2012 Universe Benchmarks Highlights
Measuring Employee Savings and Investing Behavior in Defined Contribution Plans

The Calm Amid the Storm
About This Material

The Aon Hewitt 2012 Universe Benchmarks—Measuring Employee Savings and Investing Behavior in Defined Contribution Plans research report analyzes participant behavior across the participation rates, savings levels, plan balances, investments, account activity, and demographics of more than 3.6 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, and 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.
The Calm Amid the Storm

Results from Aon Hewitt’s recent 2012 Hot Topics in Retirement survey illustrated the continued employer shift from defined benefit plans to defined contribution plans, forcing employees to assume more responsibility for their financial well-being in retirement. While the need for accountability is heightened, this survey also found employer confidence in actual behavior at an all-time low. The combination of needs and behavior has resulted in many plan sponsors taking proactive steps to enhance their plan design to focus more on automation and outcomes.

In some ways, the economic challenges have exacerbated the lack of employee involvement in their defined contribution plan, which has both positive and negative implications. The good news is that most people are still saving for retirement and this has been aided by plan design changes in recent years. Through all the bad news, challenges, and concerns, the majority of employees are still working toward their retirement goals. In spite of today’s volatile economic climate, there appears to be a calm amid the storm.

This Aon Hewitt 2012 Universe Benchmarks—Measuring Employee Savings and Investing Behavior in Defined Contribution Plans research report analyzes participant behavior of more than 3.6 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. **Employees are still saving.** Participation rates remain near a high point and savings rates declined only marginally.

2. **Automation has played a strong role in many savings behaviors; however, if not implemented robustly, it can have negative consequences as well.**

   – When in place, automatic enrollment greatly increases participation rates across all segments of workers, particularly for younger, lower tenured, and lower paid employees.

   – Most employees remain where defaulted and as such are heavier users of diversified portfolios. This has helped them better weather the market volatility in recent years.

   – Automatic enrollees are saving less than participants who proactively enrolled. Those subject to automatic enrollment are often defaulted at lower savings rates and therefore have lower contribution rates, on average, and are far more likely to miss out on employer-matching contributions.
3. **Leakage from the plan has edged downward.** Following several years of increases in loans and hardship withdrawals, this activity decreased during the year. However, loans and hardship withdrawal rates remain higher than the prerecession levels.

4. **Diversification improved modestly; however, active portfolio management remains a challenge for most employees.** Premixed portfolios have continued to gain more attraction from employees, both proactively and through defaults. These employees are better diversified and also have an embedded rebalancing strategy. Participants using an investment advisory service/product have better weathered recent market volatility. While this is good news, the reality is that the bulk of employees are not actively managing their portfolio. The risks of this are great, particularly among those who are nearing retirement.

This analysis outlines clear steps plan sponsors can take to assist employees’ retirement savings habits. One of the dominant themes of Aon Hewitt’s 2012 *Hot Topics in Retirement* report was the need for continued innovation—that the industry, plan sponsors, and service providers persist in influencing and changing behaviors by designing plans in a way that positively influences outcomes. It is our hope that we can use the trends shown by defined contribution plan participants’ responses to recent economic events to create new provisions, designs, and communications to improve retirement plan savings in the future.

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**Retirement Income Adequacy**

According to the Aon Hewitt report *The Real Deal, 2012 Retirement Income Adequacy at Large Companies*, the average projected retirement income shortfall among full-career contributing employees is 2.2 times final pay at age 65. This has improved in recent periods given continued savings, default behavior, and stronger investment returns. Additionally, for workers to meet their needs in retirement, the following requirements apply:

- 85% average replacement ratio is needed at the point of retirement (age 65).
- 11 times pay is needed at age 65, in addition to social security, for adequate income through retirement.
The three main recommendations based on the results of this study include:

1. **Harness inertia by using automation to its full potential.** Automatic enrollment has strongly influenced participation rates, savings rates, and investment behavior. However, three opportunities for improvement remain:

   – **Increase default contribution rates and combine with automatic escalation.** Default employees at higher initial savings rates, preferably at or above the employer-matching threshold. Additionally, embed contribution escalation to a rate that can assist employees in meeting their long-term 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 as a plan feature.** Amid the market volatility in the past few years, the need for automatic rebalancing has received greater focus among participants and plan sponsors. 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.

2. **Provide investment advisory solutions, particularly to near-retirees.** While much of the focus remains on solving problems for the “average participant” and those early in their careers, as the baby-boomer generation enters retirement, it’s critical that companies generate and implement more customized solutions. Employers can continue to influence employees through personalized messages and expanding the plan to include solutions such as managed accounts. For plans that currently offer these solutions, it remains important to remind employees of the availability of services and solutions to ensure stronger usage.

   Retirement income solutions that reside outside the plan, within the plan, or alongside the plan are relatively new features introduced in the defined contribution industry that can help with retirement savings as well. Plan sponsors can offer these solutions to assist near-retirees with understanding their income needs in retirement.

3. **Curb leakage out of the plan, and look for new ways to reach employees.** Examine opportunities to reach and influence employee behavior. For example, more plans are allowing loan repayments post-termination, through direct debit, which can decrease loan default rates. Further, use communication opportunities and online tools and modelers to help employees understand the ramifications of accessing monies prior to retirement. Finally, leverage personalized and targeted messages to better influence participants.
Participation and Savings Rates: Participants continue to stay the course

While economic challenges and market volatility persist, most participants continue to save and maintain previous savings levels. Additionally, as automatic enrollment has become commonplace, it’s easier to see its benefits and drawbacks. Participation rates remain up from previous years.

- Participation rates are consistent with the previous year, at 76%, and remain at an all-time high.

- Improvements in participation were seen among 20- to 29-year-olds. Conversely, slight decreases in participation rates occurred for those earning less than $60,000 per year among age groups 30 and above.

Savings rates are down only marginally.

- The average before-tax contribution rate remained nearly unchanged at 7.2% of pay (compared to 7.3% in 2010).

- Nearly three out of every 10 participants (29%) saved at a level below the company’s match threshold and therefore received only a portion of the employer-matching contribution. This level is similar to previous periods.

Automatic enrollment strongly influences results, both positively and negatively.

- Participation rates are greatly improved by automatic enrollment: The participation rate among those subject to automatic enrollment is 83%—18 percentage points higher than those not subject to automatic enrollment.

While many Americans are struggling to be optimistic, the good news is that most are still saving—and just as important, they’re continuing to respond to defaults and prioritize saving for retirement. This means that the hard work and effort employers put into their defined contribution plans is helping. The retirement system is a work in progress, and successful undertakings, along with lessons learned, can prove meaningful in providing insight for years to come.

The remainder of this summary provides further insight into the broad Universe Benchmarks report findings across each participant behavior area—including participation and savings, balances returns, investments, and account activity. Additional detail can be found in the full 2012 Universe Benchmarks report.
Plan Balances and Rate of Return: Returns and balances were mixed

Many participants saw their defined contribution plan balances tread water during 2011 amid continued market volatility. While returns were off slightly during the year, they ended the year up significantly from the large losses that occurred in 2008.

Balances remain substantially higher than pre-downturn levels.

- The average participant’s total plan balance is $74,380, up substantially from 2009 ($70,970).
- The median plan balance is $23,370, slightly lower than the previous year ($24,680).

Rates of return were strong for the previous three-year period.

- The median three-year, annualized participant rate of return was quite strong at 12.0%, covering 2009 through 2011.
- The median rate of return earned during 2011 was –0.7% across the universe, with half of participants earning above, and half below this amount. Nearly four in 10 participants earned a rate of return between +2% and –2%.

Investments: Employees are increasingly better diversified and leveraging diversified portfolios

Premixed portfolios—particularly target-date funds—continue to greatly influence plan assets and participant diversification. Increasingly, employees are better diversified and are using a greater number of asset classes. Furthermore, those using premixed funds are using them more appropriately, as a single diversified portfolio rather than as another “fund” in the plan.

Asset allocation continues to move substantially toward premixed portfolios, primarily to target-date funds.

- Across participants, the average allocation to premixed portfolios is now at 38%, up 13 percentage points in the past two years. This is by far the largest asset class, followed by Large U.S. equity and GIC/stable value at 13% each.
- Across plan assets, this trend toward premixed funds is also illustrated with 17% of assets now residing in premixed funds, up from 11% in 2009. The largest asset class remains Large U.S. equity at 20%, and GIC/stable value holds 17% of plan assets.
Premixed portfolios also are being used broadly and more appropriately.

- When available, 63% of participants allocate to a premixed portfolio, up from 51% in 2009. Heaviest users remain younger and lower tenured employees due to proactive choice as well as default behavior.
- Among those participants who hold a premixed portfolio, it’s also becoming a larger part of their total allocation—the average person held 65% of his or her balance in premixed funds in 2011, up from 56% in 2009.

Asset class usage is growing, fueled by premixed portfolio usage and advisory services.

- On average, participants leverage 5.2 asset classes, up from recent periods.
- The percentage of participants holding five or more asset classes jumped by 10 percentage points since 2009, to 71% of participants in 2011.

Account activity revealed a positive trend, as loans and hardship withdrawals were down throughout the year. This decline follows record highs among plan participants, coinciding with the economic downturn. Additionally, while passivity in investment behavior has increased, this also corresponds to increasing usage of premixed portfolios and could offset one another (given that rebalancing is not required with these portfolios).

Trading activity is at a record low.

- Only 15% of participants initiated a trade during 2011, which continues to be down significantly from nearly 20% in 2008 and prior years.
- Even after excluding participants who are exclusively invested in premixed portfolios and therefore immune from rebalancing, trading activity is quite low at just 18% of participants.
- When available, 7.9% of participants enrolled in automatic rebalancing.

Loans usage has declined.

- Loan activity was down slightly; 27% of participants have a loan outstanding, down from 28% in 2010. The average outstanding principal is 21% of total balances, consistent with previous years.
- Middle-aged and middle-income employees are most likely to use the loan feature. For example, among 40- to 49-year-olds earning $40,000 to $59,999, a total of 45% of this group had a loan outstanding at year-end.
Loans are not overly detrimental to savings provided they’re repaid and the employee continues saving. However, default rates post-termination remain high, at 63% of terminated employees. Furthermore, the average contribution rate of those with loans is 6.2% of pay, versus 7.9% for all others.

**Withdrawals are down marginally.**

- During 2011, 6.6% of participants initiated a withdrawal, versus 6.9% the previous year. This remains significantly higher since the 2006–2007 timeframe. Of this amount, 23% was due to hardship.

- Participants with lower salaries are more apt to take withdrawals, and these are more likely to be hardship withdrawals. Among participants earning $40,000 to $59,999, 8.6% participants took a withdrawal, but only 3.4% of those earning $100,000 or more did so.

- Reasons for hardship withdrawals remain consistent, with more than half (51%) reporting the reason being to avoid eviction/foreclosure. Paying for medical or education expenses tied for second at 13% each.

**Cash-outs post-termination remain high.**

- When assessing termination behavior one year post-termination, 40% of participants access their retirement dollars via a cash distribution; this is similar to previous years.

- In addition, 30% of participants roll over their balance to another qualified institution, and 30% leave assets in the current plan.

- When viewed on an asset-weighted basis, leakage is not as significant but remains a serious issue. Overall, 7% of assets left via a cash distribution, 41% were rolled over, and the remaining 52% remained in the plan.
Conclusion

These results suggest that in spite of today’s volatile economic climate, there appears to be a calm amid the storm. As data was analyzed, four key trends emerged:

1. Employees are still saving;

2. Automation has played a strong role in many savings behaviors; however, if not implemented robustly, it can have negative consequences as well;

3. Leakage from the plan has edged downward; and

4. Diversification improved modestly; however, active portfolio management remains a challenge for most employees.

By examining these trends shown by the defined contribution plan participants’ responses to recent economic events, we have identified three main recommendations:

1. Harness inertia by using automation to its full potential;

2. Provide investment advisory solutions, particularly to near-retirees; and

3. Curb leakage out of the plan, and look for new ways to reach employees.

The full report looks deeper into specific participant behavior areas—including participation and savings, plan balances and rate of return, investments, and account activity.

Though economic challenges have proven to negatively influence employee defined contribution savings, employees are still saving and maintaining previous savings levels. These savings have been aided by plan design changes in recent years. By identifying new avenues that help their employees save (advisory services and automatic enrollment), employers can increase their employees retirement income adequacy.
About Aon Hewitt

Aon Hewitt is the global leader in human resource solutions. The company partners with organizations to solve their most complex benefits, talent and related financial challenges, and improve business performance. Aon Hewitt designs, implements, communicates and administers a wide range of human capital, retirement, investment management, health care, compensation and talent management strategies. With more than 29,000 professionals in 90 countries, Aon Hewitt makes the world a better place to work for clients and their employees.

For more information on Aon Hewitt, please visit www.aonhewitt.com.

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