average only 17% of participants make any fund transfer in one year. Automatic rebalancing is a useful tool to help participants regularly rebalance their portfolios to their target allocations.

### Automatic Rebalancing

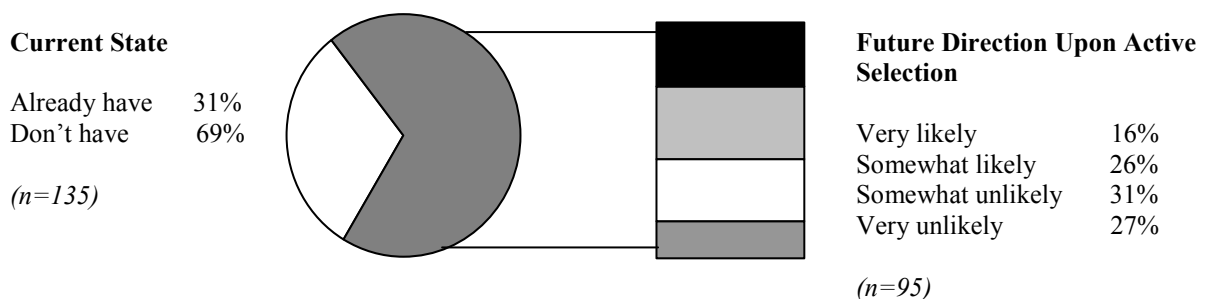


### Contribution Escalation

Thirty-one percent of respondents currently have the some form of contribution escalation in their defined contribution plans. Thirteen percent of respondents indicated that they already offer contribution escalation as a part of automatic enrollment, whereas 31% already offer it upon active selection. Among employers that do not currently have contribution escalation as a plan feature, 39% are very likely or somewhat likely to offer it as part of automatic enrollment in 2007, whereas a slightly greater number of respondents (42%) said they were likely or very likely to offer contribution escalation upon active selection in 2007.

The option of saving more in the future appeals to employees, and contribution escalation enables them to lock in this positive future behavior. Increasing savings rates gradually like this can have a significant long-term impact on employee savings and the ability of employees to accumulate sufficient retirement assets. It also improves ADP testing results, potentially allowing highly compensated employees to save more money. Also research, albeit in the short-term, has found that contribution escalation does have a positive impact on contribution rates and that participants have chosen to allow and continue their escalation(s).

### Contribution Escalation



### **Roth 401(k)**

Twelve percent of respondents report that they already offer a Roth 401(k) as an option in their 401(k) plan; this trend is consistent with the 13% of respondents who reported in 2006 that they were very likely to add the feature. Although some barriers still remain, given the PPA has removed the sunset of the Roth feature; plan sponsors are more likely to consider the Roth 401(k). Of those plan sponsors that do not yet offer the Roth 401(k), 32% said they are very likely or somewhat likely to add the feature in 2007.

Sponsors of open defined benefit plans are much more likely to offer a Roth 401(k) in 2007 than sponsors with only a defined contribution plan (38% versus 26%).

### **Roth 401(k)**

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	<b>Very Likely</b>	<b>Somewhat Likely</b>	<b>Somewhat Unlikely</b>	<b>Very Unlikely</b>
Roth 401(k) account	11%	21%	33%	35%

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(n=121)

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Among the companies that were very *unlikely* or somewhat *unlikely* to add a Roth 401(k) account, 67% said that it must be clear that employees would use the Roth 401(k) before adding one. Forty-six percent of the employers in these categories cited administrative complexity as a barrier, closely followed by 43% who are concerned about the complexity of communication about the plan. As more data emerges that demonstrates measurable employee utilization, and complexities related to the Roth are effectively reduced, it is likely interest in Roth accounts will continue to increase.

### **Requirement Needed to Offer Roth 401(k)**

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67%	It must be clear that general Roth 401(k) usage will be significant enough to justify adding it to the plan
46%	The administrative complexity and/or cost of offering the Roth 401(k) must be reduced
43%	There must be access to better tools and resources to effectively manage the complexity of Roth 401(k) communication
26%	Employees must ask for it
20%	Nothing—not interested in offering a Roth 401(k) at this time

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(n=82; multiple responses)

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According to Hewitt's study, *How Workers Are Using the Roth 401(k)*, the experience of the early adopters is positive. Just three months after the implementations, the Roth feature was used significantly by 7.6% of participants. It is more likely to be used by younger employees given that they can benefit the most from the feature. With a well-executed communication strategy, the introduction of the Roth 401(k) does not appear to result in a reduction in the overall contribution rate of those electing the Roth 401(k), nor does it negatively impact participation rates in the plan due to complexity. However, this analysis was based on firms that were early adopters and tended to be financial or professional services

firms. While the results of the study were positive, they are likely influenced by the specific characteristics of the underlying population and may not be typical results.

### **Annuities**

Fifteen percent of respondents said they already offer annuities as an optional form of payment in their defined contribution plan. Of the remainder, only 1% said they are very likely to add this feature in 2007, and 17% said they were somewhat likely to do so. For annuities outside the plan, only 3% of respondents currently promote or facilitate use of outside annuities as rollover options for plan distributions. Of the remainder, only 2% said they were very likely to promote or facilitate use of outside annuities, and 16% said they were somewhat likely to do so in 2007.

While accumulation remains the focus of most defined contribution plans, distribution is gaining attention from the media and retirement plan professionals. Plan sponsors are not yet taking significant action in this area, however, and utilization of these features remains low when available. Annuities add a level of complexity and, therefore, the communication about the feature is critical.

### **Annuities**

	<b>Very Likely</b>	<b>Somewhat Likely</b>	<b>Somewhat Unlikely</b>	<b>Very Unlikely</b>
Annuities as a form of payment under the plan ( <i>n=115</i> )	1%	17%	37%	35%
Promote or facilitate use of annuities outside the plan as rollover options for plan distributions ( <i>n=134</i> )	2%	16%	38%	44%

### **401(k) Disability Insurance**

One percent of respondents said they already offer 401(k) disability insurance to plan participants. Of the remainder, only one percent said they were very likely to offer 401(k) disability insurance in 2007 and 7% said they are somewhat likely to do so. 401(k) disability insurance allows employees the ability to have their ongoing contributions and their employers' contributions insured in the event of a disability.

### **401(k) Disability Insurance**

	<b>Very Likely</b>	<b>Somewhat Likely</b>	<b>Somewhat Unlikely</b>	<b>Very Unlikely</b>
401(k) disability insurance (the ability for employees to have their contributions and their employers' contributions insured in the event of disability)  ( <i>n=136</i> )	1%	7%	33%	59%

## Individual Insurance Products

One percent of respondents already offer a type of individual insurance products to plan participants. These products, for example, may offer participants the ability to insure their retirement balances for a given fee. Of the remainder of respondents, only 7% said they were somewhat likely to offer individual insurance products in 2007.

## Individual Insurance Products

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Individual insurance products (e.g., preservation of principal (employee contributions), guaranteed minimum annuity payout, other)	0%	7%	31%	62%

(n=137)

## Features to Help With Investment Selection

### Current Offerings

Many employers already support their employees in their saving and investing decisions by offering tools to assist with investment selection. Thirty-one percent of respondents already offer investment guidance (where any investment suggestions are based on asset classes only), 30% offer a third party investment advisory service (online or phone advice on specific fund/contributions suggestions), and 12% provide in-person investment advisors to their employees for their defined contribution plans.

As another way to help employees diversify their investment, 57% of respondents offer target maturity/lifecycle premixed investment options and 38% provide a target-risk premixed investment option in their plans. *Target maturity* funds are diversified premixed portfolios that participants select based on their expected retirement date such as 2010, 2020, or 2030. These portfolios are dynamic and change to become increasingly conservative as the target maturity date approaches. *Target risk* funds are diversified premixed portfolios that are selected based on the risk tolerance of the investor, such as conservative, moderate, or aggressive.

Managed accounts, offered by 15% of respondents, offer investment support by giving employees the ability to delegate overall management of their 401(k) accounts to an outside investment professional for a fee that is taken directly from their account.

### Offerings in 2007

Among respondents that do not currently provide the various investment selection support features, 59% of respondents are very likely or somewhat likely to offer investment guidance (investment suggestions based on asset classes only) in 2007. Fifty-six percent of respondents are very likely or somewhat likely to offer target maturity/lifecycle premixed investment options, and 52% plan to offer third party investment advisory services (online or phone advice on specific investments or funds). One-quarter of respondents said they were very likely or somewhat likely to offer managed accounts.

In September 2006, the DOL issued a draft of their proposed safe harbor guidelines for investment defaults. In particular, QDIAs were identified—including target maturity funds, balanced funds, or managed accounts. This seems to be contributing to the increased interest in some of these investment selection approaches.

Fewer companies are considering in-person advice and target risk premixed portfolios. The cost of in-person advice can be cost prohibitive and only useful for a small segment of a population. Target risk funds are becoming less prevalent because of the difficulty employees have identifying their risk tolerance, and due to the perceived ease and preference for target maturity funds.

### **Features to Help With Investment Selection Offerings in 2007**

	<b>Very Likely</b>	<b>Somewhat Likely</b>	<b>Somewhat Unlikely</b>	<b>Very Unlikely</b>
Investment guidance (investment suggestions based on asset classes only) ( <i>n=94</i> )	23%	36%	23%	17%
Target maturity/lifecycle premixed fund ( <i>n=57</i> )	28%	28%	23%	21%
Third party investment advisory services (online or phone advice on specific investments or funds) ( <i>n=98</i> )	13%	39%	32%	16%
Managed accounts (the ability for employees to delegate overall management of their 401(k) accounts to an outside investment professional) ( <i>n=116</i> )	9%	16%	31%	44%
In-person investment advisor ( <i>n=120</i> )	7%	16%	26%	52%
Target risk/lifecycle premixed fund ( <i>n=86</i> )	8%	14%	27%	51%

## **Contribution Structure**

Among plans that provide a company contribution, 78% of survey respondents do not plan to make changes to their company matching contribution, and 44% do not plan to make changes to their nonmatching contribution. Thirteen percent of respondents plan on adopting post-Pension Protection Act ADP/ACP 2008 safe harbor design with automatic enrollment and 8% plan to add/increase the company match.

### **Likely Changes to Contribution Structure in 2007**

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78%	No change to company match is planned
44%	No change to company nonmatching contribution is planned
13%	Adopt post-PPA ADP/ACP 2008 safe harbor design (with automatic enrollment)
8%	Add/increase the company match
5%	Adopt pre-PPA ADP/ACP safe harbor design
5%	Change company contribution structure, while keeping overall company contribution even
3%	Add/increase company nonmatching contribution
2%	Reduce/eliminate the company nonmatching contribution
1%	Reduce/eliminate the company match

*(n=134; multiple responses)*

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## **Employer Stock Fund**

Over half of respondents (53%) that participated in this year's survey offer an employer stock fund as an investment option in their defined contribution plans. Among those employers, 67% do not have any operational changes planned for the employer stock fund in 2007.

Ten percent of respondents plan to limit the percentage of employee contributions that may be invested in the fund. According to Hewitt's survey, *Trends and Experience in 401(k) Plans 2005*, 17% of plan sponsors already limit employees' investment in the employer stock fund. The average maximum contribution employees can invest in employer stock is 30%. Given the attention on company stock in recent years, it is likely most employers who offer a stock fund have already made changes they felt appropriate to increase participant diversification rights and/or limit employee stock concentration.

### **Likely Actions in 2007 to the Employer Stock Fund as an Investment Option**

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- 67% An employer stock fund is available, but no operational changes are planned
- 19% Allow for faster diversification as required by the Pension Protection Act
- 10% Limit employees' investment in employer stock (to a maximum percentage threshold)
- 6% Hire a third party as a fiduciary of the employer stock fund
- 4% Eliminate it as an investment option
- 4% Freeze the employer stock fund so that no new contributions can be made to it (but not immediately eliminate it)
- 3% Remove those designated as investment insiders from the investment committee to protect against claims of conflicts of interest
- 4% Other (e.g., allow match to be invested according to employees' investment elections and not in company stock fund)

*(n=73; multiple responses)*

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### Communication Initiatives in 2007

In addition to automating plan features, many employers are using communication to improve employee elections and behaviors in their 401(k) plans. In particular, employers are very likely or somewhat likely to undertake specific communication initiatives to 401(k) eligible employees on topics like diversification, contribution levels, and plan participation. This is consistent with prior surveys and has been reinforced by some of the notice and communication requirements of the PPA. In addition, there continues to be an overall focus on increasing basic employee understanding and appreciation of the plan.

Employers are less likely to communicate specifically about the behaviors of loan-taking, withdrawals, and rolling over versus cashing out of the plan upon distribution.

### Likely Defined Contribution Communication Initiatives in 2007

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Diversification ( <i>n</i> =136)	62%	29%	5%	4%
General understanding and appreciation of the plan ( <i>n</i> =136)	54%	36%	6%	4%
Contribution levels ( <i>n</i> =137)	54%	35%	7%	4%
Plan participation ( <i>n</i> =138)	65%	23%	7%	5%
Retirement income adequacy ( <i>n</i> =134)	31%	49%	14%	6%
Retirement considerations and the retirement process ( <i>n</i> =132)	30%	35%	27%	8%
Plan and fund expenses ( <i>n</i> =132)	21%	35%	33%	11%
Rolling over versus cashing out of the plan upon distribution ( <i>n</i> =132)	18%	25%	36%	21%
Withdrawals ( <i>n</i> =132)	9%	24%	36%	31%
Loan-taking ( <i>n</i> =134)	11%	20%	35%	34%

## Investment Fund Offerings

In 2007, the majority of respondents plan to review and/or enhance their plan investment options. Employers are very likely or somewhat likely to review DC fund operations, including fund expenses, revenue sharing, and communication of those topics to employees; perform a comprehensive review of fund offerings; and find ways to reduce costs of funds offered. The recent scrutiny of defined contribution plan expenses by legal entities and regulators has significantly increased employer focus. Further, given the limited usage of certain fund offerings and issues with lack of appropriate diversification among employees, many employers are revisiting their fund design to ensure it is optimal.

In general, respondents who offer only a defined contribution plan are more likely to be taking action with respect to fund offerings than sponsors that also have a pension plan. It is possible that the current focus on pension plans is distracting from the focus on defined contribution fund offerings.

### Likely Actions to Investment Fund Offerings in 2007

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Review DC fund operations, including fund expenses, revenue sharing, and communication of those topics to employees ( <i>n=135</i> )	50%	27%	20%	3%
Perform a comprehensive review of fund offerings ( <i>n=135</i> )	48%	28%	14%	10%
Find ways to reduce costs of funds offered ( <i>n=130</i> )	12%	43%	28%	17%
Add premixed/lifecycle funds (including risk-based and/or target maturity funds) ( <i>n=121</i> )	26%	13%	20%	41%
Increase the number of funds offered in the plan (other than premixed/lifecycle funds) ( <i>n=135</i> )	7%	16%	35%	42%
Switch from risk-based to target maturity premixed/lifecycle funds ( <i>n=122</i> )	9%	7%	26%	58%
Change some or all funds from actively managed to index funds ( <i>n=132</i> )	8%	5%	39%	48%
Implement a self-directed brokerage account ( <i>n=126</i> )	4%	2%	15%	79%
Replace mutual funds with privately managed funds (either separate accounts or collective trusts) ( <i>n=131</i> )	1%	5%	38%	56%
Reduce the number of funds offered in the plan ( <i>n=133</i> )	3%	3%	34%	60%

Among the employers stating they will likely increase the number of funds offered in the plan, the type of funds they are likely to add are inflation protected bond funds, REIT funds, high yield bond funds, and sector funds. Notably, plans looking to adopt one of these less common asset classes are more likely to add several.

## Defined Benefit Plans

This section of the survey shows findings from respondents that provide any form of defined benefit plan (traditional or hybrid, open or closed). Depending on the questions, results may be shown for a subset of these respondents, as indicated.

### Likely Changes to Defined Benefit Plans in 2007

Two-thirds of the employers participating in the survey that provide an open defined benefit plan are likely to stay the course in 2007; less than one in five say they are very likely or somewhat likely to close participation and no longer allow new employees to enter their defined benefit plan. These results have declined since last year's survey results, when 29% reported being very likely or somewhat likely to close their pension plans. This may mean the trend of moving away from defined benefit plans is slowing. Additionally, 30% report they are very likely or somewhat likely to change aspects of the plan design, but continue to offer a defined benefit plan to current and future employees.

### Likely Changes to Open Defined Benefit Plans in 2007

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
No changes, continue with current plan as is ( <i>n</i> =51)	41%	26%	8%	25%
Close participation: no longer allow new employees to enter the defined benefit plan ( <i>n</i> =52)	6%	11%	25%	58%
Change aspects of the plan design, but continue to offer a defined benefit plan to current and future employees ( <i>n</i> =53)	11%	19%	19%	49%
Freeze accruals; cease benefit accruals for all or a portion of participants ( <i>n</i> =52)	4%	6%	21%	69%
Change traditional defined benefit plan to a hybrid plan (cash balance or pension equity) ( <i>n</i> =36)	6%	6%	19%	69%
Terminate the plan: fully fund and remove all company liability through lump sum payout to participants or third party annuity purchase ( <i>n</i> =52)	0%	0%	12%	88%
Change to other new plan design ("Fair Value," "Stable Value," "Retirement Shares," or other pension design) ( <i>n</i> =52)	0%	0%	25%	75%

Respondents that are likely to make changes to their defined benefit plans overwhelmingly responded that they will communicate the changes to employees through broad-based written communications. In addition, employers are expected to target communication to appropriate groups and provide information to employees through seminars/workshops.

### Types of Communications

	Percent of Employers Likely to Make Changes		
	All Defined Benefit Plans	Open Defined Benefit Plans	Closed/Frozen Defined Benefit
Broad-based written communication on the plan changes	92%	100%	75%
Targeted communication to appropriate groups	67%	67%	67%
Seminars, workshops	64%	71%	50%
Existing communication channels	53%	58%	42%
Personalized statements to show impact of changes	39%	38%	42%
Online modeling tools to show impact of changes	31%	38%	17%
Training managers to communicate changes	19%	17%	25%
Other (e.g., already communicated)	11%	8%	17%
<i>(multiple responses)</i>	<i>(n=36)</i>	<i>(n=24)</i>	<i>(n=12)</i>

Among respondents that are *unlikely* to make changes to their open defined benefit plan(s) in 2007, the primary reason they are staying the course is because the plan is an efficient vehicle in the delivery of retirement benefits. Among the closed/frozen plans, no change is needed because it is already closed/frozen.

### Primary Reason Defined Benefit Employers Are Not Making Changes in 2007

	Percent of Employers
Plan is an efficient vehicle for delivering retirement benefits	43%
Fits workforce needs and/or preferences	21%
Plan is necessary to remain competitive	15%
Plan is over funded and costs little to nothing; no reason to change	12%
Plan is already frozen; no need to change	3%
PPA and recent court ruling validate hybrid plan designs	0%
Other (e.g., currently reviewing)	6%
<i>(n=33)</i>	

Respondents that offer a defined benefit plan are likely to perform funding and accounting projections, review funding strategy, and adjust equity exposure and/or overall asset allocation in 2007. This demonstrates that employers are using levers other than plan design to manage the costs and risks of their defined benefit pension plans. Less likely areas of focus include transferring the plan (both assets and liabilities) to an outside party to reduce risk of exposure or transferring excess pension assets into a health benefits account.

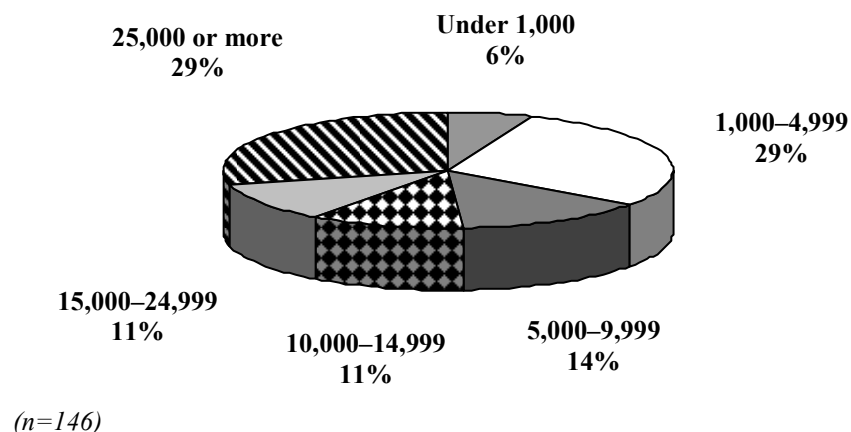
**Likely Actions Defined Benefit Plan Employers Will Take in 2007 for All Defined Benefit Plans**

	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Perform funding and accounting projections ( <i>n</i> =98)	50%	31%	16%	3%
Review funding strategy ( <i>n</i> =99)	30%	43%	8%	19%
Adjust equity exposure and/or overall asset allocation ( <i>n</i> =95)	15%	31%	26%	28%
Extend notice period for QJSA and benefit election period to 180 days ( <i>n</i> =97)	14%	16%	29%	41%
Allow in-service distributions as early as age 62, as permitted by PPA ( <i>n</i> =97)	8%	18%	29%	45%
Add or liberalize a lump sum option ( <i>n</i> =96)	3%	6%	19%	72%
Purchase annuities for retirees ( <i>n</i> =97)	3%	4%	19%	74%
Transfer excess pension assets into a health benefits account under Code Section 420 ( <i>n</i> =97)	1%	3%	22%	75%
Transfer the plan (both assets and liabilities) to an outside party to reduce risk of exposure ( <i>n</i> =96)	2%	1%	15%	82%

**Participating Employer Information**

**Number of U.S. Employees**

Over one-half of survey respondents have 10,000 or more employees. The median number of U.S. employees is 10,000 and the average is 26,854.



## Company Stock

Seven out of ten survey respondents have publicly-traded stock.

### **Company Stock Publicly Traded**

	<b>Percent of Employers</b>
Yes	71%
No	29%

*(n=146)*

## Industry

	<b>Percent of Employers</b>		<b>Percent of Employers</b>
Aerospace/defense	1%	Energy/utilities	7%
Agriculture	1%	Entertainment/communication/publishing	1%
Automotive/transport manufacturing	1%	Financial services	7%
Banking	3%	Food	1%
Beverages	1%	Government	1%
Business services	3%	Health care	8%
Charitable organizations	0%	Industrial manufacturing	2%
Chemicals	2%	Insurance	8%
Computer hardware	1%	Leisure	1%
Computer services	1%	Media	0%
Construction	2%	Metals/mining	4%
Consumer products manufacturing	7%	Pharmaceuticals	1%
Consumer services	1%	Retail (includes wholesale & distribution)	12%
Diversified manufacturing	8%	Telecom equipment	1%
Diversified nonmanufacturing	0%	Telecom services	1%
Education	1%	Transportation services	3%
Electronics/electrical	1%	Other	7%

*(n=146)*

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