

TRENDS AND ISSUES

NOVEMBER 2011

REDESIGNING RETIREMENT PLANS WITH R21 PRINCIPLES

CASE STUDY OF THE EMPLOYEE RETIREMENT PROGRAM FOR THE TIAA-CREF FAMILY OF COMPANIES

Michael Chambers
Director, Benefits Strategy & Finance
TIAA-CREF

Deborah Hamilton
Vice President, Benefits & Human
Resource Operations
TIAA-CREF

Paul J. Yakoboski
Senior Research Fellow
TIAA-CREF Institute

EXECUTIVE SUMMARY

For several years, TIAA-CREF has been advocating publicly and to our clients for a new retirement system for the 21st century – Retirement 21 (R21)–that can provide long-term retirement security to all Americans. As TIAA-CREF presented this vision for retirement security, we undertook an examination of own employee retirement program (which includes two defined contribution retirement plans) with an objective to put these principles into practice within the TIAA-CREF family of companies.

Retirement 21 principles derive from the premise that the overriding objective of an employer-sponsored retirement program should be to provide an adequate and secure level of income throughout retirement to program participants, while balancing the shared responsibility for retirement security between employee and employer. Emerging tenets of well-designed DC plans that follow the R21 blueprint are:

- Automatic enrollment in the program.
- Employer and employee contributions sufficient to produce an adequate retirement income.
- Helping workers manage risk by offering an investment menu allowing appropriate and sufficiently diversified portfolios without an overwhelming number of options.
- Inclusion of an annuity in the investment menu and annuitization as a payout option to enable employees to cover, at a minimum, their core living expenses in retirement with a lifetime annuity.
- A means to save for retirement healthcare expenditures and incentives to do so.
- Comprehensive education and advice.



In 2011, after an extensive review, we launched a revised retirement program that was designed to encourage greater employee savings for retirement by redirecting a portion of company retirement contributions into matching contributions to the TIAA 401(k) Plan and Retirement Healthcare Savings Plan (all employees of the TIAA-CREF family of companies are employed by TIAA, which is the plan sponsor).

Key elements of the program's redesign and launch included:

- A reallocation of some nondiscretionary employer contributions from the company's primary defined contribution retirement plan to a new matching contribution—100% on the first 3% of salary contributed by an employee—in the company's 401(k) plan.
- Auto-enrollment of employees in the 401(k) plan at a 3% contribution rate.
- Addition of a matching contribution into the Retirement Healthcare Savings Plan (RHSP).
- More flexible deferral and savings options, including introduction of a Roth 401(k) option and auto-save functions.
- A proactive campaign encouraging every employee to receive retirement planning advice and counseling services.
- A greater overall company contribution on behalf of the employee in 2011 than in 2010 if an employee contributes 3% of salary to his or her 401(k) account.
- As a result of these changes, we wanted to increase employee participation in the retirement program, help employees take a greater role in planning for their retirement; and provide greater value to those employees.

INTRODUCTION

TIAA-CREF began a review of its employee retirement programs in 2008 and made interim changes to the program design in 2009, primarily in response to the economic downturn. In June 2009, TIAA announced that company contributions to the primary DC retirement plan would be reduced by a flat 25% for all employees effective August 1, 2009.

Like many companies, TIAA was looking to reduce and control expenses during the recession. In addition, evaluation of market data indicated that expenditures on retirement programs exceeded that of peer organizations and the 25% reduction brought program expenditures more in line with the market. Company contributions varied with employee age prior to the change and continued to do so after. At that time, there was no employer match to the 401(k) plan; all company contributions were non-discretionary contributions to the primary DC retirement plan.

When announcing the 2009 reduction to employees, the company also announced that the entire retirement program would be evaluated in 2009-2010 and redesigned as appropriate to ensure that employees continue to be provided with an adequate and secure retirement income. Employees were advised that based on funding considerations, changes would take effect on January 1, 2011. As the leading provider of retirement plans and services to the academic, research, medical, governmental and cultural fields, TIAA committed to a redesign supporting best-practice retirement program features as well as the R21 principles that we advocate to our clients. This paper provides a case study of the evaluation and redesign process.

GUIDING PRINCIPLES

The objectives in evaluating and redesigning TIAA's employee retirement program included:

- Enabling employees to achieve an adequate and secure income throughout retirement, based on the principle that this is a shared responsibility of both the employer and employee
- Maintaining a program consistent with the best practices of a modern, 21st century retirement program.
- Providing a competitive program with respect to other financial services companies.
- Appropriately balancing the provision of retirement benefits with the need to manage costs and provide our clients with value.

- Providing a flexible program that meets employees' needs for saving.
- Appropriately reflecting the history and culture of TIAA-CREF.

All program options were open for consideration, including the level of company commitment and how to allocate those funds between the non-contributory DC plan and a match in the 401(k) plan. At the same time, all other program design elements, e.g., eligibility requirements, contribution schedules, enrollment procedures, vesting standards and retirement payouts were subject to review and change. The review did not include changes to the investment lineup as fund selection is subject to review by an internal Investment Committee.

As a leader in retirement services, TIAA-CREF developed and advocated to our clients and the public a set of best-practice principles for DC plan design to meet the retirement income needs of a 21st century workforce. These principles are referred to as the Retirement 21 ("R21") initiative. R21 principles served as the benchmark in redesigning the TIAA employee retirement program for our own employees. Retirement 21 principles were derived from the belief that the overriding objective of an employer-sponsored retirement plan should be to provide an adequate and secure source of income throughout retirement to plan participants. Emerging from this objective were basic tenets of a well-designed DC plan:

- Automatic enrollment in the program.
- Employer and employee contributions sufficient to produce an adequate retirement income
- Helping workers manage risk by offering an investment menu allowing appropriate and sufficiently diversified portfolios without an overwhelming number of options.
- Inclusion of an annuity in the investment menu and annuitization as a payout option to enable employees to cover, at a minimum, their core living expenses in retirement with a lifetime annuity.
- A way to save for retirement healthcare expenditures and incentives to do so.
- Comprehensive education and advice

EMPLOYER CONTRIBUTIONS

The foremost design features evaluated were employer contribution provisions in light of the 25% reduction in available funding. A range of options were considered, including changing or eliminating the weighting of contributions in the base plan and reallocating non-discretionary employer contributions in the base plan to fund a matching contribution in the supplemental 401(k) plan.

Ultimately, the plans were redesigned such that nondiscretionary employer contribution rates in the primary DC plan were reduced by 1 to 2.5 percentage points, depending upon the age of the employee; these funds were in turn used to institute a 100% match on the first 3% of salary that an employee contributes to the 401(k) plan. The nondiscretionary contribution schedule and the match rate were jointly determined so that a full-career employee would realistically achieve an adequate retirement income if the individual contributed 3% of salary to the 401(k) plan.

Expecting employees to contribute 3% was considered consistent with the view that retirement income security is a responsibility shared by the employer and employee and that an employee should assume an active role in planning and preparing for retirement.

TIAA-CREF considers it best practice for retirement programs to target an income replacement rate of at least 70% from all sources, including Social Security. This translates into needed total contribution rates, including both employer and employee contributions, in the 10-14% range depending upon assumed investment returns and time horizon to retirement.

By fully leveraging the employer match under the redesigned structure, total contributions to the retirement plans would range from 11% for an employee in his or her 20's to 18.5% for an employee age 55 and older. Across all ages, employees receive a greater total employer contribution when contributing 3% themselves than they received prior to the redesign.

This meant a projected increase in the level of employer contributions given assumptions about 401(k) participation and contribution rates.

The redesigned plans also met replacement ratio targets found in the 2008 Aon Consulting-Georgia State University *Replacement Ratio Study*, with little or no employee contribution by those with salaries under \$90,000 beyond the 3% required to receive the match (see table 1). For example, an individual who was hired at age 30 earning \$30,000 would draw 37% from Social Security and 53% from the employer share of the DC plans at retirement, therefore hitting the 90% target without additional voluntary employee deferrals. However, those at higher pay levels would need to make voluntary employee contributions in order to achieve these targets.

**TABLE 1
REPLACEMENT RATIOS FROM AON REPLACEMENT RATIO STUDY**

SOURCE	SALARY LEVEL						
	\$30k	\$50k	\$70k	\$90k	\$150k	\$200k	\$250k
Target Replacement (Aon-GSU)	90%	81%	77%	78%	84%	86%	88%
From Social Security	37%	32%	26%	21%	16%	11%	8%
From Employer	53%	53%	53%	53%	53%	53%	53%
Additional Deferral Needed to Meet Target	-----	-----	-----	-----	1%*	3%*	4%*

* In addition to the assumed 3% employee contribution to receive the full match.

WEIGHTING OF CONTRIBUTIONS

Employer contributions in the base DC plan were originally age-weighted for recruitment and retention purposes. Although an imperfect proxy for tenure, age-weighting serves to reward longer-tenured employees in general. While tenure weighting would directly promote retention by rewarding years of service, a program based on tenure could create difficulties in attracting mid-career hires who might receive less from the TIAA plan than they did with their former employer.

As part of the evaluation process, salary-weighted and tenure-weighted rate schedules for employer contributions to the primary DC plan were considered as alternatives to age-weighting. It was concluded that neither carried a significant advantage over age-weighting for recruitment and retention purposes. Furthermore, a change from an age-based schedule would have created significant disruption for much of the current workforce given that there would be older short-service employees who stood to experience a decrease in the employer contribution. Grandfathering was considered, but dismissed since age could be considered as a proxy for service and the company did not want to maintain two benefit schedules.

ELIGIBILITY, ENROLLMENT AND VESTING

TIAA also made a change to the eligibility and enrollment rules. Employees now participate in the redesigned primary DC plan immediately upon start of employment; previously there had been a six-month waiting period. This change was based upon the belief that individuals should begin financial preparations for retirement as soon as possible during their work lives, which is consistent with R21 principles.

Another design change was auto-enrollment of new hires in the 401(k) plan at a 3% contribution rate. Employees were previously eligible to begin contributing to the 401(k) plan upon hire, but had to proactively enroll themselves. Furthermore, all existing employees who were not 401(k) participants prior to January 1, 2011 were auto-enrolled in the plan effective January 1 unless they opted out. Any employee can change their 401(k) participation status and/or contribution rate at any point in time. Another added feature included an option allowing participants to select automatic annual increases in their contribution rate to the 401(k) plan in 1% increments, up to a 6% maximum.

Given the design choice of allowing workers to opt into 401(k) participation or opt out of participation, we chose to allow individuals to opt out in order to maximize employee participation by creating a structure complementing behavioral tendencies: while most individuals intend to save for retirement, many fail to act upon their intentions for various reasons.

Prior to January 1, 2011, 53% of TIAA employees were deferring at least 3% of salary into the 401(k) plan and another 10% were deferring between 1% and 3%. After auto-enrollment became effective, the participation rate increased to 95% with an average deferral of 7%.

Under the program, employees vest after three years of service. No changes were made to the vesting schedule since TIAA views vesting as a reward for service.

INVESTMENT MENU DESIGN

No changes were made to the investment options available to workers in the base retirement plan and the 401(k) plan. Employees have access to a full-range of investment options offered by TIAA-CREF. This includes investment offers that are unique to TIAA-CREF and structured specifically for investing to produce retirement income, such as the TIAA Traditional Annuity and the TIAA Real Estate Fund. TIAA-CREF Target Date Retirement Funds serve as the default investment.

RETIREMENT DISTRIBUTIONS

The payout structure of the primary DC plan was not changed as part of the redesign; contributions (all of which are made by TIAA) and earnings on those contributions are distributed during retirement exclusively as annuitized payments. There is no option to receive a lump-sum distribution. The argument for this design is grounded in the program objective and Retirement 21 tenet of providing an adequate and secure level of income *throughout retirement*. Annuitization is the only means to guarantee a constant income stream throughout retirement.

The payout structure in the 401(k) plan also remained unchanged: the form of distribution is decided by the participant and annuitization is not required. Participants in the 401(k) plan have access to the range of payout options offered by TIAA-CREF, including a mix of lump sum and annuity options.

Over time, the presence of the match will increase the amount of assets available to an employee as a lump sum, while the primary plan still guarantees a core level of annuitized income. This allows retirees to meet their specific needs for sufficient lifetime income and liquid assets.

RETIREE HEALTHCARE EXPENSES

TIAA has provided employees with access to a Retirement Healthcare Savings Plan (RHSP) since 2009. In 2009, TIAA eliminated subsidies for retiree health insurance coverage for active employees, except for a group of grandfathered employees who would qualify in the next five years. Access to coverage will be available in the future, but not subsidized. At the end of 2010, the participation rate in the RHSP was 4%.

Given the impact that medical care expenses can have on the retirement income security of an individual, and the resulting need to plan and save for such expenses,¹ a matching contribution was added to the RHSP as part of the 2011 redesign of the employee retirement program. Adding a match to the RHSP was a way to offset the change in retiree health insurance coverage and was designed to encourage employees to fund retiree healthcare expenses as part of their retirement savings. For most participants, the RHSP match rate was set at 100% on the first \$300 of salary deferred and 25% on deferrals above that amount, with the match available on a maximum of 2% of salary deferred. Employee and

1 A man with median drug expenditures would need \$124,000 in savings, and a woman would need \$152,000, for a 90 percent chance of having enough money to cover healthcare expenses in retirement. A couple with median drug expenses would need \$271,000 for a 90 percent chance of having enough money. At the highest (90th percentile) level of drug spending, a man would need \$187,000 and a woman \$213,000 for a 90 percent chance of having enough money to cover healthcare expenses in retirement. (See Fronstin, Paul, Dallas Salisbury and Jack VanDerhei. "Funding Savings Needed for Health Expenses for Persons Eligible for Medicare." *EBRI Issue Brief* no. 351 (May 2010).

employer contributions to the RHSP were not factored into the income replacement calculations discussed above; the RHSP represents an additional opportunity for employees to enhance their retirement income security.

PARTICIPANT ADVICE SERVICES

A range of financial advice and counseling services are available to TIAA-CREF participants, including:

- Web-based tools for various retirement planning activities, such as evaluating asset allocations, modeling income in retirement and checking risk/return profiles; while these do not constitute advice, they may be appropriate for many individuals.
- One-on-one advice sessions that result in customized recommendations regarding contribution levels and investment allocations in the TIAA retirement plans; a participant-driven web-based version of the advice model will become available in the latter part of 2011.
- Retirement Plan Portfolio Manager (RPPM), an extension of the advice offering where TIAA-CREF manages the retirement portfolio on behalf of the individual.
- Wealth Management, which is conceptually similar to advice, but involves the development of a broader, complete financial plan.

While such services were previously available to employees as TIAA-CREF participants, they were not widely utilized. While redesigning the employee retirement program, the availability of these services for employees was highlighted and their use strongly encouraged. A company goal is for all current employees to receive an advice session in the form appropriate for their individual circumstances by the end of 2012. In addition, we decided to establish a process where TIAA-CREF consultants would have in-person or phone counseling sessions with every new company hire in order to review TIAA-CREF products and services and to elicit program enrollments. To support this goal, staffing plans were made and budget dollars allocated to staff the positions necessary to provide the advice and wealth management sessions. In addition, our field consulting group would provide bi-monthly financial education group seminars in each of the main office locations, with webinars offered to other offices.

ROLLOUT

Communication of the redesigned program began in the fall of 2010 with the objective of introducing employees to the changes and demonstrating how they align with R21 principles. An additional objective was to begin efforts to engage employees in an advice and consultation session.

As part of the communication rollout, a one-day *Retirement Benefits Symposium* was held in the company's New York, Charlotte, and Denver offices in early November. The symposium consisted of presentations by corporate leadership explaining the redesigned program, the reasons for the changes, and how to maximize the program's value. There were also smaller breakout sessions where information was provided on more specific topics such as saving for retirement healthcare; available advice and education programs and tools; and other products and services provided by TIAA-CREF such as life insurance, college savings plans, mutual funds and brokerage services. There were also presentations on navigating the new HR web-based system for making 401(k) elections, as well as a keynote speaker who talked about future trends and shaping one's own future given the changes that an aging population will have on society. The symposium sessions were subsequently made "virtually" available to employees through the corporate intranet.

The symposiums served as a pivotal point for educating employees about the redesigned plans and the full array of TIAA-CREF products and services to which they have access. Key objectives of the symposiums were to encourage employees to contribute to the 401(k) plan and utilize the appropriate products and services during 2011, in particular, the advice tools.

Other communication channels were used as well, including an all-managers conference call during which TIAA-CREF's CEO presented the changes; company town halls supporting the newly redesigned program; and online interactive brochures. Employees also received periodic emails about the redesigned program and available participant services;

several articles were posted on the company intranet with the same material. Human Resources also created a 'Benefits Hub'- a one-stop shop for all benefit-related information that helps employees navigate through enrollment in the new retirement programs as well annual enrollment in the company's healthcare plans.

CONCLUSION

The redesigned retirement program for TIAA's employee population became effective January 1, 2011. The objective of the redesign was to sponsor a state-of-the-art program that meets or exceeds the key principles of Retirement 21 that have been discussed nationally by TIAA-CREF with clients, the media and public policymakers: building sufficient savings; helping workers manage risk; providing advice and education services; guaranteeing a portion of retirement funds as a lifetime annuity; and encouraging savings for health-related expenses in retirement.

The redesigned program represents a significant employer commitment that strikes a balance between employer and employee shared responsibility for ensuring an adequate and secure income throughout retirement. Key elements of the redesign and launch included:

- A reallocation of some nondiscretionary employer contributions from the company's primary DC plan to a new matching contribution—100% on the first 3% of salary contributed by an employee—in the 401(k) plan.
- Auto-enrollment of employees in the 401(k) at a 3% contribution rate.
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As a company that strives to ensure that its clients enjoy a financially secure retirement; as an employer TIAA strives to ensure the same outcome for its employees

ABOUT THE AUTHORS

Michael Chambers is Director, Benefits Strategy & Finance, TIAA. He leads strategic initiatives related to the employee benefit programs, including retirement, health and wellness, disability, life insurance, and other benefits for TIAA's 7,200 employees. In addition, he reviews and analyzes the financial aspects of all benefit programs. Chambers has more than 25 years of in-depth experience with respect to the design, administration, financing and communication of employee benefit programs. He joined TIAA in May 2005 from Towers Perrin (now Towers Watson), a major employee benefits and actuarial consulting firm, where he was a Principal and senior actuarial and benefits consultant. Michael holds an undergraduate degree in Economics from the University of Kansas, a Master of Science in Actuarial Science from the University of Nebraska-Lincoln, and a graduate studies degree from Cambridge University. He is a Fellow of the Society of Actuaries and an Enrolled Actuary under ERISA.

Deborah Hamilton is Vice President, Benefits & Human Resource Operations at TIAA. She oversees the company's benefit strategy and manages all employee benefit programs as well as the HR operations and reporting areas for TIAA's 7,200 employees. Hamilton oversees the design of guiding principles for management of TIAA's healthcare, wellness, work-life and retirement programs and is responsible for providing the strategic direction and growth of new HR systems. In addition, she manages the operations of the company's benefit governance and investment committees. Hamilton has more than 20 years in-depth experience in employee benefits design and management. She joined TIAA in August 2005 from Spring Industries, a major home furnishings and textiles company, where she served as Benefits Director and oversaw the management and administration of all employee benefit programs. Prior to that, she spent several years in various employee benefits positions at Collins & Aikman Corporation and the Charlotte-Mecklenburg School district. She started her career as a claims analyst with New York Life and The Equitable. Hamilton holds a bachelor's degree in Economics from Hollins College in Virginia.

Paul Yakoboski is a Principal Research Fellow with the TIAA-CREF Institute. He conducts, manages and communicates research on issues such as defined contribution plan design, income and asset management in retirement, individual decision-making and preparation for retirement, managing faculty retirement patterns, and topics relevant to strategic management in higher education. He is responsible for the development and execution of Institute symposiums on such issues. Prior to joining the TIAA-CREF Institute, he held positions as Director of Research for the American Council of Life Insurers (2000 to 2004), Senior Research Associate with the Employee Benefit Research Institute (1991 to 2000) and Senior Economist with the U.S. Government Accountability Office (1989 to 1991). Yakoboski earned his Ph.D. (1990) and M.A. (1987) in economics from the University of Rochester (Rochester, NY) and his B.S. (1984) in economics from Virginia Tech (Blacksburg, VA).