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Insider

New and amended state and local paid sick leave laws

By Cindy Brockhausen and Bill Kalten

The paid sick leave (PSL) law landscape is continually changing, resulting in new legal requirements that employers need to comply with. These laws generally allow employees to use PSL for certain reasons, such as to care for their own illness or that of a family member; for matters related to when the employee or a family member is a victim of domestic violence; or for work, school or daycare closings due to public health emergencies.

To date, 14 states, Washington, D.C., and over 20 localities have PSL laws in effect, while four jurisdictions – Nevada; Maine; Bernalillo County, New Mexico; and West Hollywood, California – have earned paid time off (EPTO) laws in effect that are structured similarly to the PSL laws but allow employees to use leave for any reason.

The following state and local developments have occurred since our last update[1] that employers must now navigate if they operate in these jurisdictions:

- **Allegheny County** enacted a new PSL ordinance requiring employers with at least 26 employees to provide up to 40 hours of paid leave that employees can use for their own personal illness, to take care of sick family members, for when the employee's workplace or child's school/place of care is closed for public health reasons, or to care for a family member due to his or her exposure to a communicable disease. Employees accrue one hour of PSL for every 35 hours worked, up to 40 hours a year. Allegheny County is the third jurisdiction within Pennsylvania with a PSL law, joining Pittsburgh – which is located within Allegheny County – and Philadelphia. The new law took effect on December 15, 2021; however, fines will not be imposed until December 15, 2022.

[1] See "**State and local paid sick leave law developments**," *Insider*, July 2021.

In This Issue

1 New and amended state and local paid sick leave laws
4 SEC proposal on more extensive 'pay for performance' disclosures
7 2020 asset allocations in Fortune 1000 pension plans

News in Brief

6 President Biden extends national emergency, Outbreak Period rules continue
13 Temporary telehealth provision enacted

- **Chicago** amended its PSL ordinance to expand and clarify additional uses of PSL, such as caring for a family member whose school or place of care was closed; compliance with public health orders; and reasons related to a family member's mental and behavioral health, including substance use disorders. The amendments took effect August 1, 2021.
- **Colorado** revised its wage protections rules to clarify the requirements on vacation and paid time off payout. While the Healthy Families and Workplaces Act (HFWA) defines PSL as wages, it does not require payment of unused PSL upon separation. Effective January 1, 2022, the wage protection rules specifically define vacation pay as "...pay for leave, regardless of its label, that is usable at the employee's discretion (other than procedural requirements such as notice and approval of particular dates), rather than leave usable only upon occurrence of a qualifying event (for example, a medical need, caretaking requirement, bereavement, or holiday)." The revised rules clarify that if accrued PTO – regardless of its label – is usable for vacation, then it is "earned and

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determinable" and must be paid at termination rather than forfeited, even if the leave can be used for other reasons. As such, employers using a policy or agreement to satisfy HFWA's requirements that can be used at the employee's discretion must pay out any accrued leave at separation of employment, effective January 1, 2022.

- **Duluth, Minnesota,** expanded its Earned Safe and Sick Time (ESST) ordinance to provide use of paid sick time due to the closure of an employee's place of employment for public health reasons. The amendments also imposed new requirements that employers provide new employees with a copy of their ESST-compliant paid-leave policy and, if an employer maintains a handbook, a copy of the ESST-compliant policy. The amendments became effective on August 19, 2021.
- **New York** adopted regulations interpreting the state's PSL law that had been proposed two years earlier. While the December 2020 proposed PSL regulations were adopted with no changes, the Department of Labor clarified several key issues. Notably, employers should count the number of employees *nationwide* in determining the number of employees, requiring advanced notice for foreseeable use of PSL is not permitted, and there's no limit of unused PSL – whether earned or frontloaded – that employees can carry over to the next year.
- **West Hollywood, California,** enacted a new ordinance requiring employers to provide up to 96 hours of paid time off to full-time employees that can be taken for illness, vacation or personal necessity. Once this leave is exhausted, employers must provide an additional 80 hours of unpaid sick time for the illness of the employee or the employee's immediate family member. Both the paid and unpaid time off is prorated for part-time employees. Employees can accrue paid time off until they reach 192 hours, at which point employers must pay employees once every 30 days for accrued time off over the 192-hour threshold. Also, employers may allow employees to cash out accrued time off under the maximum. The ordinance went into effect on January 1, 2022, for hotel workers and will go into effect for all other covered workers on July 1, 2022.

For a current listing of all the states and localities with PSL and EPTO laws, see the map on the next page. Absent a federal mandate, changes at the state and local level are expected to continue.

Going forward

Covered employers in states and localities with PSL and EPTO laws should review their existing leave policies and procedures to determine whether they are in compliance with the laws in the jurisdictions in which they operate and adjust their employee leave policies if necessary. Federal contractors will also need to comply with **Executive Order 13706** and the related regulations.

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States/localities mandating paid sick leave

Arizona
California
Colorado
Connecticut
Maine[1]
Maryland
Massachusetts
Michigan
Nevada[2]
New Jersey
New Mexico[3]
New York[4]
Oregon
Rhode Island
Vermont
Washington
Washington, DC

California: *Berkeley, Emeryville, Los Angeles, Oakland, San Diego, San Francisco, Santa Monica, West Hollywood*[5]

Illinois: *Chicago, Cook County*[6]

Maryland: *Montgomery County*

Minnesota: *Duluth, Minneapolis, St. Paul*

New Mexico: *Bernalillo County*[7]

New York: *New York City*

Pennsylvania: *Allegheny County, Philadelphia, Pittsburgh*

Texas: *Austin,*[8] *San Antonio*[9]

Washington: *Seattle, Tacoma*

[1] Leave can be taken for any reason.

[2] Leave can be taken for any reason.

[3] Effective July 1, 2022.

[4] Does not prevent a city with a population of 1 million or more from enacting or enforcing local laws that meet or exceed the law's minimum requirements.

[5] Leave can be taken for any reason, effective July 1, 2022, for non-hotel employees

[6] Numerous municipalities have opted out.

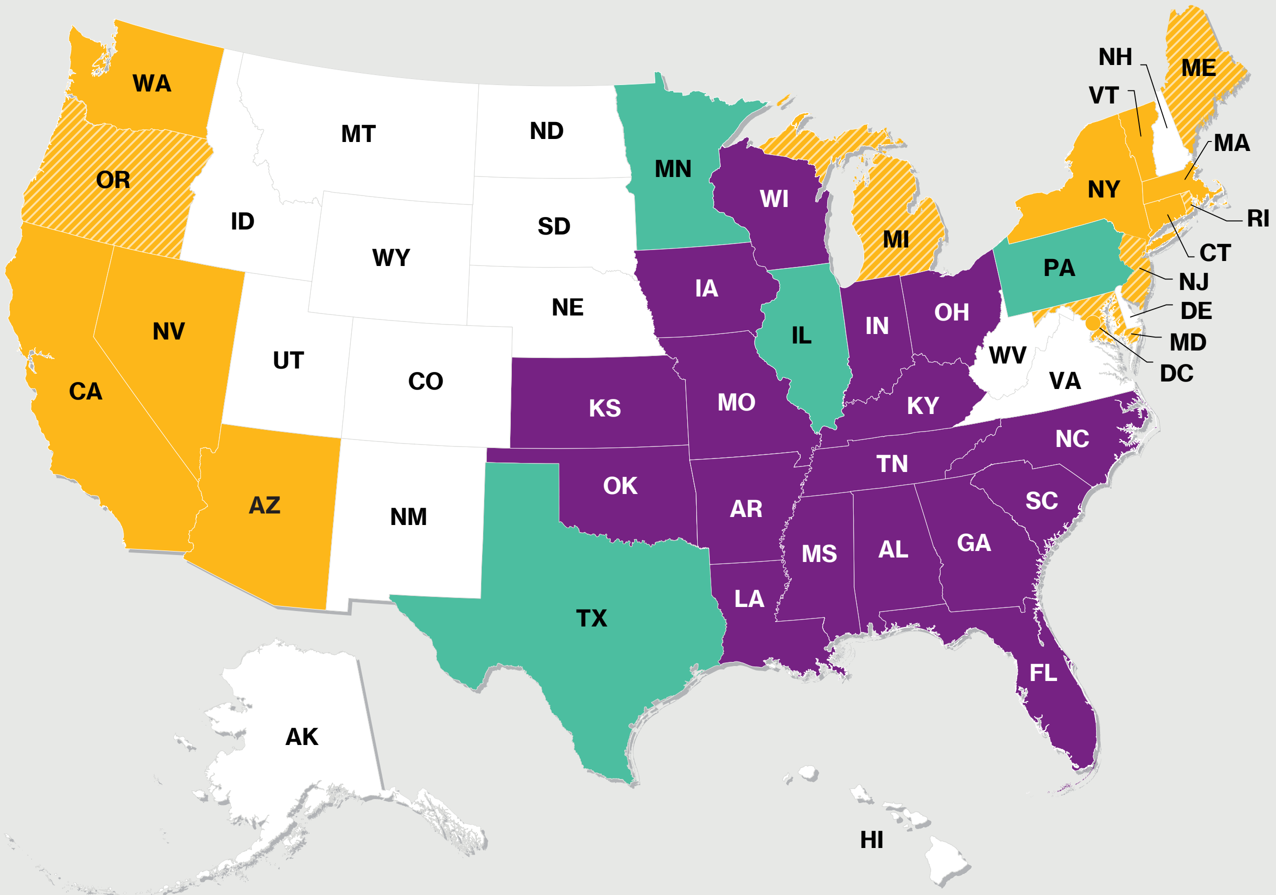
[7] Leave can be taken for any reason.

[8] Implementation blocked due to court ruling.

[9] Implementation temporarily postponed due to court ruling.

States with bans against local paid sick leave laws

Alabama
Arkansas
Florida
Georgia
Indiana
Iowa
Kansas
Kentucky
Louisiana
Maine
Maryland
Michigan
Mississippi
Missouri
New Jersey
North Carolina
Ohio
Oklahoma
Oregon
Rhode Island
South Carolina
Tennessee
Wisconsin



■ States mandating paid sick leave (and the District of Columbia)
▨ States mandating paid sick leave and prohibiting local jurisdictions from mandating paid sick leave
■ States with one or more localities (but not the state itself) that mandate paid sick leave
■ States prohibiting local jurisdictions from mandating paid sick leave

This map does not include the jurisdictions that have enacted temporary mandates in direct response to the COVID-19 pandemic.

SEC proposal on more extensive 'pay for performance' disclosures

By Gary Chase and Steve Seelig

The Securities and Exchange Commission (SEC) recently **reopened the comment period** for its previously issued proposal that would expand what companies include in their "pay versus performance" disclosures under the Dodd-Frank Wall Street Reform Act of 2010. This action expanded on its 2015 proposal and would require an extensive tabular disclosure of the performance measures that are most important to companies. This may prompt companies to reassess how they present the details of their pay programs in their compensation discussion and analysis (CD&A) for the 2023 proxy, as a more uniform, required table common to all companies may make CD&As less relevant to shareholders.

Under the recent proposal, public companies would need to provide a tabular disclosure of "compensation actually paid" to their CEOs/named executive officers (NEOs) compared with absolute and relative total shareholder return (TSR) as well as the generally accepted accounting principles (GAAP) metrics of "pre-tax net income" and "net income," plus a "company-selected measure" that represents the "most important performance measure used by the registrant to link compensation actually paid during the fiscal year to company performance."

Further, the SEC is considering requiring a tabular disclosure listing the five most important performance measures that drove "compensation actually paid."

Comments on the proposal are due on or before March 4, 2022; therefore, it is possible that calendar-year companies will need to include this disclosure on their 2023 proxy.

Background

In 2006, the SEC revised how executive pay would be presented on company proxies by requiring a single depiction of CEO/CFO/NEO pay as Total Compensation on the Summary Compensation Table (SCT). Rather than create a new regime for determining pay, the SEC instructed companies to value cash compensation as amounts earned during the year (roughly akin to FICA wages); for equity and pensions, it would look to existing GAAP measures of compensation. Equity grants would be shown on the SCT at the full grant date ASC 718 (FAS 123R, at the time) value, not spreading the value over the vesting/performance period as per the required presentation on company financial statements.

[I]t is possible that calendar-year companies will need to include this disclosure on their 2023 proxy.

One downside was that showing the full grant date value of equity almost always would be a different value than the executives ultimately received, and many companies were left to explain that fact to shareholders and then demonstrate they paid for performance. Within a few years, many companies added a CD&A pay for performance presentation of "realizable pay" or "pay realized" compared with absolute and/or relative TSR to better reflect the true value of the compensation granted to executives. Over time, these presentations became an expected part of CD&As.

Dodd-Frank was enacted in 2010, mandating that the SEC require proxy disclosure of "information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions." However, the SEC did not propose regulations for this disclosure until 2015 when it sought a tabular disclosure that compared CEO and average NEO SCT compensation (with some adjustments) and compensation "actually paid" to both absolute and relative TSR, over a five-year period.

How to complete the table

Below are details on how to complete the proposed table (figures 1 and 2, next page). The 2015 proposal includes extensive descriptions of how the mechanics of each of these calculations will work. The final regulations are expected to provide even more guidance.

- **Compensation actually paid** would continue to be defined as SCT compensation, excluding changes in pension value, with a different manner of valuing pensions and with the value of equity awards at vesting rather than when granted.
- **CEO and the average of other NEO compensation** would appear with both SCT values (columns [b] and [d]) and compensation actually paid values (columns [c] and [e]).

Figure 1. **Company-selected measure: Sample form, part 1**

Year	Summary compensation table total for PEO	Compensation actually paid to PEO	Average summary compensation table total for non-PEO NEOs	Average compensation actually paid to non-PEO NEOs
(a)	(b)	(c)	(d)	(e)
Y1				
Y2				
Y3				
Y4*				
Y5*				

Sample

Figure 2. **Company-selected measure: Sample form, part 2**

Year	Total shareholder return	Peer group total shareholder return*	Pre-tax net income (loss)	Net income (loss)	[Company-selected measure]*
(a)	(f)	(g)	(h)	(i)	(j)
Y1					
Y2					
Y3					
Y4*					
Y5*					

Sample

- **Performance measures to be disclosed,** in what we will call the "Pay vs. Performance Table," would be the company TSR (column [f]); the TSR of the company's peer group, as chosen by the company (column [g]); pre-tax net income (loss) (column [h]); net income (loss) (column [i]); and a company-selected measure.
- **Five years of history** would be required to be disclosed on the table. Small reporting companies must show only three years. Exempt from the disclosures would be foreign private issuers, registered investment companies and emerging growth companies.
- **The five most important performance measures** that drove compensation actually paid, in a separate tabular disclosure titled "Five Most Important Company Performance Measures for Determining NEO Compensation." We call this the "Top 5 Table" (Figure 3).

Proposed adjustment to executive compensation disclosure

The new Pay vs. Performance Table, if mandated, will present both tactical and strategic considerations for companies:

- **Selecting a measure for the Pay vs. Performance Table in year one.** The proposal would require a disclosure of any measure the company selects, although the SEC has not yet finalized whether this measure needs to be one that is used to determine executive pay. This selection must be made carefully, as whatever is selected as "most important"

Figure 3. **Top 5 Table**

Five Most Important Company Performance Measures for Determining NEO Compensation	
1.	**Meaure 1**
2.	**Meaure 2**
3.	**Meaure 3**
4.	**Meaure 4**
5.	**Meaure 5**

Sample

is going to drive shareholder perceptions of company success, at least as it pertains to executive pay.

- **Pay program and disclosure changes in year two and beyond.** The SEC has not yet determined how frequently companies will be allowed to change the disclosure of their "most important" measure. Because executive pay programs can change from one year to the next, the SEC will need to clarify the rules for how companies that switch measures would present their five-year history. In the longer term, these new disclosure rules will provide shareholders, proxy advisors and other stakeholders more data to analyze how different pay plans overperform and underperform compared with those of peers.
- **A new Top 5 Table.** This would present a company's chosen measures in an easy-to-follow, single disclosure with cross-references to those other sections of the proxy where more description is provided. The SEC will need to clarify whether this single disclosure mixes CEO pay

measures with those for other NEOs. Companies will need to carefully consider which metrics to include in their Top 5. Commissioners have indicated wanting to see a focus on environmental, social and governance (ESG) measures, and shareholders may view the absence of ESG measures in this table negatively if they are included in those of peer companies.

- **Existing proxy depictions of pay for performance.** Companies will need to revisit existing proxy depictions as well as how the proxy's executive summary is written. They will need to decide if the Pay vs. Performance Table will become the de facto standard by which they can demonstrate pay for performance, or if it would make sense to have several depictions, including their current realized or realizable pay disclosures.

Immediate action steps

Companies can begin taking steps now to start planning for the disclosure requirements:

- **Model the Pay vs. Performance Table for 2021 based on the proposal.** This will prove a useful exercise, both in understanding how the rules will work and in anticipating how to determine the "most important" measure. This model should include the five-year history as well.
- **Create a Top 5 Table.** List the five most important company performance measures for determining NEO compensation. The proposed rules would require cross-references to where those measures are discussed elsewhere, so charting those in advance could be helpful.
- **Start thinking about existing pay for performance depictions.** Identify and discuss with advisors the challenges in assimilating existing pay for performance disclosures with this new pay versus performance tabular disclosure.

Companies will need to carefully consider which metrics to include in their Top 5.

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News in Brief

President Biden extends national emergency, Outbreak Period rules continue

By Maureen Gammon and Anu Gogna

On February 18, 2022, President Biden issued a **notice** extending the national emergency for the COVID-19 pandemic beyond its March 1 expiration date. First declared in 2020 by President Trump, the national emergency will remain in effect until March 1, 2023, unless President Biden terminates it earlier.

Deadline relief for health plans and participants continues during the extended national emergency. Under the "Outbreak Period" rules issued by the Departments of Labor and Treasury, several important deadlines are extended, including those for the following Internal Revenue Code and ERISA requirements:[1]

- Making COBRA elections
- Making COBRA premium payments
- Providing COBRA election notices (from the plan administrator to qualified beneficiaries)
- Requesting HIPAA special enrollments
- Filing benefit claims or appeals or requesting an external review of an adverse benefits determination

[1] For more information on the Outbreak Period rules, see "**Health and welfare plan time frames extended due to COVID-19**," *Insider*, May 2020; "**DOL guidance on end of COVID-19 'Outbreak Period',**" *Insider*, March 2021; and "**IRS clarifies COBRA time frame extensions**," *Insider*, October 2021.

2020 asset allocations in Fortune 1000 pension plans

By Mercedes Aguirre and Brendan McFarland

Overview of the 2020 Asset Allocation Study of Fortune 1000 Pension Plans

During 2020, plan sponsors witnessed extraordinary levels of volatility and uncertainty affecting financial markets, which were mostly driven by the spread of the COVID-19 pandemic in the first quarter. Auspiciously, both equity and debt markets recovered throughout the year, with the former achieving double-digit gains — more than surpassing the year-to-date deep loss — by the end of 2020. Despite robust equity returns, portfolio gains from the assets' boost were partially offset by lower interest rates. Interest rates used to gauge pension obligations decreased to record low levels over the year, dropping by more than 50 basis points and prompting an increase in pension obligations. This coupled with the equity performance resulted in tepid funding improvements. It is in this challenging context of outstanding uncertainty that the asset allocation strategy adopted by sponsors plays a crucial role in the plans' investment returns, funding status and cash requirements to cover such things as employer contributions.

The Financial Accounting Standards Board began requiring more detailed pension disclosures in 2009, and WTW has been analyzing asset allocations ever since.[1] These analyses track asset allocation trends and patterns over time in Fortune 1000 plans. This 12th edition looks at fiscal year-end 2020 pension allocations by asset class, such as cash, equity, debt and alternatives, as well as by a variety of other attributes of both the assets and the plans.

The analysis is performed on both an aggregate-sponsor (weighted by plan assets) and average-sponsor basis as well as by plan size, plan status (open, frozen or closed) and funded status (defined as the ratio between total fair value of assets over total liabilities, considering both U.S. and non-U.S. plans). We examine the prevalence and amount of pension assets invested in company securities. Finally, we compare asset holdings from 2009 through 2020 for a consistent sample of plan sponsors and examine the relationship between risk-reduction strategies and asset allocations.

Over the past decade, there has been a steady shift from equities to low-volatility investments.

Analysis highlights

- There is a strong correlation between a pension plan's status and its portfolio's risk profile, with frozen plans holding more liability-hedging investments compared with closed and open plans. On average, frozen pension plans held above 56% of their assets in debt and cash investments versus less than 50% for sponsors of open plans.
- Over the past decade, there has been a steady shift from equities to low-volatility investments. Looking at a consistent sample, average allocations to public equities declined by roughly 14 percentage points since 2009, while allocations to debt increased by almost 16%. Sponsors show a gradual search for returns via alternative investments (including hedge funds, private equity and real estate), which increased from 6.7% in 2009 to 7.8% in 2020.
- The use of alternative investments has a well-established correlation with the plan's size. While larger plans allocated 9.5% to alternative investments, smaller plans only hold around 3.4% of their portfolios in these investment vehicles.
- In 2020, more than 8% of Fortune 1000 defined benefit (DB) plan sponsors held pension assets in the form of company securities, and among that group, such securities averaged 5.5% of plan assets.
- There is a clear trend of sponsors increasingly following a de-risking path, either via liability management activities or via their asset allocation strategy. As for the latter, over the past decade sponsors have been focusing more on liability hedging investment vehicles, as the number of plans holding more than 50% of their asset mix in fixed-income securities tripled from 2009 to 2020.

[1] See "**2019 asset allocations in Fortune 1000 pension plans**," *Insider*, January 2021.

Figure 1a. **Aggregate asset class distribution, 2020**

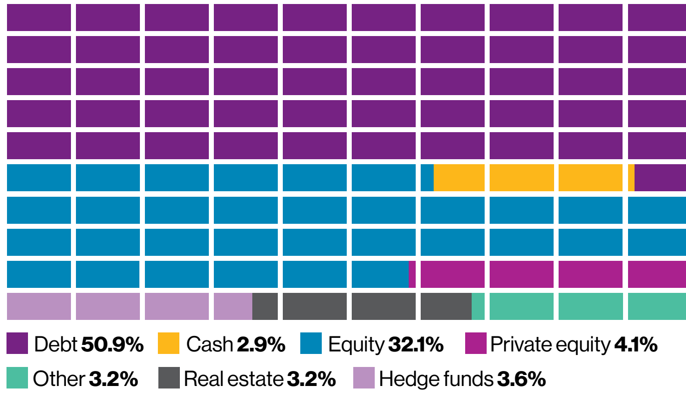
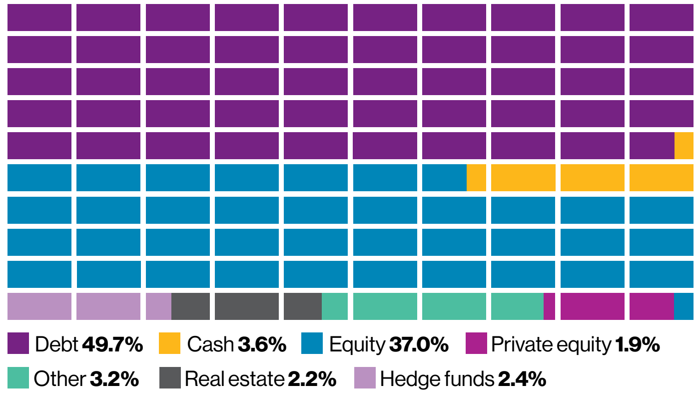


Figure 1b. **Average asset class distribution, 2020**



Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

2020 aggregate and average asset allocations

WTW's analysis of 2020 fiscal year-end DB plan asset allocations first takes a detailed look at 451 Fortune 1000 plan sponsors' pension disclosures.[2]

Figure 1a summarizes aggregate asset allocations weighted by the value of the sponsor's plan assets and shows total-dollar allocations. As of year-end 2020, the 451 companies in this analysis held more than $2.0 trillion in pension assets, comprised by cash, public equity, debt and alternative investments (real estate, private equity, hedge funds and other).

At year-end 2020, 32.1% of pension assets were allocated to public equity and 50.9% were allocated to debt, with the remaining assets spread among the other various categories.

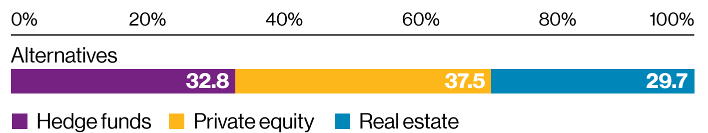
Figure 1b depicts average asset allocations (not weighted by plan assets) for the same sample of companies. The average Fortune 1000 pension plan sponsors in the analysis held above $4.8 billion in assets at year-end 2020.

The average allocation to public equity was 37.0%, while the average debt allocation was 49.7%. As for alternative assets – real estate, private equity, hedge funds and other investments – allocations averaged 9.7%, while aggregate allocations were 14.1%. The difference between the aggregate and the average reflects differences in plan size: Larger plans were more likely than smaller plans to invest in alternatives and less likely to invest in public equity.

When we considered allocations in real estate, hedge funds and private equity combined as alternative investments, we found that 69.2% of sponsors held alternative assets in their asset allocation mix. The portion allocated to the different type of alternatives varied by asset class, with private equity's share at 37.5%, hedge funds accounting for 32.8% and real estate 29.7% (Figure 2a). In 2020, roughly 40% of those sponsors that held alternatives allocated up to 5% of their assets in these types of investments, while only 4.2% of sponsors held more than 30% of their assets in alternative assets (Figure 2b).

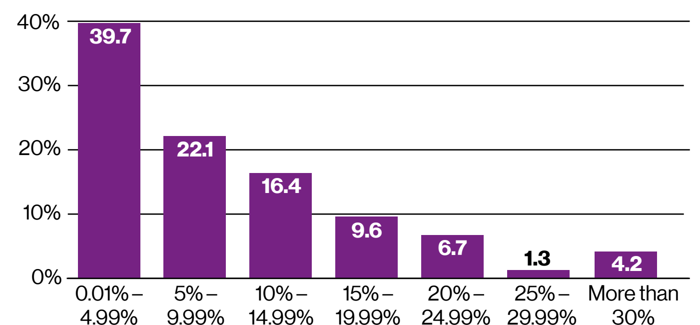
Larger plans were more likely than smaller plans to invest in alternatives.

Figure 2a. **Aggregate asset distribution within alternative investments, 2020**



Source: WTW

Figure 2b. **Distribution of companies by allocation to alternative assets, 2020**



Source: WTW

[2] The analysis consists of those Fortune 1000 DB plan sponsors that provided comprehensive asset allocation disclosures in their annual reports and that managed assets for domestic pensions.

Figure 3. **Average annual changes in equity and debt allocations, 2020**

Change magnitude	Equity allocations: % of sponsors realizing a change in their equity allocations	Equity allocations: Average change realized in equity allocations	Debt allocations: % of sponsors realizing a change in their debt allocations	Debt allocations: Average change realized in debt allocations
Increase of over 10%	4.6%	25.5%	6.6%	19.9%
5% – 9.9% increase	5.1%	6.9%	9.2%	7.2%
0% – 4.9% increase	41.6%	1.7%	34.8%	1.8%
No change	2.9%	0.0%	0.5%	0.0%
0% – 4.9% decrease	31.4%	–1.9%	38.2%	–1.7%
5% – 9.9% decrease	9.0%	–7.2%	6.8%	–7.1%
Decrease of over 10%	5.4%	–18.9%	3.2%	–38.0%

Source: WTW

Looking into a consistent sample of 411 plan sponsors, between the end of 2019 and the end of 2020, average allocation to public equity remained unchanged from the previous year, while average debt holdings experienced a minor increase of 30 basis points. Within this sample, more than half of sponsors (51%) realized increases in their share of equity or debt investments (Figure 3).

Slightly more than 3% of sponsors experienced a drop of more than 10% in their debt allocations, averaging roughly a 38% decline. For a number of these companies, this shift is a product of unloading part of their liabilities (bulk lump sums, annuity contracts and partial terminations) and rebalancing their asset allocations to better match the profile of their remaining obligations.

Asset allocations by plan size

Aggregate and average asset allocations for smaller, medium and larger plan sponsors are shown in Figures 4a and 4b. The analysis divides these sponsors into three equal groups by total pension assets: Smaller plan sponsors held less

Typically, the larger the plan, the lower the allocation to public equity.

than $708 million; midsize plan sponsors held between $708 million and $2.6 billion, and large plan sponsors held more than $2.6 billion. The largest sponsor held pension assets worth more than $92 billion. Weighting smaller, medium and larger sponsors by plan assets emphasizes the large share of pension assets held by very large plans[3] as well as the pronounced differences in investing behavior between smaller and larger plans (Figure 4a).

Typically, the larger the plan, the lower the allocation to public equity, which averaged 34.6% for large plans versus 41.6% for small plans (Figure 4b), the opposite in terms of their fixed-income allocation (debt and cash). This particular year, a set of small plans moving their entire portfolio to cash drove the average debt allocation lower compared with the other two

[3] The 10 largest plans held 30.4% of all plan assets.

Figure 4a. **Aggregate asset allocations by plan size, 2020**

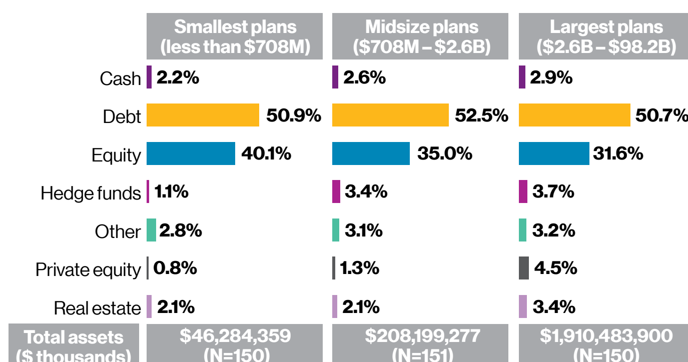
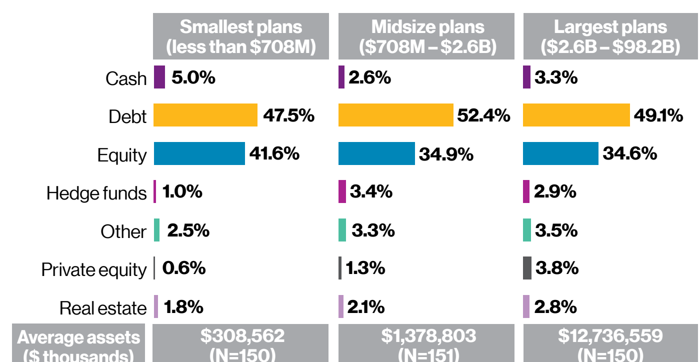


Figure 4b. **Average asset allocations by plan size, 2020**



Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

Figure 5a. **Aggregate asset allocations by plan status, 2020**

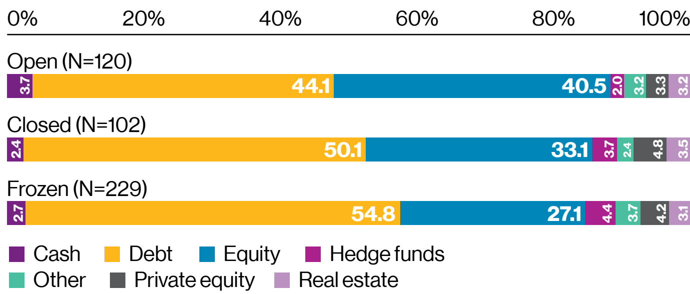
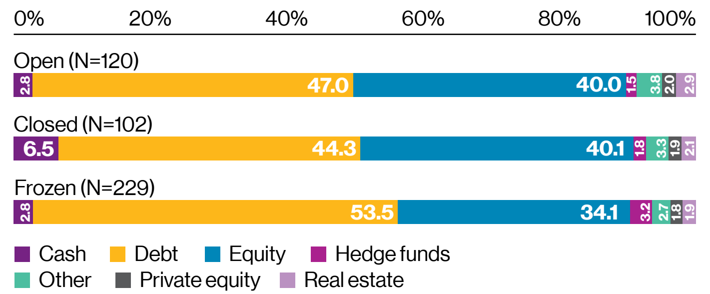


Figure 5b. **Average asset allocations by plan status, 2020**



Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

groups. Overall, larger plans allocated less to public equities and more to alternative investments (real estate, private equity and hedge funds). On average, these plans allocated more than twice as much as smaller plans to other return-seeking investments (13.0% versus 5.9%), which might reflect larger plans' access to economies of scale and in-house investment structures that enable them to effectively manage alternative assets. Despite differences in plan size, the three groups of sponsors held more than 50% of their assets in fixed-income investments, evidencing a common path toward de-risking among all DB plan sponsors.

Asset allocations by plan status

For this part of the analysis, we divided plan sponsors into three mutually exclusive categories by the current status of their primary pension plan: open, closed to new hires or frozen. Open DB plans are those still offered to newly hired employees, while closed plans stopped being offered to new hires after a fixed date. In frozen plans, accruals by service, pay or both have ceased for plan participants. Roughly three-quarters of the companies in our analysis sponsored either a closed or a frozen pension plan, while the remaining still offered an open plan.

Figures 5a and 5b show asset allocations by plan status and demonstrate a relationship between the plan's current status and the portfolio's risk profile, with the correlation strongest on an aggregate basis (Figure 5a). Frozen pensions held more risk-averse investments compared with plans – either open or closed – in which workers were still actively accruing pensions. In aggregate, sponsors of frozen plans held almost 57.5% of their assets in debt and cash versus only 47.8% for sponsors of open plans.

Asset allocations by funded status

Much like the prior year, stock markets and interest rate movements presented two very different scenarios. During the first quarter of 2020, equity markets plummeted, showing double-digit losses coupled with a drop in interest rates to measure plan assets. Equity markets shifted gears by the second quarter with a V-like recovery, and by the beginning of August, the market had regained all its year-to-date losses, ending 2020 with gains of more than 10%. Additionally, interest rate changes added to funding volatility during 2020, experiencing marked swings throughout the year, finally closing more than 50 basis points below rates realized at the beginning of the year. All this translated into particularly high levels of uncertainty, both in the asset and the liability side, as well as the need to rebalance the plans' portfolios swiftly in order to keep on track with their target allocations. Although the year closed with robust equity returns, asset gains were mostly offset by the decrease in interest rates that hit record low levels, increasing the value of pension obligations. The net effect of these opposing forces affecting funding levels was tepid but positive.

Our 2020 analysis shows a correlation between funded status and asset allocations (Figure 6a, next page). As sponsors get closer to full funding levels, their portfolios tend to become more conservative in nature, typically as a result of investment de-risking strategies such as liability-driven investment (LDI) and asset glide paths.[4] Same as last year, average fixed-income holdings surpassed equity investments across all funding levels, evidencing the sponsors' continuous efforts toward de-risking.

[4] LDI strategies typically use fixed-income assets as a hedge against interest-rate-driven movements in plan liabilities. In years when long-term, high-quality corporate bond interest rates decline, with corresponding increases in plan obligations, corporate bonds will produce positive returns and vice versa. In a glide path strategy, future target allocations are based on the plan's funded status, with the sponsor shifting assets from equities to debt as funding levels climb to mitigate risk and volatility.

Figure 6a**. Average asset allocations by plan funded status, 2020**

Asset class	Funded status				
	Less than 70%	70% – 79%	80% – 89%	90% – 99%	100% or more
Cash	2.4%	2.9%	2.6%	2.8%	5.9%
Debt	43.5%	43.1%	52.0%	53.9%	54.4%
Equity	43.6%	42.1%	35.3%	34.5%	32.7%
Hedge funds	3.5%	3.5%	2.2%	1.9%	1.5%
Other	3.1%	3.7%	3.7%	2.2%	2.7%
Private equity	1.5%	2.0%	1.9%	2.3%	1.6%
Real estate	2.4%	2.7%	2.3%	2.4%	1.2%
Total %	100%	100%	100%	100%	100%
N	60	90	130	96	73

Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

Well-funded plans with lower benefit accrual rates are typically associated with higher allocations to fixed-income assets.

While plans tend to become more risk averse as their funded status nears full funding, a closer look also uncovers a further link between debt allocations and benefit accruals.[5] Figure 6b depicts the relationship between higher allocations to debt as the plan's funded status and benefit accrual rate improves. Well-funded plans with lower benefit accrual rates are typically associated with higher allocations to fixed-income assets, while higher accrual rates (reflecting active pensions) correspond with higher allocations to return-seeking assets.

Pension assets held in company securities

Around 8% of Fortune 1000 DB plan sponsors held company securities as pension assets in 2020. These allocations averaged 5.5% of pension assets in 2020 (3.8% when weighted by end-of-year plan assets). The weighted average is lower than the simple average because larger plans allocated lower percentages to company securities than did smaller plans.

Almost 8% of these sponsors explicitly noted plan contributions in the form of company securities in 2020.

In 2020, company securities constituted less than 6% of pension assets in 68% of these plans and made up more than 9% of pension assets in 19% of them (Figure 7, next page).[6]

Trends in allocations since 2009

We next track asset allocation trends from the past decade, based on a consistent sample of 188 pension sponsors that have been in the Fortune 1000 over the past 11 years.

[5] The accrual rate is the ratio between the pension's service cost and the year-end projected benefit obligation.

[6] To promote asset diversification, pension law does not allow U.S. DB plans to invest more than 10% of pension assets in company securities.

Figure 6b**. Average allocations to debt by funded status and benefit accrual rates, 2020**

Accrual rate	Funded status									
	Less than 70%		70% – 79%		80% – 89%		90% – 99%		100% or more	
	N	Debt %	N	Debt %	N	Debt %	N	Debt %	N	Debt %
Less than 0.5%	15	34.6%	22	42.8%	47	57.3%	33	63.8%	37	60.2%
0.5% – 0.99%	11	45.1%	19	46.5%	20	51.0%	13	57.6%	7	63.5%
1.0% – 1.9%	13	57.5%	21	40.5%	38	50.4%	28	49.6%	12	54.4%
2.0% – 2.9%	10	39.2%	12	40.2%	11	52.4%	14	40.4%	7	35.0%
3.0% or more	8	42.9%	15	45.0%	10	38.7%	4	48.9%	9	42.3%
N	57		89		126		92		72	

Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

Figure 8 shows asset allocations for these companies on an aggregate basis for 2009, 2012, 2015, 2018 and 2020.

The shift from equities to fixed-income investments has been consistent throughout the period. Since 2009, aggregate allocations to public equities declined by 13.3 percentage points, while allocations to debt increased by 16.3%.

Asset de-risking

Between 2009 and 2020, among a consistent sample of 188 sponsors, the number of plans whose pensions held 50% or more in cash and fixed-income assets almost tripled, rising from 18% to 52% (Figure 9). On average, this group has shown a significant increase of their liability-hedging investments holdings, going from 39.0% of cash and debt in 2009 up to 53.2% in 2020.

The analysis shows a clear de-risking trend, with plan sponsors focusing more on hedging liabilities and less on higher returns. Many sponsors have complemented de-risking via asset allocation strategies with other liability-reduction strategies, such as offering lump sum buyouts, purchasing annuities and terminating their plans.

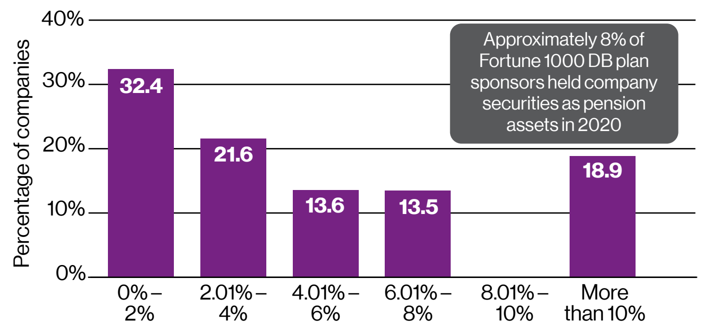
Conclusion

The year 2020 had many things in common with the previous year, with sponsors facing funding volatility and an outstanding performance of the equity market that was partially offset by declining interest rates used to measure pension obligations. These movements translated yet again into slight improvement in pension funding levels.

In terms of allocation strategy, the de-risking trend continued during 2020, as sponsors kept shifting to more conservative portfolios by increasing the allocation to low-volatility instruments. Roughly 53% of sponsors held more than 50% of their assets invested in fixed-income securities (debt and cash) resulting in better hedging from variability in their liabilities. In addition, we found that irrespective of the plan status, sponsors had, on average, more than 45% of assets held in liability hedging investments. As to funding levels, average allocation to fixed-income holdings outnumbered allocation to public equities across all buckets. Yet, the evidence down the de-risking path is stronger when looking at sponsors with over-funded or near fully funded levels (60.3% and 56.7%, respectively). Notwithstanding, the same can be said from a plan size perspective, with all groupings having more than half of their portfolios tilted toward this asset class. The analysis exhibited marked shifts in debt allocations within a group of small or midsize plans; some

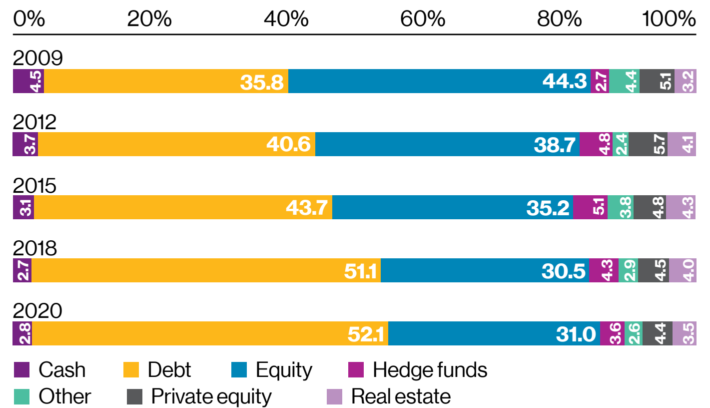
Many sponsors have complemented de-risking via asset allocation strategies with other liability-reduction strategies.

Figure 7. **Allocations to company stock, 2020**



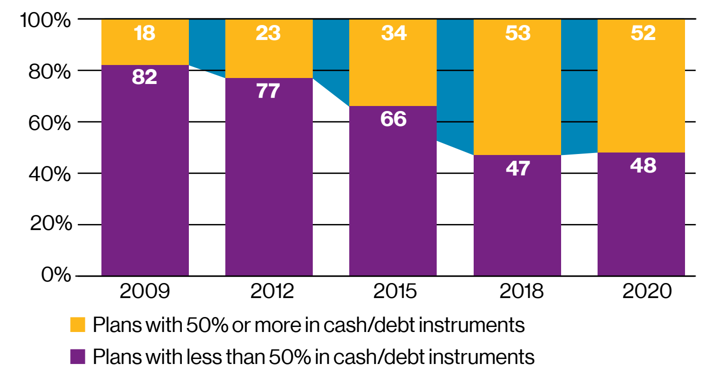
Source: WTW

Figure 8. **Aggregate asset allocations by investment class for consistent sample of Fortune 1000 companies (%), 2009, 2012, 2015, 2018 and 2020**



Source: WTW

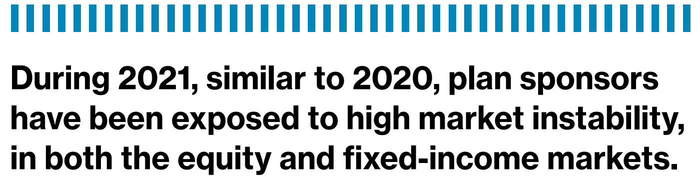
Figure 9. **Prevalence of companies with more than 50% of pension assets in cash/debt instruments for consistent sample of Fortune 1000 companies, 2009, 2012, 2015, 2018 and 2020**



Source: WTW

seemed to have increased their cash holdings, possibly with the aim of taking de-risking action, while others closed the year more tilted to equity holdings, possibly reflecting a delay in their portfolio rebalancing.

During 2021, similar to 2020, plan sponsors have been exposed to high market instability, in both the equity and fixed-income markets. Although forces moving both the asset and liability sides worked in tandem helping drive funding levels higher, they did so with a considerable amount of volatility. On the liability side, interest rates moved within a range of more than 50 basis points throughout the year, albeit staying always above beginning-of-year levels. In a context of continued COVID-19 waves and uncertainties regarding the appearances of new variants, worries regarding the pace of the economic growth and persistent inflationary pressures pose an array of possible scenarios that are hard to predict, raising even more the need to focus on pension risk management. In addition to this, implications of the American Rescue Plan Act adopted in earlier 2021 are yet to be seen in terms of a plan's funding policy and its effects on asset allocation strategy.



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News in Brief

Temporary telehealth provision enacted

By Ann Marie Breheny and Ben Lupin

On March 15, President Biden signed the Consolidated Appropriations Act, 2022, which reinstates a temporary safe harbor allowing high-deductible health plans (HDHPs) with a health savings account (HSA) to cover telehealth and other remote healthcare services before a plan member's deductible is met or with a deductible lower than the required minimum one.

Under the reinstated safe harbor, employees would also remain eligible to make and receive contributions to their HSAs. Normally, if an employer covers all costs related to telehealth services, an employee would be disqualified from participating in an HSA.

The original safe harbor, part of the Coronavirus Aid, Relief and Economic Security Act, provided relief through December 31, 2021. The reinstatement applies from April 1 to December 31, 2022, but is not retroactive, leaving a gap for plan sponsors and participants and raising questions about how the IRS will address the issue of HSA eligibility in these circumstances for the first quarter of 2022.

Plan sponsors that offer telehealth or remote health services and currently charge HSA-eligible participants less than the fair market value of the services may want to discuss how to address this provision with their legal counsel.

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