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Insider

Preliminary implications of the 2022 midterm elections on employee benefits, compensation

By Ann Marie Breheny, Bill Kalten, Ben Lupin and Steve Seelig

The results of the 2022 midterm elections will shape the legislative landscape for employee benefit and compensation policy over the next two years. Below is an outline of the current status of the election results, other changes that are expected for the 118th Congress (2023 – 2024), and preliminary observations about potential benefit and compensation-related implications.

Vote counts continue, but control of Congress is now clear

As of this writing, some races are still undetermined, but control of Congress is clear. Senate Democrats will retain the majority with at least 50 seats (Vice President Kamala Harris provides the tie-breaking vote, giving Democrats the majority). Republicans will hold the House majority for the 2023 – 2024 legislative term.

A Republican majority in the House will have significant implications for the 118th Congress.

General legislative outlook

In a divided Congress, where each chamber is controlled by a different party, differing policy priorities likely will make it more difficult to move legislation to final enactment. Each chamber could block action on legislation approved by the other chamber in most circumstances. In addition, President Biden could veto much of the legislation he opposes, especially targeted or stand-alone legislation.

In This Issue

1 Preliminary implications of the 2022 midterm elections on employee benefits, compensation
4 2023 inflation-adjusted limits announced for a range of employee benefit plans
5 SEC adopts final clawback rules on incentive-based executive compensation
8 2021 asset allocations in Fortune 1000 pension plans

News in Brief:

3 'Family glitch' fix updated to include calendar-year cafeteria plans

The lack of a 60-vote Senate majority will continue to be an obstacle in the Senate. For example, Democrats currently hold majorities in both the House and Senate, but many bills approved by the House have stalled because they cannot get the 60 votes need to move through the Senate under regular procedures.

During the upcoming session, legislation will have several possible pathways to enactment:

1. Legislation with significant bipartisan support could gain momentum and move through Congress.
2. Lawmakers in both chambers — and both parties — could seek to attach unrelated provisions to must-pass bills.

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3. Budget reconciliation will not be a viable legislative tool in a divided Congress. Budget reconciliation allows certain legislation to be enacted with a 51-vote majority in the Senate, using streamlined legislative procedures. During the current Congress, budget reconciliation was used for the American Rescue Plan Act in 2021 and the Inflation Reduction Act in 2022.

If policy changes face significant difficulty in a divided or narrowly controlled Congress, pressure will likely be placed on the Biden administration to make changes through Executive Orders, regulations and other administrative procedures.

With Republicans holding the House majority, we can expect active oversight of administrative and regulatory activities, including benefit-related regulations and guidance. Policies that could be subject to oversight and review during the 118th Congress include the fiduciary rule; environmental, social and governance (ESG) factors; the ACA family glitch; and cryptocurrency in retirement plans.[1] Implementation of the Inflation Reduction Act could also be subject to significant oversight.[2]

Key departures, other changes

The retirement of some lawmakers, changes in House and Senate committees, and other factors also affect the agenda and outlook for benefits and compensation. Several lawmakers who have been active in retirement policy are retiring after the 2022 legislative term, most notably:

- Senator Rob Portman (R-OH). Senator Portman has worked with Senator Ben Cardin (D-MD) to co-sponsor important bipartisan retirement security legislation since both lawmakers served in the House. Their bipartisan actions helped move the SECURE Act to final enactment and has helped set the stage for possible action on SECURE 2.0 this year.
- Representative Kevin Brady (R-TX). Representative Brady, currently the ranking Republican on the House Ways and Means Committee, partnered with current Ways and Means Committee Chair Richard Neal (D-MA) to help move the SECURE Act to final enactment and co-sponsor the House-approved Securing a Strong Retirement Act (H.R.2954). His committee position has also extended his influence on other benefit-related changes in recent years.

The retirement of some lawmakers, changes in House and Senate committees, and other factors also affect the agenda and outlook for benefits and compensation.

In congressional committees, including those with primary jurisdiction over benefit-related issues, important changes will occur. Some possible changes that could affect benefit-related committees in the 118th Congress include:

- New leadership at the Senate Health, Education, Labor and Pensions Committee:
  - Senator Patty Murray (D-WA) currently chairs the Senate's Health, Education, Labor and Pensions (HELP) Committee, which has jurisdiction over ERISA. She has had a strong interest in healthcare, retirement, paid leave, workforce protections, and other benefit and workforce issues. She is expected to succeed retiring Senator Patrick Leahy (D-VT) as the chair of the Senate Appropriations Committee. Senator Bernie Sanders (I-VT), who currently chairs the Senate Budget Committee, has announced that he will seek the top seat on the committee.
  - Senator Richard Burr (R-NC) is currently the ranking Republican on the Senate HELP Committee. He is retiring at the end of the 2022 legislative session. Senator Bill Cassidy (R-LA) plans to seek the ranking Republican seat.
- A new top Republican (and possibly a new committee name) at the House Education and Labor Committee:
  - Representative Virginia Foxx (R-VA) has served three terms as the highest ranking Republican on the House Education and Labor Committee. House Republicans

[1] For more information on the "family glitch" loophole in the Affordable Care Act, see "**IRS finalizes 'family glitch' fix**," *Insider*, October 2022.

[2] For more information on the Inflation Reduction Act, see "**Inflation Reduction Act retirement and prescription drug benefit implications**," *Insider*, August 2022.

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limit members to three terms as chair and/or ranking member of a committee, so she will have to step aside from the top seat next year unless she receives a waiver. Representative Tim Walberg (R-MI) could chair the committee.
- Representative Bobby Scott (D-VA) currently chairs the committee and is expected to be the ranking Democrat on the committee.
- The committee's name may change.

Outgoing Congress must wrap up work for 2022

Before the 118th Congress commences in early 2023, the current Congress will return to session to finish its work for 2022. Government funding expires on December 16, so Congress must approve new government funding.

Congress may also consider a broader year-end package. If so, the SECURE 2.0 retirement package is expected to be under consideration. Lawmakers will be working to reconcile differences between the retirement bills approved by the House, the Senate Finance Committee and the Senate HELP Committee and develop a unified bill that could be attached to a year-end package.[3]

Other provisions with implications for employers could be under discussion during the post-election legislative session, including healthcare and tax provisions. It is not yet clear which provisions may move through Congress during the remaining weeks of the 2022 session, and it's possible that final details will be settled in the last days before the current Congress adjourns.

Going forward

Companies should watch for and monitor additional developments once election results are finalized and lawmakers begin to organize and set the agenda for the 118th Congress.

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[3] For more information on SECURE 2.0, see "**Senate Finance Committee approves SECURE 2.0 legislation**," *Insider*, July 2022.

News in Brief:
'Family glitch' fix updated to include calendar-year cafeteria plans

By Maureen Gammon, Anu Gogna and Ben Lupin

On October 11, 2022, the IRS issued **final regulations** to fix the so-called "family glitch" loophole in the Affordable Care Act (ACA), which affects eligibility for premium tax credits when purchasing health coverage on the ACA exchange. The IRS also issued **Notice 2022-41**, which allows employees, spouses and dependents to drop employer-sponsored family health coverage and enroll in subsidized exchange coverage midyear (rather than just during the annual open enrollment or special enrollment periods) if the employer plan sponsor amends its cafeteria plan to allow for such changes.[1]

Originally, the guidance applied only to non-calendar year cafeteria plans; however, a revised version of Notice 2022-41 was recently released, unannounced, that allows the additional permitted election change event to be adopted for *any* cafeteria plan, both calendar year and non-calendar year.

Applicable large employers (ALEs) that are subject to the ACA's employer mandate should note that these final regulations *do not* impact the affordability or minimum value analysis under those rules; therefore, as long as an ALE offers affordable, minimum value coverage to its full-time employees and their dependents (based on *self-only* coverage affordability), the employer would not face employer mandate penalties under the tax code.

Employer plan sponsors should determine whether to amend their cafeteria plans to allow election changes for those family members of employees who may be eligible for ACA exchange coverage with premium tax credits. Employers choosing to amend their plans must do so within the time frames set out in the notice.

[1] For more information on the final regulations adopted to fix the "family glitch" loophole, see "**IRS finalizes 'family glitch' fix**," *Insider*, October 2022.

2023 inflation-adjusted limits announced for a range of employee benefit plans

By Cindy Brockhausen, Gary Chase and Kathleen Rosenow

On October 18, 2022, the IRS released **Revenue Procedure 2022-38** containing the 2023 tax-year inflation adjustments for a number of income tax provisions, including health flexible spending arrangements, qualified transportation fringe benefits, qualified adoption assistance programs and eligible long-term care premiums. Revenue Procedure 2022-38 also includes the indexed dollar amounts for the federal income tax-related standard deduction.[1]

On October 21, 2022, the IRS released **Notice 2022-55**, which includes the qualified retirement plan limits for 2023. These limits restrict the contributions that can be made to, and benefits that can be paid from, qualified retirement plans as well as the compensation that can be used when determining benefits.

The table below includes these limits, along with the **Social Security maximum taxable wage base** that was announced on October 13, 2022, and the limits relevant to health savings accounts and excepted-benefit health reimbursement arrangements that were released earlier this year in **Revenue Procedure 2022-24**.

The 2023 tax-related limits potentially affect the design, administration, communication and tax reporting for retirement and benefit-related plans.

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[1] Revenue Procedure 2022-38 also contains the federal income tax rate tables for 2023.

Type of benefit	2022	2023
Health flexible spending arrangements (health FSAs) (general and limited purpose)		
Maximum annual health FSA salary reduction contribution	$2,850	**$3,050**
Maximum annual health FSA carryover of unused amounts from the prior plan year for plans that permit carryover	$570	**$610**
Qualified transportation fringe benefits		
Monthly limitation amounts		
— Transit pass and commuter highway vehicle (combined)	$280	**$300**
— Qualified parking	$280	**$300**
Qualified adoption assistance		
Maximum per adoption income tax exclusion		
— Child with special needs (regardless of actual expenses)	$14,890	**$15,950**
— Other adoptions	$14,890	**$15,950**
Adjusted gross income (AGI) tax exclusion phaseout		
— Phaseout begins	$223,410	**$239,230**
— Phaseout complete	$263,410	**$279,230**

Type of benefit	2022	2023
Dependent care assistance (including FSAs)*		
Maximum annual dependent care assistance benefit		
— Individual or a married couple filing jointly	$5,000	**$5,000**
— Married individual filing separately	$2,500	**$2,500**
Qualified retirement plan limits		
Maximum recognizable compensation	$305,000	**$330,000**
Highly compensated employee (HCE)	$135,000	**$150,000**
Section 415 benefit limits		
— Defined benefit plans	$245,000	**$265,000**
— Defined contribution plans	$61,000	**$66,000**
Limit on pretax elective deferrals		
— Under age 50	$20,500	**$22,500**
— Age 50 and over	$27,000	**$30,000**
Qualifying longevity annuity contract (QLAC)		
Investment limit	$145,000	**$155,000**
Social Security taxable wage base		
Taxable wage base	$147,000	**$160,200**

Type of benefit	2022	2023
Eligible long-term care (LTC) premiums		
Annual limitation on LTC premiums includible as medical care		
Age before close of tax year		
— 40 or under	$450	**$480**
— 41 to 50	$850	**$890**
— 51 to 60	$1,690	**$1,790**
— 61 to 70	$4,510	**$4,770**
— More than 70	$5,640	**$5,960**
Standard deduction		
Filing status		
— Married individuals filing jointly	$25,900	**$27,700**
— Heads of households	$19,400	**$20,800**
— Unmarried individuals	$12,950	**$13,850**
— Married individuals filing separately	$12,950	**$13,850**

Type of benefit	2022	2023
Health savings accounts (HSAs)		
Individual coverage		
— Maximum annual HSA contribution	$3,650	**$3,850**
— Minimum annual deductible for high-deductible health plan (HDHP)	$1,400	**$1,500**
— Maximum annual out-of-pocket expenses for HDHP	$7,050	**$7,500**
Family coverage		
— Maximum annual HSA contribution	$7,300	**$7,750**
— Minimum annual deductible for HDHP	$2,800	**$3,000**
— Maximum annual out-of-pocket expenses for HDHP	$14,100	**$15,000**
Catch-up contributions** (for individuals attaining age 55 by December 31 until enrolled in Medicare)	$1,000	**$1,000**
Excepted-benefit HRAs (EB-HRAs)		
— Maximum amount employers can contribute	$1,800	**$1,950**

* The dependent care assistance limits under the tax code are not adjusted for inflation; any change would require statutory amendment.
** The HSA catch-up contribution amount for participants attaining age 55 by December 31 of the tax year is not adjusted for inflation; any change would require statutory amendment.

SEC adopts final clawback rules on incentive-based executive compensation

By Gary Chase, Stephen Douglas and Steve Seelig

The Securities and Exchange Commission (SEC) approved **final rules (Rule 10D-1)** implementing Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and issued a related **fact sheet**. The new rules direct national securities exchanges and associations to establish listing standards requiring registrants to implement "clawback" policies to recoup erroneously awarded incentive-based compensation following a material restatement of financial disclosures. The final rules also expand annual reporting and proxy disclosures to allow shareholders to have quick access to the clawback policies, understand if they have been invoked and review how they have affected executive pay.

The final rules largely follow the proposed rules, with updates and clarifications to address some of the questions surrounding how these "no-fault" Dodd-Frank clawback policies should be implemented.[1] Companies can use reasonable estimates for stock-based compensation to determine how much is to be clawed back and will have the option not to pursue recovering such compensation if the direct expense of doing so would exceed the amount to be recovered.

The following Q&As are intended to help companies as they start to consider how to implement these policies.

Which companies are covered?

The final clawback rules apply to all listed companies, including emerging growth companies, smaller reporting companies, foreign private issuers and controlled companies. The final rules also adopt the limited exemptions included in the proposed rules for certain security futures products, registered investment companies that have not awarded incentive compensation and registered unit investment trusts.

What's the timing?

It is likely that companies will need to have a compliant clawback policy in place before the end of 2023. The timeline for implementation of the Rule 10D-1 requirements is as follows (note, there is a difference between the *effective date of the final regulations* and the *effective date of the listing standards*):

[1] For more information on the proposed rules, see "**SEC requests additional comments on Dodd-Frank clawback rules**," *Insider*, July 2022.

- The effective date of the final regulations is 60 days after publication in the Federal Register.
- The listing exchanges are required to file proposed listing standards with the SEC within 90 days of the Federal Register publication date.
- The SEC then would approve those proposed standards, but in any case, such standards must become effective no later than one year following publication of the final regulations.
- Companies must then adopt a compliant recovery policy no later than 60 days following the date on which the applicable listing standards becomes effective.

The mandated clawback policy must apply to any incentive-based compensation that is received by current or former executive officers on or after the effective date of the applicable listing standard. As a result, grants made before the listing exchange rule's effective date will be subject to the clawback policy if they are dependent on a financial measure attained after the effective date.

What financial restatements are covered?

The clawback requirement covers only accounting restatements due to the company's material noncompliance with any financial reporting requirement under the securities laws. According to the SEC, the final rules do not include a definition of "material noncompliance" because it can be found in existing accounting standards and related guidance.

The SEC's final rule expanded on the proposed rules outlining the types of restatements that are subject to the clawback requirement. Under the final rule, the clawback requirement may apply as a result of an accounting restatement that corrects two types of errors:

1. An error that is material to previously issued financial statements (commonly referred to as "Big R" restatements that are required to be reported in an 8-K filing)
2. An error that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period (commonly referred to as "little r" restatements)

Companies, in consultation with their accountants and attorneys, will be required to determine when the materiality threshold has been met and whether a clawback should be invoked.

Where must the policy and corrections be disclosed?

The new rules require companies to adopt a compliant clawback policy and to disclose certain aspects of such

The rules cover both current and former executive officers, with "officers" defined in regulations issued under the Securities Exchange Act.

policies and their application in annual reports and proxy statements. Compliance with the disclosure requirements is required in the first annual report, information statement or proxy that must be filed after the effective date of the new listing standards. For calendar-year companies, this could mean the 2023 annual report and the 2024 proxy.

The disclosure regime is as follows:

- In the years after a Dodd-Frank clawback policy is adopted, the SEC will require disclosure of the policy as an exhibit to companies' annual reports.
- Companies also will need to update their compensation discussion and analysis (CD&A) to describe their policies and decisions regarding the adjustment or recovery of awards or payments to named executive officers.
- In a year when a restatement takes place, the annual report must indicate by check boxes that the financial statements included in the filings reflect a correction of an error to previously issued financial statements and whether any such corrections are restatements that required a recovery analysis. If a clawback did take place, the proxy then must disclose details of how the clawback amount was calculated and the total amount clawed back, and from whom it was recouped.

Who are executive officers?

The rules cover both *current* and *former* executive officers, with "officers" defined in regulations issued under the Securities Exchange Act. This includes the company's:

- President
- Principal financial officer
- Principal accounting officer (if there is none, the controller)
- Any vice president in charge of a principal business unit, division or function
- Any other person who performs policymaking functions for the company, including executive officers of the company's parent(s) or subsidiaries who perform such policymaking functions for the company

Note that this is often a broader group than covered by a company's existing clawback policies, which tend to focus on officers listed in the proxy.

Individuals in these roles are only considered an executive officer subject to recovery if they serve as an executive officer at any time during the recovery period (described below), and the recovery is only required for incentive compensation received while the individual served as an executive officer.

What compensation is subject to being clawed back?

The statute provides that, regardless of when the restatement takes place, only incentive compensation received during the three-year period before the restatement is "required" is subject to being clawed back. This three-year lookback period begins when the board, compensation committee or officers authorized to take such action conclude or reasonably should have concluded (or a court or regulator determines) that a material error existed in prior financial statements.

The regulations define incentive compensation as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure." "Financial reporting measures" are defined as:

- Measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements (the regulations include a non-exhaustive list of these measures)
- Any measures derived wholly or in part from such financial information (non-GAAP financial measures)
- Other measures, metrics and ratios that are not non-GAAP measures (e.g., same store sales)
- Stock price and total shareholder return (TSR)

Incentive compensation does not include equity awards for which vesting is contingent solely upon completion of a specified employment period and/or attaining one or more nonfinancial reporting measures.

How is the clawback to be calculated?

The amount that must be recouped is the difference between the amount of incentive-based compensation earned by an executive during the three-year lookback period and the amount the executive would have received based on the restated financial statements. This is the case even if amounts are paid after the end of the fiscal year when the financial reporting measures are attained, which is the rule as to how cash compensation is measured when calculating summary compensation table total compensation.

If a company's executive compensation committee...determine that the cost of recovery would exceed the amount to be recovered, they would have the discretion not to pursue the clawback.

Deciding how this amount is to be calculated is left up to each individual company. Regardless, erroneously awarded compensation must be calculated without taking into account any tax liabilities that may have been incurred or paid by the executive.

For many incentive plans with financial hurdles, the calculation of the recoverable amount can be made by comparing the before and after information presented in the financial statements. For incentive-based compensation based on TSR or stock price, companies will need to make a reasonable estimate of the impact of the restatement and seek expert advice on determining reasonable methods for performing the calculation.

Once those calculations are completed, companies will be required to disclose the amount of erroneously awarded compensation attributable to any accounting restatement, including an analysis of how the compensation was calculated, and document the relevant exchange.

Can discretion be exercised in enforcing a clawback?

Enforcement can be avoided only in very limited circumstances. If a company's executive compensation committee — or in the absence of such a committee, a majority of the independent directors serving on the board — determine that the cost of recovery would exceed the amount to be recovered, they would have the discretion not to pursue the clawback. Their reasoning must be discussed in the CD&A. A foreign private issuer would not be required to pursue recovery if it receives a legal opinion that doing so would violate local country law as in effect when these rules were finalized. The final rules also allow companies to forgo recovery for amounts deferred under tax-qualified retirement plans, although the SEC doesn't expect this situation will arise very frequently; however, erroneously awarded incentive-based compensation contributed to plans limited only to executive officers, supplemental executive retirement plans, or other nonqualified plans and the resulting benefits would still be subject to being clawed back.

How and when are amounts to be recovered?

It is up to each company to determine how to recover any compensation in a manner consistent with the purpose

behind the statute. Companies also must act "reasonably promptly," with the SEC noting that directors and officers should pursue the most appropriate balance of cost and speed in determining the appropriate means to seek recovery. The SEC notes that companies could explore such methods as withholding from future pay, withholding from incentive awards earned but not paid, or cancelling unvested equity and non-equity awards.

Does the proposal permit indemnification?

No. The final rules specifically prohibit companies from entering into indemnity agreements with executives or purchasing insurance on behalf of executives to indemnify them against the financial effects of a clawback; however, the final rules do not directly prohibit executives from obtaining their own insurance against financial loss from clawbacks.

Going forward

Now that the clawback rules have been finalized, companies should consider taking the following steps to prepare:

- Determine how to integrate existing clawbacks, especially those focused on misdeeds, with the "no-fault" concept under Dodd-Frank.
- For companies with existing clawback policies, decide whether to integrate the Rule 10D-1 clawback policy with existing policies, replace existing policies or adopt the Rule 10D-1 policy on a stand-alone basis.

It is up to each company to determine how to recover any compensation in a manner consistent with the purpose behind the statute.

- Inventory existing incentive compensation arrangements to understand those where payouts are based on subjective, strategic or operational measures compared with those based on financial reporting and stock price measures.
- Create a process for determining if a Dodd-Frank clawback provision has been triggered once the need for a restatement is determined and decide how to include that process in existing documentation and in board/committee charters.
- Consider seeking expert guidance to determine a "reasonable estimate" of the amount to be recouped when equity or TSR-based incentive compensation is involved. Boards will also likely want to consult with experts to help them determine whether a clawback is worth pursuing weighed against the related expenses of doing so.

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2021 asset allocations in Fortune 1000 pension plans

By Mercedes Aguirre and Brendan McFarland

Overview of the 2021 Asset Allocation Study of Fortune 1000 Pension Plans

The funded position of defined benefit (DB) plans sponsored by Fortune 1000 companies started 2022 in their strongest funded position since the global financial crisis of 2007 to 2009, obtaining an aggregate funded position of 95.7% at the end of 2021. This was bolstered by strong historical investment returns in both equity markets and fixed-income assets, despite historically low interest rates. As of October 2022, with equity markets in correction territory and interest rates increasing by 240 basis points,[1] the position of asset allocations for these pension plans at the start of the year can provide insight into how these plans may be faring.

Analysis highlights

- Over the past 12 years, there has been a steady shift from equities to debt investments, which are predominantly used by pension funds to reduce volatility in pension funded status. Looking at a consistent sample, aggregate pension assets allocated to public equities declined by roughly 16 percentage points since 2009, while allocations to debt increased by almost 17 percentage points.

[1] CE BofA US Corporate AAA-AA 10+ and ICE BofA US Corporate AAA-AA 15+

- There is a strong correlation between a pension plan's status and its asset allocation, with frozen plans holding more liability-hedging investments compared with closed and open plans. On average, frozen pension plans held roughly 61% of their assets in debt and cash investments versus only 50% for sponsors of open plans. Sponsors with open or closed plans still have ongoing benefits being earned by employees, thus utilizing more growth-oriented investments to help fund those benefit costs.
- The use of alternative investments has a well-established correlation with the plan's size. While larger plans allocated more than 13% to alternative investments in aggregate terms, smaller plans only held around 3% of their portfolios in these investment vehicles by the end of 2021. In addition, only 11% of smaller plans held more than 10% of their portfolios in alternative 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 2021.

About the study

The Financial Accounting Standards Board began requiring more detailed pension disclosures in 2009, and WTW has been analyzing asset allocations ever since.[2] These analyses track asset allocation trends and patterns over time in Fortune 1000 plans. This 13th edition looks at fiscal year-end 2021 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

There is a clear trend of sponsors increasingly following a de-risking path, either via liability management activities or via their asset allocation strategy.

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 on a global basis). We examine the prevalence and amount of pension assets invested in company securities. Finally, we compare asset holdings from 2009 through 2021 for a consistent sample of plan sponsors to examine how plan sponsors have modified their risk management strategies over time.

2021 aggregate and average asset allocations

WTW's analysis of 2021 fiscal year-end DB plan asset allocations first takes a detailed look at 434 Fortune 1000 plan sponsors' pension disclosures.[3]

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 2021, the companies in this analysis held more than $2.1 trillion in pension assets, comprising cash, public equity, debt and alternative investments (real estate, private equity, hedge funds and other).

At year-end 2021, 29.6% of pension assets, in aggregate, were allocated to public equity and 51.8% 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.

[2] See "**2020 asset allocations in Fortune 1000 pension plans**," *Insider*, March 2022.

[3] 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 pensions.

Figure 1a. **Aggregate asset class distribution, 2021**

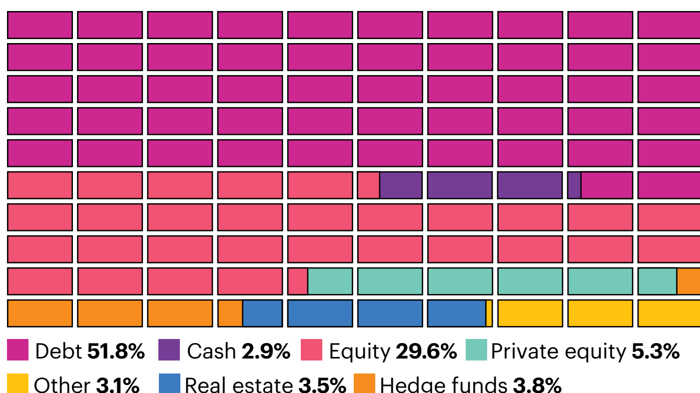
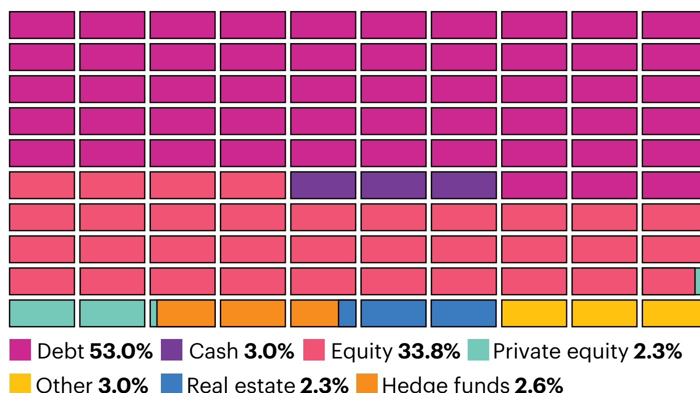


Figure 1b. **Average asset class distribution, 2021**

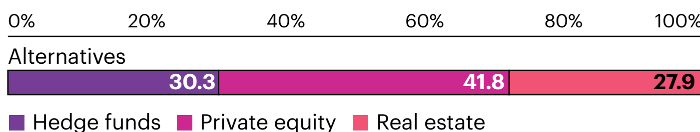


Notes: Cash includes cash equivalents and money market instruments; debt includes insurance contracts, and hedge fund assets include derivatives and interest rate swaps.
Source: WTW

The average Fortune 1000 pension plan sponsors in the analysis held on average above $4.9 billion in assets at year-end 2021.

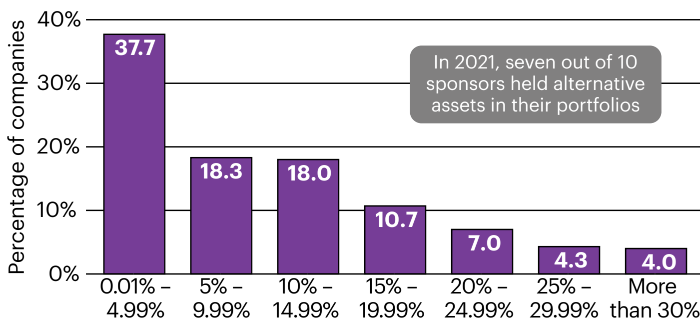
The average allocation to public equity was 33.8%, while the average debt allocation was 53.0%. As for alternative assets — real estate, private equity, hedge funds and other investments — allocations averaged 7.2%, compared with aggregate allocations of 12.6%. The difference between the aggregate and the average reflects differences in plan size: Larger plans were more inclined than smaller plans to invest in private equity and other alternatives.

Figure 2a. **Aggregate asset distribution within alternative investments, 2021**



Source: WTW

Figure 2b. **Distribution of companies by allocation to alternative assets, 2021**



Source: WTW

These recent allocations to debt holdings most likely reflect higher funding levels triggering or accelerating de-risking strategies.

When we considered allocations in real estate, hedge funds and private equity combined as alternative investments, we found that 69.1% of sponsors held alternative assets in their DB plan asset allocation mix. The portion allocated within the different types of alternatives varied by asset class, with private equity's share at 41.8%, hedge funds accounting for 30.3% and real estate 27.9% (Figure 2a). In 2021, nearly four out of 10 sponsors that held alternative assets held allocations of up to 5% of their assets in these types of investments (Figure 2b).

Changes to asset holdings over 2021

Looking into a consistent sample of 418 plan sponsors, between the end of 2020 and the end of 2021, average allocation to public equity declined by 3.5%, while average debt holdings experienced an increase of 3.0% over the period. These recent allocations to debt holdings most likely reflect higher funding levels triggering or accelerating de-risking strategies, such as glide paths, which reduce equity exposure as the plan moves closer to full funding.

More than 60% of sponsors showed an increase in their average allocations to debt, with 14.4% showing increases of more than 10% of their holdings. On the other hand, only 34% of sponsors realized an increase in their equity holdings, where only 3.1% experienced increases of more than 10% in their equity allocations (Figure 3).

Figure 3. **Average annual changes in equity and debt allocations, 2021**

	Equity allocations		Debt allocations	
Change magnitude	% of sponsors realizing a change in their equity allocations	Average change realized in equity allocations	% of sponsors realizing a change in their debt allocations	Average change realized in debt allocations
Increase of over 10%	**3.2%**	**19.6%**	**14.7%**	**20.5%**
5% – 9.9% increase	**6.9%**	**7.4%**	**14.7%**	**7.2%**
0.1% – 4.9% increase	**24.3%**	**1.9%**	**31.9%**	**2.2%**
0% – 4.9% decrease	**34.2%**	**–2.5%**	**28.0%**	**–1.9%**
5% – 9.9% decrease	**16.2%**	**–7.1%**	**7.4%**	**–7.3%**
Decrease of over 10%	**15.2%**	**–21.3%**	**3.2%**	**–20.4%**

Source: WTW
Notes: For those with allocations to debt and equity.

Asset allocations by plan size

Aggregate and average asset allocations for smaller, midsize and larger plan sponsors are shown in figures 4a and 4b. The analysis divides these sponsors into three groups by total pension assets: Smaller plan sponsors (144 companies) held less than $682.4 million; midsize plan sponsors (145 companies) held between $690 million and $2.7 billion, and larger plan sponsors (145 companies) held more than $2.7 billion. The largest sponsor held pension assets worth nearly $92 billion. Weighting smaller, midsize and larger sponsors by plan assets emphasizes the large share of pension assets held by very large plans[4] 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 32.4% for larger plans versus 37.4% for smaller plans (Figure 4b). Larger plans are more likely to take on risk in the form of alternative assets. On average, these plans allocated more than three times as much as smaller plans to other return-seeking investments (10.9% versus 3.3%), which might reflect larger plans' access to economies of scale and in-house investment structures that enable them to manage alternative assets effectively.

[4] The 10 largest plans held 30.5% of all plan assets.

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 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 and there is a need for growth to support the cost of those benefits. In aggregate, sponsors of frozen plans held almost 60.1% of their assets in debt and cash versus only 46.7% for sponsors of open plans.

Figure 4a. **Aggregate asset allocations by plan size, 2021**

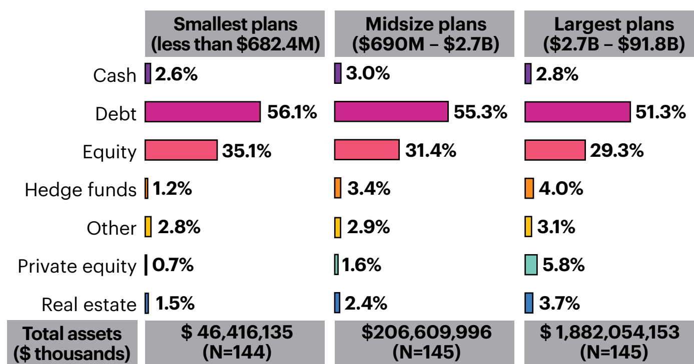
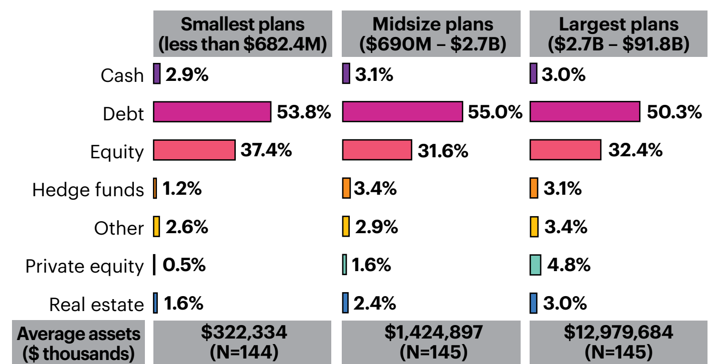


Figure 4b. **Average asset allocations by plan size, 2021**



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, 2021**

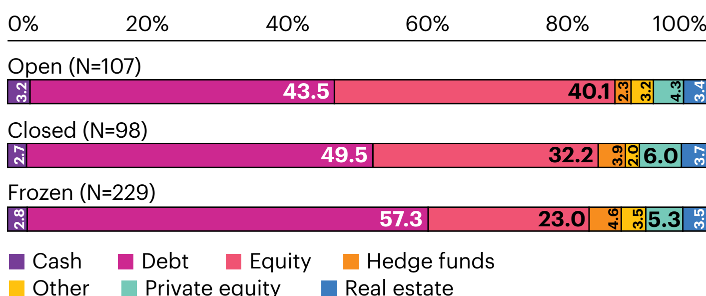
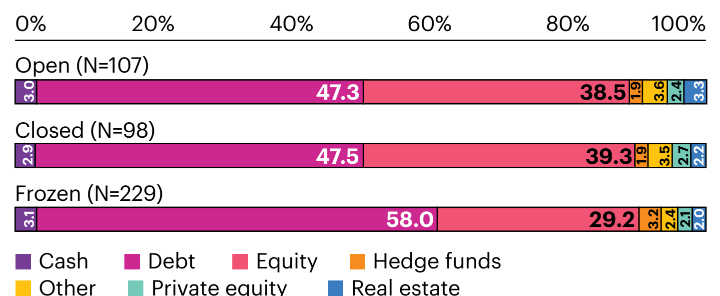


Figure 5b. **Average asset allocations by plan status, 2021**



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

Asset allocations by funded status

Throughout 2021, plan sponsors benefited from fortuitous market conditions on both the assets and liabilities side. From an asset perspective, sponsors earned higher returns from strong performance of the equity market, which recorded double-digit gains as 2021 came to an end. In addition, increasing discount rates helped push pension deficits down by reducing obligations. These two forces working in tandem resulted in a favorable scenario for plan sponsors, adding to funding improvements.[5]

Our 2021 analysis shows a correlation between funded status and asset allocations (Figure 6a). 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.[6] Similar to prior years, average fixed-income holdings surpassed equity investments across all funding levels, demonstrating sponsors' continuous efforts toward de-risking.

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. Figure 6b depicts the relationship between higher allocations to debt as the plan's funded status and benefit accrual rate[7] 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

Roughly 9% of Fortune 1000 DB plan sponsors held company securities as pension assets in 2021. These

[5] 2021 WTW Pension 100

[6] 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 or other market factors (like interest rates), with the sponsor shifting assets from equities to debt as funding levels improve to mitigate risk and volatility.

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

Figure 6a. **Average asset allocations by plan funded status, 2021**

Asset class	Funded status: Less than 80%	80% – 89%	90% – 99%	100% or more
Cash	2.4%	2.5%	3.6%	3.1%
Debt	47.1%	49.8%	56.5%	54.8%
Equity	41.2%	36.7%	29.0%	32.8%
Hedge funds	2.3%	3.3%	2.9%	1.8%
Other	2.9%	3.3%	3.1%	2.7%
Private equity	1.8%	1.7%	2.7%	2.6%
Real estate	2.3%	2.7%	2.2%	2.2%
Total %	100%	100%	100%	100%
N	28	103	131	137

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

From an asset perspective, sponsors earned higher returns from strong performance of the equity market, which recorded double-digit gains as 2021 came to an end.

Figure 6b. **Average allocations to debt by funded status and benefit accrual rates, 2021**

	Funded status							
	Less than 80%		80% – 89%		90% – 99%		100% or more	
Accrual rate	N	Debt %	N	Debt %	N	Debt %	N	Debt %
Less than 0.5%	25	50.5%	42	51.5%	59	60.6%	67	61.1%
0.5% – 1.9%	9	50.0%	20	51.0%	24	51.5%	23	55.6%
2.0% – 2.9%	3	34.6%	10	46.6%	13	49.3%	15	41.3%
3.0% or more	8	40.7%	8	39.2%	6	48.6%	11	42.1%
N	45		80		102		116	

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

allocations averaged 5.7% of pension assets in 2021 (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.

Two sponsors holding company stock explicitly noted making plan contributions in the form of company securities in 2021.

In 2021, company securities constituted less than 6% of pension assets in 65% of these plans and made up more than 10% of pension assets in 20% of them (Figure 7).[8]

Trends in allocations since 2009

We next track asset allocation trends from the past decade, based on a consistent sample of 183 pension sponsors that have been in the Fortune 1000 over the past 12 years. Figure 8 shows asset allocations for these companies on an aggregate basis for 2009, 2012, 2015, 2018 and 2021.

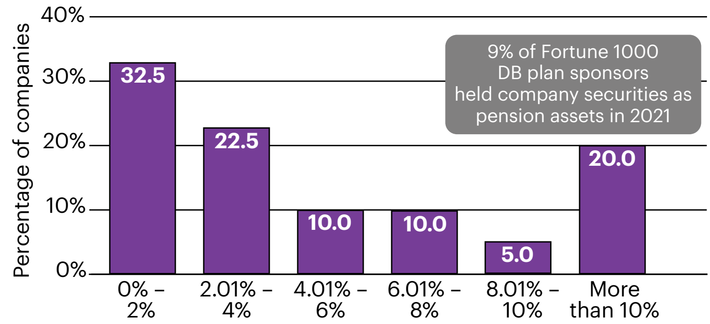
The shift from equities to fixed-income investments has been consistent throughout the period. Since 2009, aggregate allocations to public equities declined by 15.8 percentage points, while allocations to debt increased by 16.9%.

Asset de-risking

Between 2009 and 2021, among a consistent sample of 183 sponsors, the proportion of plans whose pensions held 50% or more in cash and fixed-income assets tripled, rising from 18% to 59% (Figure 9). For those that had less than 50% in fixed-income holdings by 2009 but shifted to a fixed-income-intensive portfolio by 2021 (having 50% or more in debt and cash), average allocations to fixed income were 34.9% and 70.9% for 2009 and 2021, respectively, demonstrating a marked shift in their strategy. At the end of 2021, a little more than one in four plan sponsors held more than 70% of their assets in fixed income, up from only 3% in 2009.

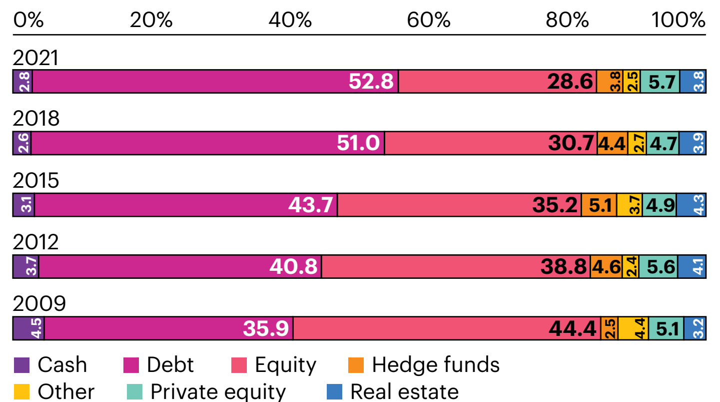
The analysis shows a clear de-risking trend, with plan sponsors focusing more on hedging liabilities and less on higher returns. Many sponsors have complemented de-risking via asset allocation strategies with other liability-reduction strategies, such as offering lump sum buyouts, purchasing annuities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

Figure 7. **Allocations to company stock, 2021**



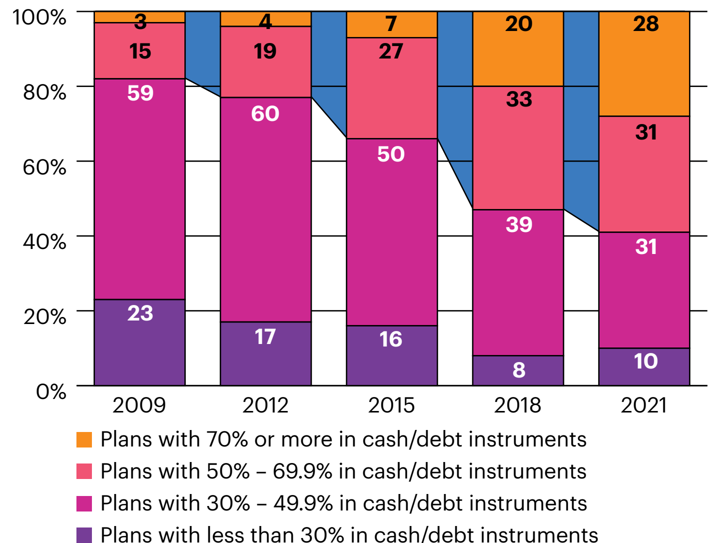
Source: WTW

Figure 8. **Aggregate asset allocations by investment class for consistent sample of Fortune 1000 companies (%), 2009, 2012, 2015, 2018 and 2021**



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 2021**



Source: WTW

[8] Sponsors are prohibited from making additional contributions in the form of company stock (without special regulatory exemption) if total employer securities exceed 10% of plan assets.

Conclusion

Plan sponsors started 2022 in the strongest funded position since prior to the financial crisis, having benefited from several years of strong equity performance and prior contributions despite a long period of declining interest rates. From an asset management perspective, sponsors continued their path toward more de-risking portfolios as by 2021, with nearly 55% of plan assets allocated to liability hedging investments (debt and cash). Sponsors that manage frozen pension plans are further down the investment de-risking path, as many of these sponsors seek to reduce funded status volatility given the plans' legacy status. While the majority of pension plan assets are investments in public equities and fixed-income securities, sponsors of larger plans continue to utilize alternative assets (such as private equity, hedge funds and real estate) to improve returns as well as manage risk by providing diversification within their asset portfolio.

Through the first three quarters of 2022, public equities values entered correction territory and fixed-income returns were negative as interest rates rose to levels not seen since 2013. While losses on equities have been unfavorable to plan sponsor funded position, the rise in interest rates has reduced plan obligations (which, depending on the degree of liability hedging, may offset some of the decline from equity volatility). Given these market conditions with the asset de-risking that has been taken by many plan sponsors over the past few years, the effect of the volatility on plan funded status is expected to be smaller than seen in past periods of economic volatility for many sponsors. Note that there may still be implications on funding requirements or on the annual pension cost reflected on the sponsor's income statement.

Given the market volatility in 2022, plan sponsors are actively studying their next steps to manage their pension funded position and risk.

Given the market volatility in 2022, plan sponsors are actively studying their next steps to manage their pension funded position and risk. Some may explore changes to their investment philosophy due to the need to meet a higher hurdle rate and improve funded status while continuing to manage risk through diversification or liability-hedging strategies. Some sponsors may find the plan in a strong funded position in order to continue to provide pension benefits to employees. Others may explore risk transfer, such as purchasing annuities from an insurer, or prepare to expand lump sum options in 2023. As evidenced by the variation in asset allocation strategies illustrated herein, the appropriate strategy will differ by plan sponsor depending on the effect of the capital market environment, each plan sponsor's risk tolerance and overall objectives for the plan.

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