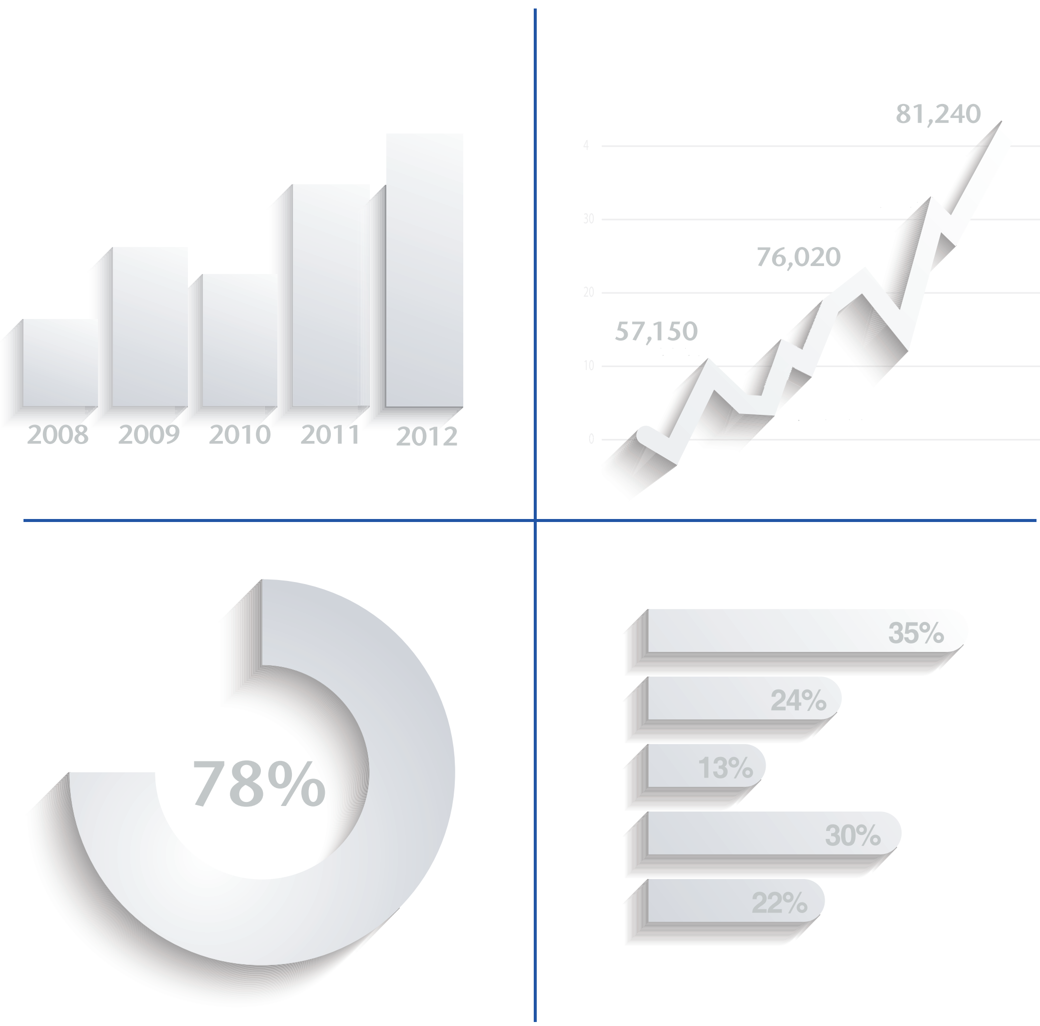
Consulting | Outsourcing
Retirement

2013 Universe Benchmarks

Measuring Employee Savings and Investing Behavior in Defined Contribution Plans

Highlights



AON Hewitt

About This Material

The Aon Hewitt *2013 Universe Benchmarks* research report analyzes participant behavior across the participation rates, savings levels, plan balances, investments, account activity and demographics of more than 3.5 million employees eligible for defined contribution plans. Participant behavior is separated into demographic groups that include age, salary, tenure, balance and gender.

The result is a comprehensive study that can be used by plan sponsors:

- **As a benchmark**—Plan sponsors can learn how their workers' saving and investing behavior compares to that of the average worker.

- **To shape plan structure**—Employers can better understand general patterns of participant behavior across demographic groups to better determine who might benefit from certain plan features and also benefit from new opportunities to improve results.

- **For targeting communication**—Demographic analysis helps plan sponsors pinpoint which groups of workers may benefit from certain communication or education about the plan.

Background

This analysis, dating back to 2002, examines the saving and investment behavior of 3.5 million eligible employees across 141 defined contribution plans, with an average of 24,700 eligible employees per plan.

Information on plans in Universe Benchmarks:

- 96% of the plans covered in the analysis offered some type of employer matching contribution in 2012
- 59% of the plans offered after-tax contributions
- 20 funds offered on average (including premixed portfolios); 14 funds offered on average (counting premixed portfolios once)
- 90% of the plans offered premixed funds
- 59% of the plans offered company stock as an investment option
- 38% of the plans offered self-directed brokerage accounts (SDBAs)

The average eligible employee in the resulting analysis:

- 43 years of age
- $57,890 annual salary
- 9.4 years of tenure
- $81,240 total plan balance

Overview of Findings

One of the dominant themes of Aon Hewitt's *2013 Hot Topics in Retirement* report is that plan sponsors are embracing a more holistic perspective on their retirement programs. They are focusing on financial wellness and measuring projected retirement income adequacy, instead of merely concentrating on current participation and savings levels.

As most individuals now use their employers' defined contribution plan as their primary retirement vehicle, there is more personal responsibility to save for adequate retirement income. However, employees continue to lack involvement in their defined contribution plan. This has both positive and negative implications. The good news is most people are still saving for retirement, which has been aided by plan design changes in recent years. The bad news is a majority of employees are still facing a number of challenges and concerns as they are working towards their retirement goals.

This Aon Hewitt *2013 Universe Benchmarks* research report analyzes participant behavior of more than 3.5 million employees eligible for defined contribution plans. This report focuses primarily on the quality of participation, plan balances, investments, account activity and demographics.

As data was analyzed, four key trends emerged:

1. **Participation rates hit an all-time high and saving rates increased slightly.**

2. **Automation plays a strong role in many savings behaviors.**

3. **Leakage declined while continuing to decrease from its peak in 2010.**

4. **Diversification improved and balances recovered to prerecession levels.**

The trends shown by defined contribution plan participants' responses to recent economic events and automatic features continues to help retirement plan sponsors to create new provisions, designs and communications to improve retirement plan savings in the future. This report reviews over a decade of participant behavior from our first report in 2002 to present.

Highlights include:

Participation and Savings Rates

- **78.0%** participation rate hit an all-time high and increased about two percentage points higher than last year
- **7.3%** average before-tax contribution rate increased slightly from the low of 7.2% in 2011
- **6.0%** average Roth contribution, was down from 6.4% in 2011
- **72.5%** of participants saved at or above the company's match threshold up from 71.3% in 2011
- **81.4%** participation rate among those subject to automatic enrollment versus 63.5% of participants not subject to automatic enrollment

Plan Balances and Rate of Return

- **$81,240** average participant's plan balance rebounded to prerecession levels, up substantially from 2008 at $57,150
- **11.9%** median participant rate of return increased substantially from -0.7% in 2011
- **7.7%** and **2.5%**, were the median three-year and five-year annualized rates of return

Investments

- **39.7%** average allocation to premixed portfolios weighted by participant, increased 13 percentage points in the past two years
- **68.3%** average total plan balance in equities, increased from 66.8% in 2011
- **13.4%** average allocation to company stock when available declined since 2002 at 41.8%
- **5.3** asset classes, on average, held by participants, up from recent periods

Account Activity

- **14.5%** of participants initiated a trade during 2012, down significantly from nearly 20% in 2008
- **16.7%** of participants initiated a trade among those not using premixed portfolios, down from 18.1% in 2011
- **26.6%** of participants had an outstanding loan, down from the 2009 high of 27.6%
- **6.5%** of participants initiated a withdrawal, significantly higher since 2006 at 4.9%
- **43.1%** took a cash distribution among participants who terminated employment in 2012
- **5.6%** of assets were cashed out of the plan, this decreased from 7.3% in 2011

Recommendations

1. **Leverage the full potential of automation.** Participation is at an all-time high, but there is still work to be done. To improve participation, many plan sponsors have harnessed the power of inertia by utilizing automatic enrollment. The impact has been profound as 81.4% of individuals subject to automatic enrollment participate in the plan, but only 63.5% of employees participate if they must enroll on their own. Significant progress has been made to increase savings through techniques such as automatic enrollment, automatic contribution escalation and automatic rebalancing. Recommendations to leverage automation:

   - **Adopt automatic enrollment.** Automatic enrollment has strongly influenced participation rates, savings rates and investment behavior.
   - **Increase automatic enrollment default contribution rates.** Default employees at higher initial savings rates, preferably at or above the employer-matching threshold.
   - **Include automatic escalation in automatic enrollment.** By including contribution escalation and escalating to a higher target rate, plan sponsors can assist employees in increasing their savings rate, thus meeting their long-term retirement savings needs.
   - **Expand automatic enrollment to existing nonparticipants.** While automatic enrollment is meaningful for new hires, it can impact future retirement savings for existing nonparticipants as well. When implemented as a one-time "back-sweep" or ongoing sweep, all nonparticipants can benefit from the influence of defaults.
   - **Add automatic rebalancing and automatic escalation as plan features.** By allowing participants to have their plan balances automatically rebalanced periodically, it provides a simplified way to keep participants on track in terms of having diversified plan balances.
   - **Stretch employer-matching contributions.** By stretching the matching contribution to a higher rate, plan sponsors could have a positive impact on participants' savings rate levels. For example, employers offering a 100% match of up to 3% could consider offering 50% match up to 6% to increase the average deferral rates.

2. **Offer an array of investment advisory help.** Investment returns were robust in 2012. The median return was 11.9% which was up substantially from -0.7% in 2011. Plan sponsors who wish to have higher rates of return should consider offering an array of investment features:

   - **Target-date funds.** Target-date funds provide participants with a turn-key investment approach. To ensure the plan is offering the appropriate target-date funds, consider evaluating the target-date funds by reviewing glide paths.
   - **Online guidance or investment advice/managed account features.** Online guidance based on asset classes, personalized advice on specific plan investments or managed account features that offer professionally managed account by a third-party provider are all helpful tools that can assist employees' savings behaviors.
   - **Seminars, personal financial planning and lifetime income solutions.** Plan sponsors can leverage multiple solutions and technology to communicate various aspects of retirement plans as well as overall financial wellness to help participants overall savings behaviors.

3. **Curb leakage out of the plan and look for new ways to reach employees.** Participants' saving and investing for retirement improved in 2012, however leakage continues to erode retirement savings prematurely. Our study shows only slight improvements in plan leakage: 26.6% of participants have a loan outstanding, 6.5% of participants initiated a withdrawal and 43.1% took cash distributions among participants who terminated employment in 2012.

   Leakage remains significantly higher since prerecession levels of 2006. Additional recommendations to reduce leakage:

   - **Modify availability of loans/withdrawals.** There is room to restrict access to certain funds while retaining sufficient flexibility and access for workers. For example, loans and withdrawals could be permitted only on employee savings, not employer contributions.
   - **Limit dollars available for loans and withdrawals.** While the average loan and withdrawal are relatively small compared to limits in place, reducing the maximum allowable dollar amounts would eliminate some of the largest loans and withdrawals.
   - **Simplify post-termination loan repayment process.** Most employers currently do not accept loan repayments after employment termination because payroll deductions can no longer be made. To solve this problem, participants could be allowed to continue to make payments through the term of the loan from personal accounts.
   - **Encourage lifetime income solutions and options.** Steady lifetime income provides increased security by mitigating risks such as investment risk and longevity risk.

4. Look for innovative ways to promote and educate a digital workforce. Access to information has expanded greatly over the past decade and plan sponsors should utilize all the various channels of communication to reach employees.

- **Promote and work within the employer system.** While in a qualified employer plan, participants often benefit from lower prices, professional investment management, tools and education, advice and fiduciary protections.
- **Use multiple levels of technology to communicate.** Use technology to reach employees about their retirement savings plans by using various channels of communication, such as webinars, podcasts, text messages and social media.
- **Provide increased education and resources.** As many employers are already doing today, providing education and promoting financial literacy can, over time, make a positive and significant impact on savings behaviors.

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About Aon Hewitt

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