Redesigning a Defined Contribution Program—A Case Study of the TIAA-CREF Employee Plans

Faced with the same economic pressures as other businesses in recent years, how would a leading financial services organization and Fortune 100 company redesign its own employer-sponsored retirement program in a way that didn’t put its workforce’s retirement security at risk? This article provides a case example, describing key elements from the state-of-the-art redesign and launch of TIAA-CREF’s retirement program for its own workforce. The redesigned program strikes a balance between employer and employee shared responsibility for ensuring an adequate and secure income throughout retirement by building sufficient savings, helping workers manage risk, providing advice and educational services, guaranteeing a portion of retirement funds as a lifetime annuity and encouraging savings for health-related retirement expenses.

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Can defined contribution (DC) plans provide individuals with an adequate and secure income throughout retirement? Based on the 401(k) experience in the recent recession, many would answer “no.” But TIAA-CREF has provided a successful DC system since 1918 when the Carnegie Foundation established Teachers Insurance and Annuity Association (TIAA).

TIAA is also a retirement plan sponsor for its employees. Facing the same economic pressures as other businesses in recent years, TIAA decreased funding for its employee retirement plans. But in addition, it undertook a careful evaluation of those plans to redesign them with the objective of sponsoring a program that builds sufficient savings, helps workers manage risk, provides advice and educational services, guarantees a portion of retirement funds as a lifetime annuity, and encourages savings for health-related expenses in retirement.

The redesigned retirement program for TIAA’s workforce became effective January 1, 2011. Key elements of the redesign and launch included:

- A reallocation of some nondiscretionary employer contributions from the company’s money purchase plan to a new matching contribution—100% on the first 3% of salary contributed by an employee—in the 401(k) plan
• Autoenrollment of employees in the 401(k) at a 3% contribution rate
• Addition of a matching contribution in the retirement health care savings plan
• A proactive campaign encouraging every employee to receive retirement planning advice and counseling services
• A higher overall company contribution on behalf of the employee in 2011 than in 2010 if an employee fully leverages the match to his or her 401(k) account.

Experience has shown that many workers who have the opportunity to participate in a 401(k) plan or similar arrangement make saving and investing decisions that are unlikely to produce an adequate retirement income throughout their retirement years. This phenomenon frequently reflects a lack of information, understanding, interest and engagement. Furthermore, absent from typical 401(k) plan design are elements focused on income generation during the retirement years. A significant accumulation itself is necessary but not sufficient for generating an adequate and secure retirement income. Savings must be managed and converted to income during retirement.

DC plans can address these issues through appropriate design, such as the strategic use of plan defaults. In 2007, the TIAA-CREF Institute published a report outlining design best practices for primary DC plans in the public sector. More recently, the TIAA-CREF Institute hosted a pair of forums to rethink DC plan design. In December 2010, experts in behavioral economics, actuarial science, human decision making, and financial education and advice examined creative uses of plan features, product designs and participant services to address the retirement income needs of a workforce that differs in ability to save, in financial needs and priorities, and in level of engagement on such issues. In April 2011, senior human resource (HR) officers responsible for plan sponsorship at colleges, universities and nonprofit hospitals gathered to discuss these same issues.

Subsequent to the first forum, attendees and other research experts on the subject were surveyed regarding the design of DC plans that serve as primary retirement plans. Responses indicated a degree of consensus regarding various design elements, such as:

• Autoenrollment being the most effective design to maximize participation (in the absence of mandatory participation)
• Appropriate contributions (participant and sponsor combined) being at least 10% of salary
• Providing participants with the opportunity within the plan to annuitize assets.

What Makes for a Well-Designed DC Plan?

Risks associated with providing retirement income—specifically, investment risks associated with funding retirement and longevity risks associated with converting savings to income—shifted from employers to employees with the advent of the 401(k) plan and the tremendous growth those plans sparked in the DC plan environment. In the aftermath of the 2008-2009 recession and crash in financial markets, the financial services industry, public policy officials and the retirement research community have focused increased attention on DC plan design. The basic questions under scrutiny have been:

• Can DC plans provide an adequate and secure retirement income?
• What are the characteristics of a well-designed retirement plan?
• Are there specific plan features that help ensure the retirement income security of workers?

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Redesigning an Existing DC Plan

In 2009, TIAA-CREF began advocating to its clients and the public a set of best practices for DC plan design 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:

• Automatic enrollment of eligible workers
• Employer and employee contributions sufficient to produce an adequate retirement income
• An investment menu that allows appropriately 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 allow employees to cover their core living
expenses in retirement, at a minimum, with a guaranteed level of lifetime income
• A means for saving for retirement health care expenditures and incentives for doing so
• Comprehensive education and advice.

In its capacity as the leading provider of retirement plans and services to the academic, research, medical, governmental and cultural fields, TIAA is also a retirement plan sponsor for its employees. As such, it has to meet the needs of a diverse workforce who don’t all have a background that would make them expert in matters of personal finance, such as saving for retirement. TIAA began a review of its employee retirement program in 2008 and made interim changes in 2009, primarily in response to the economic downturn. Like many companies, TIAA was looking to reduce and control expenses during the recession.

In June 2009, TIAA announced that company age-weighted contributions to the money purchase plan (MPP) would be reduced by 25% for all employees, effective August 1, 2009. An evaluation of market data had indicated that expenditures on retirement programs exceeded that of peer organizations and the 25% reduction brought expenditures more in line with the market. At the time, there was no employer match to the 401(k) plan; all company contributions were nondiscretionary contributions to the MPP.

When announcing the 2009 reduction to employees, TIAA also announced that the retirement program would be evaluated in 2009-2010 and redesigned as appropriate to ensure that it continued to provide employees with an adequate and secure retirement income. All aspects of the program would be considered, except for the investment menu since fund selection is subject to review by an internal investment committee. This meant that eligibility requirements, enrollment procedures, contribution schedules, the allocation of company funding between the noncontributory MPP and a potential match in the 401(k) plan, vesting schedules and retirement payouts were subject to review and change. TIAA committed to a program redesign built upon the best-practice DC plan features that TIAA-CREF advocates to clients. Based on funding considerations, any changes would take effect on January 1, 2011.

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 employer and employee
• Maintaining a design 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 clients with value
• Providing a flexible program that meets employees’ needs for saving
• Appropriately reflecting the history and culture of TIAA-CREF.

With full leveraging of the employer match under the redesigned contribution structure, total contributions in the retirement plans would range from 11% for employees in their 20s to 18.5% for employees aged 55 and older.
Employer contribution schedules were a primary area of evaluation given the 25% reduction in funding. A range of options were considered, including changing or eliminating the age weighting of contributions to the MPP and reallocating nondiscretionary employer contributions in the MPP to fund a matching contribution in the 401(k) plan.

Ultimately, the plans were redesigned such that company contribution rates in the MPP were reduced by one to 2.5 percentage points, depending on the age of the employee; these funds were used to institute a 100% company match on the first 3% of salary contributed by an employee to the 401(k) plan. The MPP contribution schedule (weighted by age) and the 401(k) plan match provisions were jointly determined so that a full-career employee would realistically achieve an adequate retirement income if the employee fully leveraged the 401(k) match. Expecting a 3% contribution by employees was considered consistent with the view that providing for a financially secure retirement is a responsibility shared by the employer and employee.

TIAA-CREF considers it best practice for employer-sponsored plans to target an income replacement rate of at least 70% of preretirement earnings, accounting for retirement income from all sources, such as defined benefit pensions and Social Security. This translates into a contribution rate, employer and employee contributions combined, in the 10-14% range (allowing for Social Security but assuming no pension income), depending on assumed investment returns and time horizon to retirement.

With full leveraging of the employer match under the redesigned contribution structure, total contributions in the retirement plans would range from 11% for employees in their 20s to 18.5% for employees aged 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 aggregate company contributions given assumptions about 401(k) participation and employee contribution levels.

The redesigned contribution schedules also met replacement ratio targets found in the 2008 Aon Consulting–Georgia State University Replacement Ratio Study for employees earning up to $90,000 with no contribution beyond the 3% necessary to fully leverage the company match (see the table). For example, at age 65, an employee who was hired at age 30 earning $30,000 would draw 37% from Social Security, 53% from employer contributions to the DC plans and 12% from a 3% employee contribution, thus surpassing the 90% target. However, employees at higher pay levels would need to contribute above 3% in order to achieve the study’s targets.

Employer contributions in the MPP 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 midcareer hires who might receive less from the TIAA plan than they did with their former employer.

In the evaluation process, salary-weighted and tenure-weighted contribution schedules 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 contribution schedules under the MPP.

Eligibility and Enrollment

TIAA also changed eligibility for the MPP so that employees now participate in the redesigned plan immediately upon start of employment; previously, there had been a six-month waiting period. This change was based on the belief that individuals should begin financial preparations for retirement as soon as possible during their work lives.

Autoenrollment of new hires at a 3% contribution rate was also instituted with the 401(k) plan. Previously, employees were eligible to begin contributing to the 401(k) plan upon hire, but they had to enroll proactively. This change in enrollment policy was intended to maximize employee participation in the 401(k) plan by creating a structure complementing the behavioral tendency for individuals to procrastinate in making decisions or implementing decisions they have made.

In addition, current employees not participating in the 401(k) plan were autoenrolled in the plan effective January 1, 2011 unless they opted out. An employee can change his or her 401(k) participation status and contribution rate at any point in time. Another feature incorporated into the 401(k) plan was the option for automatic increases in a participant’s contribution rate by one percentage point annually, up to a 6% contribution rate.

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 autoenrollment became effective, the participation rate increased to 95% with an average deferral of 7%.

No change was made to the vesting schedule—three-year cliff vesting—for company contributions. TIAA views vesting as a reward for service.

Retirement Distributions

The payout structure of the MPP was not changed in the redesign; company contributions and earnings on those contributions are distributed during retirement exclusively as annuitized payments. There is no option for receiving a lump-sum distribution. This design is consistent with the plan’s objective to provide an adequate and secure level of income throughout retirement. Annuity is the only means to guarantee a constant income stream throughout retirement.

The payout structure in the 401(k) plan did not change either. Participants decide among the range of payout options offered by TIAA-CREF, including a mix of lump sum and annuity options. Annuity payment of 401(k) balances is not required.

Over time, the presence of a company match in the 401(k) plan will increase the assets available to an employee as a lump sum, while the MPP will still guarantee a core level of annuitized income. This provides retirees with the flexibility for meeting their individual needs for both sufficient lifetime income and liquid assets.

Retirement Health Care Savings Plan

TIAA has provided employees with access to a retirement health care savings plan (RHSP) since 2009. In 2009, TIAA eliminated subsidies for retiree health insurance coverage for active employees, with the exception of employees who would qualify for those subsidies within the next five years. Access to coverage will be available to future retirees, but will not be subsidized. At the end of 2010, 4% of employees participated in the RHSP.

Given the impact that medical care expenses can have on the retirement in-
come security of an individual, and the resulting need to plan and save for such expenses, a matching contribution was added to the RHSP as part of the 2011 redesign of the employee retirement program. A matching contribution in the RHSP was a way to offset the change in retiree health insurance coverage and was designed to encourage employees to fund retiree health care 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. Effective January 1, 2012, the company matching contribution to the RHSP changed to 100% of the first $750 contributed each year for all employees. Participation in the RHSP increased to 12% of employees in 2011 and 21% in 2012. Employee and 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**

The evaluation and redesign process also considered the advisory services available to TIAA employees as plan participants. 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
- 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 have been available to TIAA employees, they were not widely used. Highlighting the availability of these services and strongly encouraging their use became a point of emphasis in the redesign. A company goal was set for all employees to receive an advice session in the form appropriate for their individual circumstances over the next four years. In addition, TIAA-CREF consultants would have in-person or phone counseling sessions with new hires to review TIAA-CREF products and services and to elicit program enrollments. To support these initiatives, plans were made and budget dollars allocated to staff the positions necessary to provide the advice and wealth management sessions.

**Rollout**

Communication of the redesigned retirement program began in the fall of 2010 with the objective of introducing employees to the changes and demonstrating their alignment with TIAA-CREF’s principles for a well-designed retirement plan. 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 hosted at the company’s corporate centers in New York, Charlotte and Denver in early November. The symposium consisted of presentations by corporate leadership explaining the redesigned program, the reasons for the change, and how to maximize the program’s value. There were also smaller breakout sessions that provided information on more specific topics such as saving for retirement health care; 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 discussed shaping one’s own future given the changes that an aging population will have on society. The symposium sessions were sub-
sequently made available “virtually” to employees through the corporate intranet.

The symposiums were 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 use the appropriate products and services during 2011, in particular, the advice tools.

Other communication channels were used in the rollout 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 e-mails about

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the redesigned program and available participant services; sev-
several articles were posted on the company intranet with the same
t material. HR also created a “Benefits Hub,” an online one-stop
location for all benefit-related information that helps employees
navigate through enrollment in the new retirement programs as
well as annual enrollment in the company’s health care plans.

Conclusion

The redesigned retirement program for TIAA’s workforce
became effective January 1, 2011. As a company, TIAA strives
to ensure that its clients enjoy a financially secure retirement;
as an employer, TIAA strives to ensure the same outcome for
its employees. To that end, the objective of the redesign was a
state-of-the-art program that builds sufficient savings, helps
workers manage risk, provides advice and education services,
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Endnotes

1. All employees of the TIAA-CREF family of companies are em-
   ployed by TIAA, which is the plan sponsor.
2. See Roderick B. Crane, Michael Heller and Paul J. Yakoboski, “Best-
   Practice Benchmarks for Public-Sector Core Defined Contribution Plans, ”
3. See Paul J. Yakoboski, “Rethinking Defined Contribution Retire-
4. See Paul J. Yakoboski, “Rethinking Defined Contribution Retire-
   ment Plan Design: Plan Sponsor Perspectives,” TIAA-CREF Institute Trends
   and Issues, December 2011.
5. See Paul J. Yakoboski, “Rethinking Defined Contribution Retire-
   ment Plan Design: A Survey of Experts,” TIAA-CREF Institute Trends and
   Issues, August 2011.
6. 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 in-
   come, such as the TIAA Traditional Annuity and the TIAA Real Estate Ac-
   count. TIAA-CREF Target Date Retirement Funds serve as the default
   investment.
7. Aon Consulting, Replacement Ratio Study, 2008. Results reflect cal-
   culations that consider gross preretirement income, taxes and savings, as
   well as changes in age- and work-related expenditures, savings patterns and
   taxes after retirement.
8. A 65-year-old male with median drug expenditures would need
   $124,000 in savings, and a 65-year-old female would need $152,000, for a
   90% chance of having enough money to cover health care expenses in retire-
   ment. A couple with median drug expenses would need $271,000 for a 90%
   chance of having enough money to cover health care expenses in retire-
   ment. (See Paul Fronstin, Dallas Salisbury and Jack VanDerhei, “Funding
   Savings Needed for Health Expenses for Persons Eligible for Medicare,”
   EBRI Issue Brief no. 351, May 2010.)