Testimony
on Behalf of Ariel Investments, LLC

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to the
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Disparities for Women and Minorities in Retirement and Health Care

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Executive Summary

Ariel Investments and its non-profit affiliate, Ariel Education Initiative, have long been involved in the struggle for financial equality. Through our efforts we have been able to expose and analyze the wealth gap between minorities and whites. We have conducted our Black Investor Survey over the last eleven years to understand African-American and white savings and investing patterns. From these studies, came the inspiration for Ariel and Hewitt's 2009 comprehensive study of 401(k) investing entitled, *401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups.* This was the largest ever study analyzing 401(k) investing by race and ethnicity. The study of over 3 million 401(k) participants found that African-Americans and Hispanics trailed their white and Asian counterparts in participation and contribution, and they were more likely to take loans and hardship withdrawals. All of these actions lead to lower account balances. Even when all factors such as salary and tenure were held constant, there were still significant differences. Our study inspired the Office of Personnel Management to examine the Thrift Savings Plan by race and gender. They also found significant differences between minorities and whites, and men and women.

Resolving this seminal issue will have to involve the government, employers, and individuals themselves. However, we do believe there are certain solutions that the government and employers can take right now. These include encouraging employers to collect 401(k) data by race, modifying 401(k) loan requirements, and instituting financial literacy curriculum in all schools.

Ariel Statement

Chairman LeBlanc, Vice Chair Theda Harber, distinguished Members of the ERISA Advisory Council, thank you for the opportunity to address the council today on behalf of Ariel Investments, LLC. My name is Amar Parikh, and I am the Director of Corporate Affairs at Ariel Investments, LLC. My testimony today focuses on analysis and recommendations for bridging the racial and gender retirement wealth gap.

Ariel Investments is a Chicago-based minority owned money management firm and mutual fund company that serves individual investors through our no-load mutual funds and also manages separate accounts for institutional clients. We believe in empowering minorities with the tools, information, and education they need to invest wisely. Ariel Education Initiative, the nonprofit affiliate of Ariel Investments, was founded in 1989 by John W. Rogers, Jr. (Founder and Chairman of Ariel Investments, LLC) as a private operating foundation with a mission to strengthen the neighborhoods and cities in which we live and work. The Ariel Education Initiative currently supports the following major projects: Ariel Community Academy, a small Chicago Public School based on a student-family-school-community partnership; Ariel-Nuveen Investment Program, where students learn financial literacy via a unique financial curriculum that includes the opportunity to invest real money; and The Extended Day Program, which helps students explore the fullness of their potential academically, socially, artistically and personally.

Through the Ariel Education Initiative we also conduct studies pertaining to savings and investment disparities in minority communities. For the last eleven years we have conducted the Ariel/Schwab Black Investor Survey, which has sought to examine savings and investing differences between blacks and whites. The data collected for these studies was conducted through phone interviews. Last year we decided to take a more expansive approach and focus on 401(k) plan disparities among African-Americans, Asians, Hispanic, and whites. Through a generous grant provided by the Rockefeller Foundation, we partnered with Hewitt Associates, a leading provider of Human Resources solutions, to conduct this ground breaking 401(k) study, *401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*. Hewitt collected 401(k) data as of December 2007 for nearly 3 million eligible employees working for 57 of the largest U.S. companies. This data included race, ethnicity, gender, age, salary, job tenure, and other account information. We then analyzed the data by race and ethnicity, something never done before on such a large scale. We also enlisted the help of leading minority think-tanks including the Joint Center for Political Studies, the National Urban League, the Chicago Urban League, National Council of La Raza, and the Raben Group in order to help determine the best solutions for the issues we found.

Nature of the Gaps

The findings in the *401(k) Plans in Living Color* study were truly astonishing. The study showed race and ethnicity was the dominant factor in determining the outcome of an individual's 401(k). There are meaningful differences in African-American and Hispanic participation rates, contribution rates, loans and early withdrawal statistics compared to their white and Asian counterparts. These factors eventually lead to lower account balances. The table below provides a snapshot of the study findings.

401(k) Saving and Investing Behaviors by Race and Ethnicity

	Participation Rate	Contribution Rate	Equity Investments	Loans	Hardship Withdrawals	401(k) Balance for Employees Earning $30,000–$59,999
African-American	66%	6.0%	66%	39%	7.8%	$21,224
Asian	76%	9.4%	73%	16%	2.0%	$32,590
Hispanic	65%	6.3%	70%	29%	3.4%	$22,017
White	77%	7.9%	72%	21%	2.1%	$35,551

Even when factors such as salary, job tenure, and age were held constant, African-Americans were still 7% less likely to participate than whites, and Hispanics were 6% less likely. Asians on the other hand were 3% more likely to participate. When you hold those other factors constant, African-American savers contributed 11% less pay than whites and Hispanics contributed 6% less. In contrast, Asians contributed 21% more.

Hardship Withdrawals

Some of the most disturbing findings were in the areas of the hardship withdrawals and loans, which are major sources of leakage in 401(k) accounts. Hardship withdrawals are particularly devastating. Not only is the investor charged a penalty and the applicable taxes, but they lose out on the compounding effect on their assets had they remained invested. Unfortunately, withdrawn money is not paid back. The figures were even worse for African-Americans in their 30's and African-American women. We found that 11% of African-Americans in their 30's took a hardship withdrawal, and overall, 9% of

African-American women took a hardship withdrawal compared to 6% of African-American men. When controlled for other factors, such as age, job tenure, etc. we found African-Americans were 167% more likely to take a withdrawal than whites. Hispanics were 50% more likely.

Loans

Loans can also be quite harmful to 401(k)'s, especially in cases of termination. We do not believe the ability to receive a loan should be terminated, and we recognize the ability to take a loan may actually encourage plan participation. Unfortunately, our current economic environment of high unemployment, poses some serious dangers for individuals with loans. When an employee is terminated most companies require prompt repayment of the loan. If the loan cannot be repaid, it becomes a distribution resulting in taxes and penalties. But, more importantly it becomes a permanent reduction in an employee's retirement savings. African-Americans and Hispanics are once again more likely to have outstanding loans. For African-Americans and Hispanics the percentage rate of individuals taking a loan peaked in the $30,000-$89,000 salary range, and then it diminishes as salary increases. However similar racial differences exist across all salary levels. Once again, we believe loans should not be eliminated, but there are fundamental aspects of loans that can be changed in order to make them less harmful to plan participants. We will review some of our loan recommendations later in our testimony.

Account Balances

The effect of lower participation and contribution rates, less exposure to equities, and higher rates of hardship withdrawals and loans have a lasting negative effect on account balances. African-American and Hispanic workers, not surprisingly, have account balances that are smaller than their white and Asian peers. For example, employees who earn between $30,000 and $59,999 show a significant difference in 401(k) account balances: African-Americans ($21,224), Hispanics ($22,017), Asians ($32,590), and whites ($35,551). This disparity exists even at higher pay levels. For instance, African-American employees who earn $120,000 or more have saved $154,902 in their 401(k) plans compared to $223,408 for white workers in the same pay range. While other factors influence account balances, the variation exists even after these adjustments.

Office of Personnel Management Study

On May 26, 2010, Senator Herb Kohl (D-WI) released a study by the Office of Personnel Management (OPM) examining Federal Thrift Savings Plan (TSP) participation rates by ethnicity and gender. This study was conducted at the Senator's request, and OPM noted that it was the Ariel/Hewitt study that served as the catalyst for this study. Despite overall high participation in the TSP, there are stark racial disparities in participation rates, salary deferral rates and TSP balance. The study, which surveyed approximately 1.5 million federal employees, also found glaring differences in how men and women participate in TSP. The study found minorities are less likely to participate in TSP than their white counterparts (82.5% compared to 87.8%), and when they do, minorities contribute about 25% less, resulting in smaller account balances at the time of retirement. Without a significant effort to improve participation and contribution levels, minority workers are in danger of retiring in poverty. Of note, while women participate in TSP at a slightly higher rate than men (86.4% compared to 85.8%) they lag in salary deferral rates, resulting in smaller account balances. This study is very important in understanding that the disparities we see in the private sector are mirrored in the public sector.

Possible Reasons for Differences

So, why do these differences exist? Although we did not study behavioral issues of various minority groups in this study, we at Ariel have learned a great deal about African-American attitudes towards investing and savings through our annual Black Investor Survey. Ariel believes there are five distinct reasons why these differences exist in the African-American community:

- *Knowledge*: Financial literacy is not taught in schools. If people do not have the proper knowledge at an early age, they will not invest adequately.
- *Misinformation*: African-Americans have misconceptions about their money. For example, they think they will not be able to access money in troubled times.
- *Trust issues*: There is a general lack of trust when it comes to the markets.
- *Exposure*: Investing is not discussed in black homes and there are few visible black people in the financial industry, so it is more difficult for them to relate.
- *Conservatism*: African-Americans are usually more conservative in their investments. They tend to invest in more tangible things like homes, and they usually invest in cash-equivalents, which do not return as much as stocks.

Recommendations

In the end, the individual is ultimately responsible for their own retirement savings. However, there are actions that employers and the government can undertake right now to address these disparities.

Recommendation 1: Encourage employers to voluntarily collect and report their 401(k) plan data by race and ethnicity of participants. This is a key step as it allows the employer to recognize potential disparities. The federal government plays an important role in this recommendation, and this is where the Department of Labor (DOL) could be of great benefit. The DOL in conjunction with the OPM, and other relevant agencies could encourage voluntary collecting and reporting of data about 401(k) plan participants. The type of data collected could be similar to what is found in the Ariel/Hewitt study. Secondly, the DOL and OPM could provide guidelines for the data collection process, such as the applicable measures and frequency of collection. This uniformity would allow for better benchmarking and comparisons between employers. Finally, the DOL could be responsible for tracking minority and gender retirement plan participation in the private sector, and the OPM would have the same responsibility for the TSP. This would ensure that at least one government agency was responsible for the supervision of this effort.

We no doubt believe that there will be some resistance, especially in the private sector, to collecting this type of information. The largest issue would obviously be reputational risk for companies that may be perceived to be grossly unfair to minorities and women. There could also be fear of lawsuits by minorities and women due to these discovered disparities. In a voluntary reporting system like what we are proposing, the obvious barrier to collecting information will be employer anxiousness. There are a couple of ways that the government can lower this apprehension. First, the government should provide some reassurance to participating companies that they will not be held liable for any discovered discrepancies. Second, the government should already have in place the measurement tools and tracking mechanisms so that employers can properly analyze their data and take pro-active steps.

Recommendation 2: Modify loan requirements in 401(k) plans to decrease the likelihood of default when an employee terminates employment. We believe extending the amount of time a terminated employee has to pay-off a loan may improve overall savings, especially for African-Americans and Hispanics. Rules could be changed (which may require legislation) to the following:

- Provide a longer period for repayments. Currently, most companies require a loan be repaid in a short period of time after termination (i.e. 60 days). We suggest the time be lengthened to a longer time period, such as 6 months. More narrowly, loan repayment requirements could be suspended for a period of time for employees who involuntarily lose their jobs.
- Allow loan repayments after termination. Unemployed individuals would be allowed to repay loans from their personal bank accounts according to a predetermined payment schedule.
- Make loans portable. If a 401(k) account balance and any outstanding loans could be easily rolled-over to your next employer, employees could be encouraged to

roll over their 401(k) and continue loan payments, which is preferable to cashing-out.

Recommendation 3: Provide financial education as a mandated part of both public and private school curricula at all levels. This solution in the long-run may be one of the most important ways to close the sizable gap in 401(k) account balances.

Recommendation 4: Design 401(k) plans in a way that benefits a broad, diverse employee base. Employers should consider the following changes to plan design:

- Implement automatic 401(k) enrollment for all new employees, and check all existing employees on an annual basis to ensure they are enrolled, assuming they have not opted out. Although auto-enrollment and auto-escalation are good measures to help bridge the gap, we do not believe that they are magic bullets to completely solving the issue.
- Set a default contribution rate for employees automatically enrolled in a 401(k) plan equal to the full company match level. Contribution rates should be automatically increased over time.
- Offer investment advice and various tools for investing to meet the needs of all participants.

Recommendation 5: Provide necessary communication, education, and resources to help individuals make wise choices. For example, employers can:

- Promote greater awareness of the consequences of taking out a loan, including at the point of initiation.

- Provide retirement planning resources such as workshops, call centers, and on-line tools and education in order for individuals to most effectively understand and use their plans.
- Create user-friendly communications that enable workers to effectively learn about their plans. Information should be available in multiple forms and should recognize differences in populations.
- Incorporate different cultural perspectives in broad-based employer communications about 401(k) plans that resonate with diverse groups of employees. This information could be promoted via affinity groups.

Conclusion

We believe racial and ethnic 401(k) plan participation disparities must be addressed immediately. Once we know and acknowledge these differences, we will be able to effectively implement tangible solutions. Through a long-term commitment from employees, employers, and the government we will be able to narrow the wealth gap, and enable all workers to achieve the American dream.

This concludes my prepared remarks. Thank you for allowing me to share the results of our study. We look forward to continuing this effort well beyond today. I look forward to your questions and comments.