

APRIL 2009

BENEFITS IN CRISIS — WEATHERING ECONOMIC CLIMATE CHANGE

PULSE SURVEY REPORT

EXECUTIVE SUMMARY

Despite the economic recession and several waves of cost cutting, most employers continue to view their benefit programs as a vital part of the workplace relationship with employees, according to a recent Towers Perrin survey of close to 500 U.S. companies. (See page 8 for details about the survey.)

Some companies, of course, have already taken steps to reduce benefits, including suspending contributions to 401(k) plans. But in contrast to media attention on the most severe cutbacks, most companies in the Towers Perrin survey are staying the course in the benefits arena, with very few taking precipitous action right now in terms of dramatic reductions or outright elimination of current plans. In part, this is because many have actively managed their programs over the past decade, particularly in terms of limiting new participation in traditional pension plans and increasing employee cost sharing for both active and retiree health benefits.

The data also suggest that companies remain committed to shared responsibility with employees, despite (or perhaps because of) their own continuing financial pressures. How that philosophy plays out remains to be seen, as the sputtering economy continues to take a toll on both employers and employees. In fact, the time may soon come when employers need to completely rethink their benefit strategies to find creative ways to share cost burdens while still offering employees basic support for financial security and risk protection.

Our respondent group is, like most U.S. companies right now, expecting a tough year. While roughly a third predict their 2009 revenues will match those in 2008, fully 56% expect to see revenues decline, in some cases by as much as 20% or more. So it's notable that even as these companies seek cost-cutting remedies and continue to shift a growing portion of benefit cost and risk to individuals, they say they are also stepping up efforts to communicate and offer more tools and support to help employees make responsible benefit choices.

Also notable is the fact that many are using the current crisis to find the right balance between cost reduction and talent management, and position benefits as part of a more holistic total rewards package, or “deal” with employees — even if that deal looks a bit battered right now.

These are welcome signs at a time when employee anxiety about financial security and declines in retirement assets is intensifying. In a survey we conducted among employees in December 2008, more than 80% agreed they were affected by the recession to some degree, and 45% also agreed their risk of job loss was greater than it had been.* Not surprisingly, we also saw a decrease in employees' level of engagement, which can directly affect job performance and productivity. Other employee research has shown a strong relationship between employees' confidence in their ability to manage the costs and risks of their benefit programs and their level of engagement. Potentially, as their confidence erodes, so will their commitment to the company and their job.**

*The Steady Pulse of the U.S. Workforce in the Midst of Crisis. Towers Perrin Pulse Survey, December 2008

**Rx for Rewards: Towers Perrin Total Rewards Study, August 2008

Our current employer survey confirms the mood of fear in the workforce and the financial pressures many people now face. Broadly, between 30% and 60% of respondents reported that their employees were postponing plans to retire, reducing participation in 401(k) plans and increasing hardship withdrawals and loans from the plan. Only 7% of respondents predicted any uptick in 401(k) participation. While this is perhaps understandable, given the drop in value many employees have seen, it nevertheless raises concerns since employers will, in all likelihood, continue to rely on defined contribution (DC) plans as a key element of overall retirement financing.

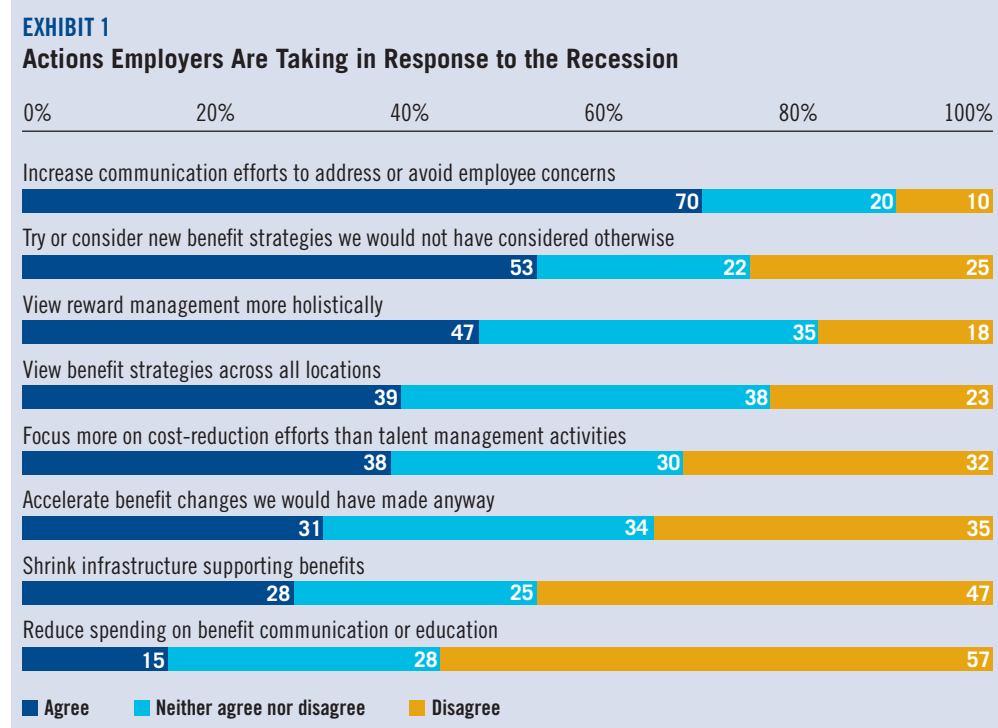
Broadly, the survey findings raise critical questions for employers as they wrestle with the effectiveness of their current programs and the breadth and scope of changes that may occur under the Obama administration. Specifically, how much financial risk can or should employees be expected to bear in helping to plan, fund and manage their own retirement? If the traditional three-legged stool is wobbling, what actions are needed to stabilize it, and what are the appropriate roles for business, government and indi-

vidual workers? What safeguards, if any, might come into play over time? What tools and support are needed to help employees more effectively manage their financial futures? And, as the cost of health care escalates (up over 150% in the last eight years) and becomes increasingly unaffordable for both individuals and their employers, what near-term solutions make sense as a stop gap, at least until the shape and timing of national health care reform become clearer?

A look at our detailed findings follows.

SETTING THE CONTEXT

Despite serious concerns about their companies' 2009 performance, most of our respondents appear far from abandoning some of the positive changes they've made in their benefit plans over the last few years. In fact, as *Exhibit 1* shows, a fair number of respondents see the economic crisis as a catalyst for actions ranging from a step-up in employee communication, to a more holistic approach to reward management, to experimentation with different benefit strategies.



Fully 70% of respondents, for instance, affirmed that their company was increasing communication to deal with employee anxiety, and more than half (57%) agreed they were not cutting back on investments in benefit communication or education. Perhaps even more telling, while 38% of respondents agreed that their company was emphasizing cost reduction over talent management right now, a nearly equal number (32%) were taking the opposite tack and putting talent issues ahead of cost cutting. Almost half (47%) had no plans to cut back on the infrastructure — whether people, systems or both — required to design and deliver benefits effectively to their employees.

RETIREMENT PICTURE

As *Exhibit 2* shows, defined benefit (DB) plan sponsors continue to close their plans to new participants, though at a slower pace than many might have expected. And among companies that have kept their DB programs open, a majority have no intention of freezing the plans. An even larger majority — over two-thirds — also have no intention of modifying DB plans for current participants.

On the DC front, fewer than 10% of respondents have suspended or plan to suspend company contributions to DC plans. Another 19% are considering the action, but nearly three-fourths of respondents have no such intentions.

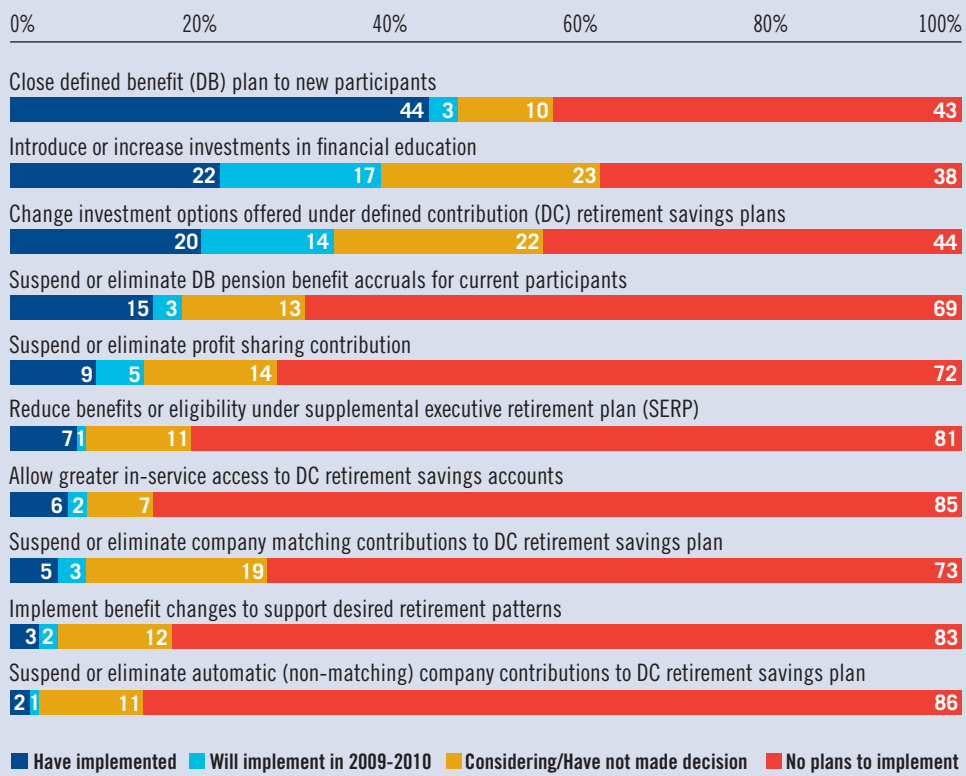
At the same time, as noted above, employers are doing more, not less, to educate employees and communicate about DC investment options. Nearly 40% of respondents are making or increasing investments in financial education for employees. And a similar percentage has changed or plans to change the investment options in DC plans.

Achilles heel exposed? These actions are under way as the falling stock market exposes what many observers now see as a weakness in 401(k) plans and other employee-managed retirement savings accounts — namely, limited employee understanding of investment strategy and the need to balance risk and return. As the media have made all too clear, accounts with equity exposure have taken a beating. And while most companies routinely warn employees of potential volatility in the equity markets, a long bull market may have created the illusion that past performance guarantees future returns, lulling people into taking on additional risk.

Companies that, just one year ago, were enthusiastic about automatic enrollment, target date funds and other DC plan features aimed at increasing participation, are now examining their communications, investment options and other plan features to ensure that employees are adequately armed to better manage their investments.

EXHIBIT 2

Changes in Retirement Plans



Darkening retirement horizons. Amid these efforts, our survey respondents confirm that an increasing number of employees are changing their retirement expectations (*Exhibit 3*). Over half (59%) of respondents say employees plan to postpone retirement in light of the current economic climate, presumably to rebuild savings and delay having to draw down their retirement accounts. Just under half (48%) of respondents also reported

that employees are moving to fixed-income investments and away from equities, suggesting that they are willing to forgo potentially higher equity returns in an effort to reduce volatility and lower their exposure to investment risk. That raises the question of whether employees will go from one extreme to the other and fail to find a more appropriate middle ground for their circumstances in trying to balance risk against growth in assets.

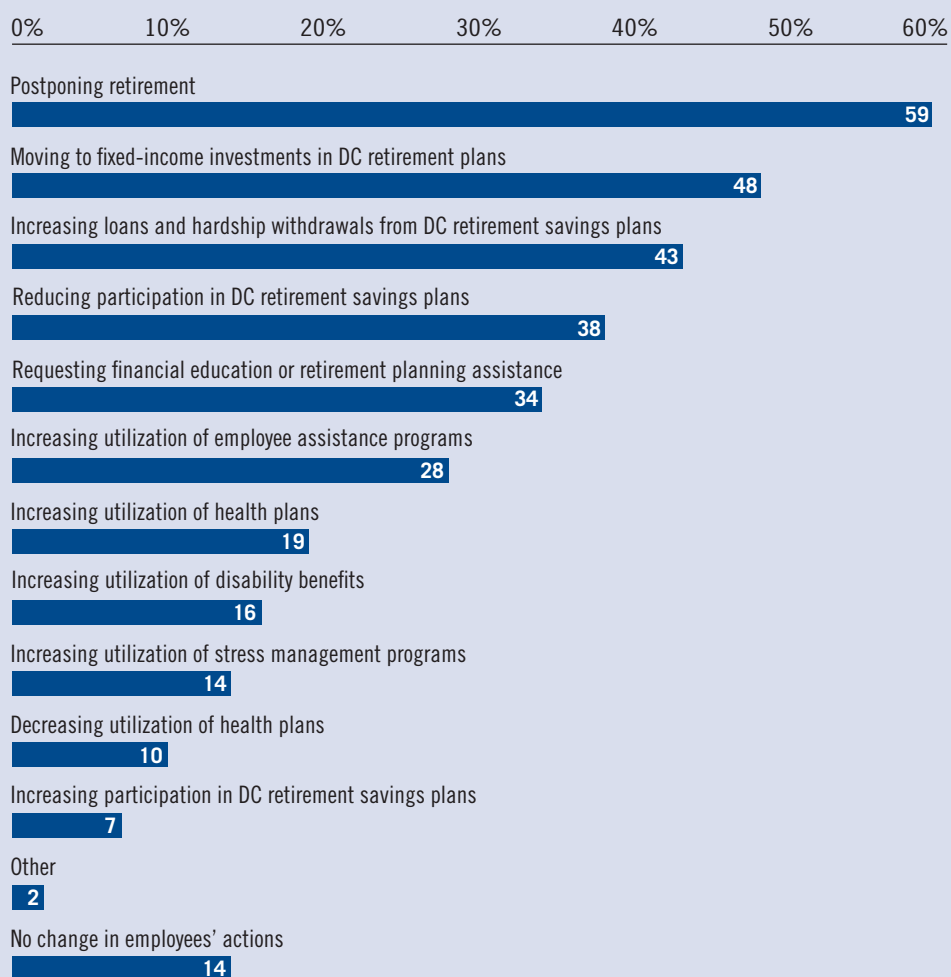
Of equal concern, 43% of respondents reported that employees are increasing loans and hardship withdrawals from DC plans, while 38% reported declining overall participation in the plans. These findings dovetail with data from our December 2008 employee survey showing that 65% of employees don't believe they will be in a financial position to retire when they had planned, and nearly a third cited fear of incurring medical expenses they can't afford.

These trends suggest that an increasing number of employees may fall far short of their retirement income needs, particularly if they are not in a DB plan, do not have other assets and back off from further participation in available DC plans.

Fuel for national debate. The findings also underscore a national debate in Congress and elsewhere regarding the question of whether too much risk has been shifted to workers. Despite the impact of current market conditions, DB plans have the benefit of professional investment managers who can take advantage of insurance-type pooling and sophisticated de-risking techniques that are not available to an individual investor. However, few observers see current conditions as breathing new life into DB plans.

EXHIBIT 3

Actions Respondents Believe Employees Are Taking in Response to the Recession

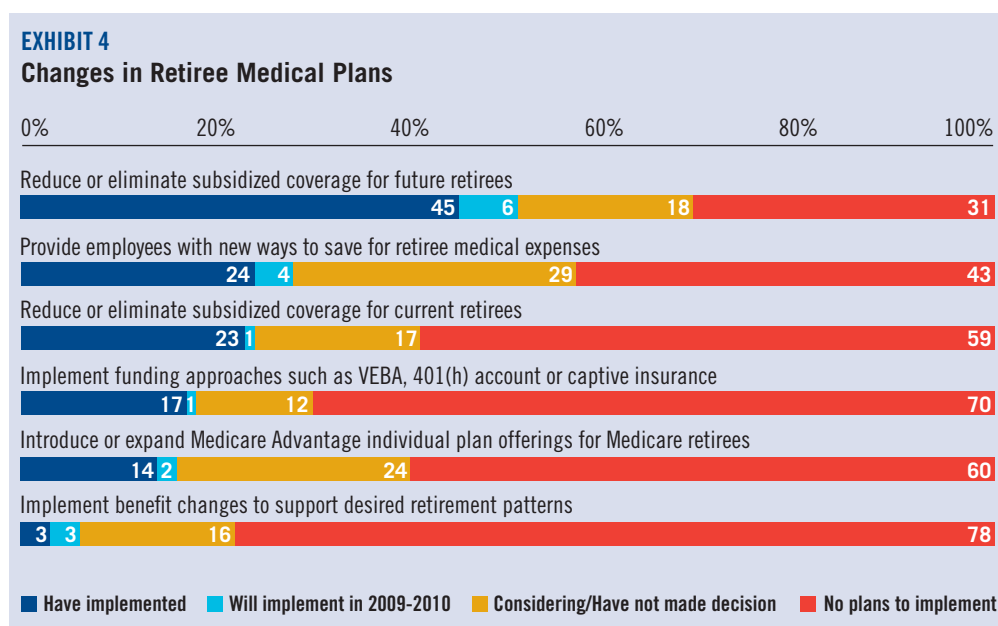


Indeed, there are emerging signs that the account-based approach will gain momentum, albeit with some significant design differences. In its budget proposal, the Obama administration would expand a “savers’ credit” to encourage middle- and lower-income employees to set money aside for retirement. The budget would also require most employers to allow workers to contribute to a balanced lifetime Individual Retirement Account that employers would set up but not necessarily fund.

THE HEALTH CARE PICTURE

On the retiree medical benefits front, our findings confirm companies’ decade-long move to reduce their financial commitment to retirees. For the most part, cost-shifting efforts remain focused on future, rather than current, retirees, although this trend may begin to change over time. As *Exhibit 4* shows, just over half (51%) of respondents have taken or plan to take steps to reduce or eliminate subsidized coverage for future retirees, compared with only about a quarter taking or considering such action for current retirees. And 59% don’t intend to cut back on or eliminate subsidized coverage for current retirees at all.

Opportunities overlooked? More surprising, perhaps, is the fact that relatively few of the respondent companies have implemented more creative funding approaches



for retiree medical costs or introduced new savings vehicles for employees. Fully 43% of respondents, for instance, don’t plan to introduce account-based health plans to help employees save for medical expenses in retirement, and 60% have no plans to introduce or expand Medicare Advantage plan offerings for post-65 retirees.

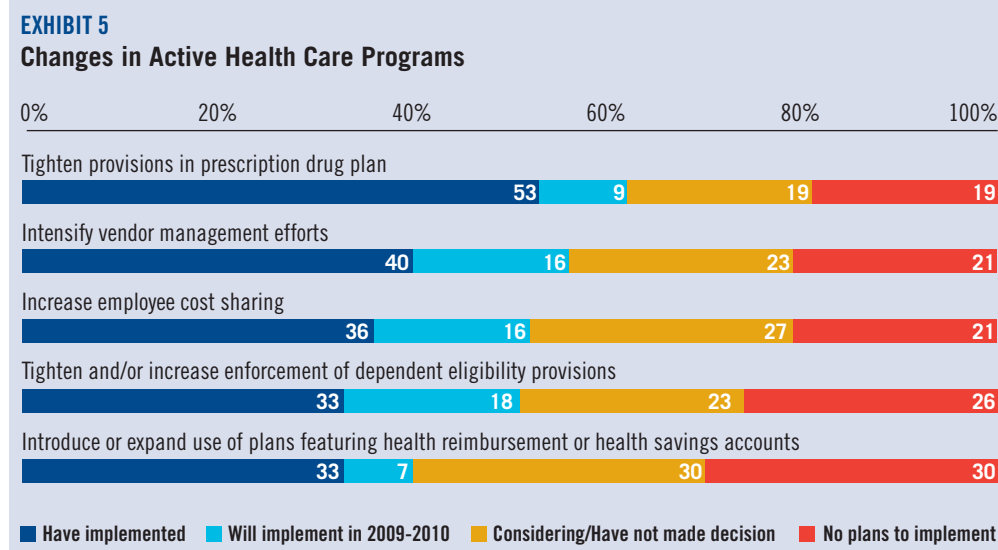
The survey respondents may be less inclined to pursue these alternatives because of questions about the current administration’s support for these vehicles. Nevertheless, employers should consider the potential value such programs can create — with little or no cost to the company. Data from another Towers Perrin employee study show, for example, that employees put high value on access to retiree medical coverage even if it is

not subsidized.* Viewing these findings in tandem, it’s hard to escape the conclusion that employers are not taking full advantage of some very real opportunities for positive action that could meet both their needs and those of retirees.

Equally interesting, given widely reported shifts in retirement patterns — particularly delayed retirements, as noted above — more than three-quarters (78%) have no intention of redesigning plans to support preferred retirement patterns in their own workforce, whether that might be encouraging people to stay in the workforce to maintain continuity in skills and experience or, conversely, promoting earlier retirement to pave the way for an influx of younger talent or different skills.

Sharing costs — and responsibility. On the active health care front, as *Exhibit 5* shows, employers are continuing to pursue the array of fairly aggressive actions that have marked recent cost management efforts. Just over half of the survey respondents are, for example, increasing employee cost sharing through higher contributions or benefit design changes. Nevertheless, the survey findings point toward growing sensitivity to the problem of affordability that years of cost shifting have helped create.

Some respondents now seem to be taking a more surgical approach to cost management, targeting program features that reinforce good consumer behaviors and the shared responsibility message. More than 60% of respondents, for instance, have tightened or plan to tighten provisions in prescription drug plans (e.g., requiring broader use of generic drugs). They're also turning their attention to program operations, and intensifying vendor management efforts, which can take the form of performance or claim audits. Just over half have taken or plan to take steps to tighten enforcement of dependent eligibility provisions — which



is no surprise, as unemployed workers try to join spouses' plans and COBRA continuation costs rise.

Account-based plans face new hurdles.

While a third of respondents already have health savings accounts built into their plans, a roughly similar number are planning to introduce such features over the next two years or are considering doing so. While these plans offer a tax-sheltered savings option for employees, they face some hurdles right now. One is continuing confusion among employees about the advantages of these plans and how to use them, driven largely by misunderstanding of the way these programs redefine employees' financial risk — clearly a sore subject in today's environment.

Even more to the point right now, growing numbers of employees are likely to simply stop contributing because they need that extra cash in hand. And those who have some savings in such plans may find they need to draw down funds today, rather than use the plans as a "health and wealth" vehicle for future expenses (including medical costs in retirement), as employers might prefer. If anything, the current climate may up the ante on effective positioning of health savings accounts along a health/wealth continuum that begins in active employment and continues through to retirement.

Investing in workforce health. One bright spot in the data is that few companies are pulling back from their focus on wellness (*Exhibit 6*). Over 70% have or are considering introducing or increasing investments in wellness and care/disease management. And 79% have no plans to reduce or eliminate investments in wellness or incentives to participate in wellness programs. Interestingly, the current crisis may be giving employers license to take a tougher stance on wellness, by introducing penalties for nonparticipation in place of incentives for participation. Taken together, these various responses confirm that more employers are embracing the notion of workforce wellness as a “health dividend” that can pay off for the company in many ways, going well beyond a reduction in claims and costs.

THE IMPACT OF CHANGE

When asked about the organizational impact of benefit changes, respondents offered mixed views (*Exhibit 7*). Nearly one-quarter (24%) expect a positive impact on productivity while another 24% worry about a negative impact. And almost a third (29%) are concerned about the negative impact on their employees’ level of engagement and willingness to “go the extra mile” on the job. This is, in fact, a very valid worry, since, as noted earlier, our December 2008 employee survey showed a modest decline in engagement levels.

EXHIBIT 6

Changes in Wellness and Health Promotion Programs

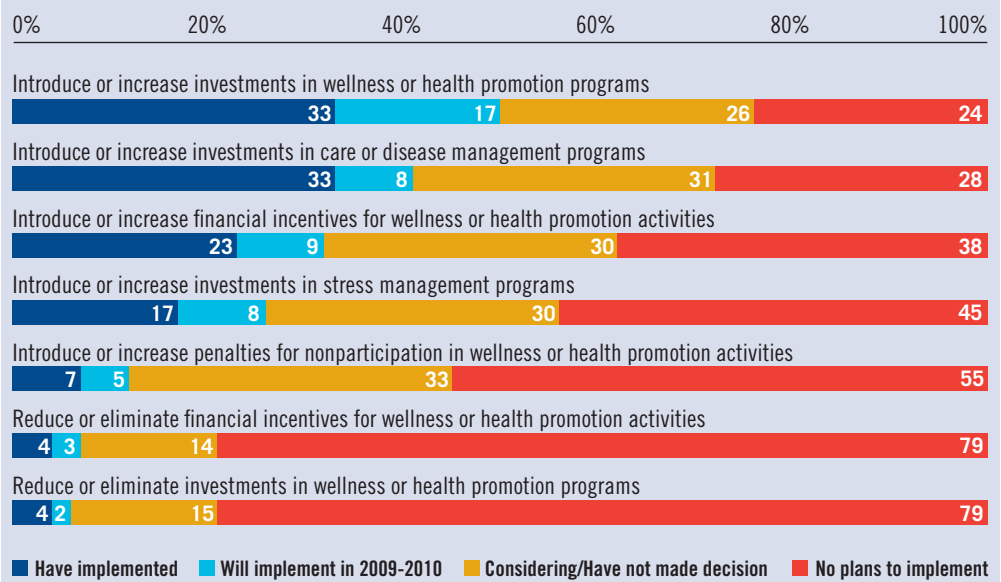
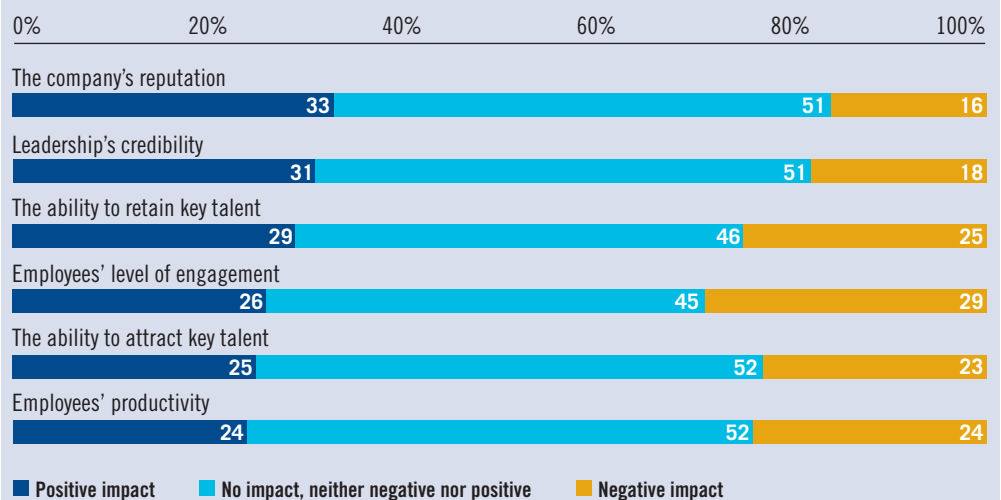


EXHIBIT 7

Expected Impact of Benefit Changes on the Organization and Workforce



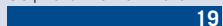
ABOUT THIS STUDY

This survey on the impact of the recession on benefit plans was conducted online in February 2009. Just under 500 HR and benefit executives responded, representing a cross section of midsize and large U.S. organizations.

Size of Responding Organizations**Total Revenues in 2008**

0% 10% 20% 30% 40%

US\$10 billion or more



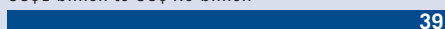
19

US\$5 billion to US\$9.9 billion



11

US\$1 billion to US\$4.9 billion



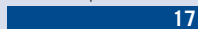
39

US\$500 million to US\$999 million



14

Under US\$500 million



17

Mean: 4.34 billion**Expectations of 2009 Performance****Anticipated 2009 Revenues vs. 2008**

0% 10% 20% 30% 40%

Up



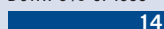
12

About the same



32

Down 5% or less



14

Down 6% to 10%



19

Down 11% to 20%



13

Down more than 20%



10

The expected impact varies significantly, however, depending on whether the company focuses more on cost reduction or talent management. Those putting a premium on talent issues (relative to cost) are far more likely to believe that changes in their benefit plans will have a positive impact on their ability to attract, retain and engage the right employees. They also have higher expectations for productivity and believe that their actions will boost management's credibility and enhance their company's reputation.

A PLATFORM FOR CHANGE

Ultimately, our survey findings suggest that, all things considered, employers are keeping their heads, despite a deep worldwide recession. That said, there's no question that companies must find new and effective ways to deal with the immediate concerns of a workforce that is steadily losing its confidence — not to mention its savings. With fewer employees having the option of a traditional DB plan, many have come to rely heavily on their 401(k) plans and have been alarmed to see their savings dragged down by falling equity markets. This is happening in tandem with the plunging U.S. real estate market, depriving many workers of a real estate asset they may have intended to use for retirement. And rising medical costs add to the equation.

In this tricky environment, employers can hunker down, cut costs and hope for the best. Or they can use the financial crisis as a platform for positive change. In fact, today's conditions are likely to change the landscape over the longer term, and companies that thrive in the new climate will be those that look ahead today. They should be prepared to engage employees in change, taking the time to truly understand what employees value, and to explore the trade-offs employees are willing to accept. Success will mean finding creative, cost-effective ways to shore up retirement and medical benefits to meet essential needs while bolstering employees' commitment to the long-term success of the organization.

ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organizations improve performance through effective people, risk and financial management. The firm provides innovative solutions in the areas of human capital strategy, program design and management, and in the areas of risk and capital management, insurance and reinsurance intermediary services, and actuarial consulting.

Towers Perrin has offices and alliance partners in the world's major markets. More information about Towers Perrin is available at www.towersperrin.com.