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Testimony on Behalf of Hewitt Associates LLC

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to the Department of Labor

Disparities for Women and Minorities in Retirement

As one of the world's premier human resources services companies, Hewitt Associates has extensive experience both designing and administering retirement plans for mid- to large-sized employers. We are the largest independent provider of administration services for retirement plans, serving more than 11 million plan participants. We do not manage funds and have no affiliations with any investment management firm. My name is Barbara Hogg, and I am a principal and senior retirement consultant at Hewitt Associates. I am honored to be addressing the Council to talk about opportunities for the Department of Labor to improve the retirement security of women and minorities.

Today, two-thirds of large employers report their 401(k) plans as their primary retirement vehicles. With this heavy reliance on defined contribution plans, it becomes increasingly critical that we understand how participants are using these plans and whether they are using them in a way that enables them to accumulate adequate levels of income in retirement. Hewitt make significant contributions toward retirement research as it relates to employer-provided benefits. As part of that research, we routinely study how employees use their defined contribution plans and have recently analyzed retirement trends among women and minority populations. In my testimony today, I will identify disparities in retirement savings levels for women and minorities and discuss the 401(k) savings behaviors that contribute to these disparities. Specifically, my testimony will focus on:

I. Differences in retirement income adequacy across different race and ethnic groups and between the genders.
II. Contributing factors to differences in retirement readiness.
III. Recommendations on how the federal government can illuminate this issue.
IV. Design features in defined contribution plans that employers should consider to help all employees achieve better retirement income adequacy.

I. Differences in Retirement Income Adequacy by Race/Ethnicity and Gender

Retirement income adequacy is increasingly a topic for concern for both employers and employees. Employers recognize that they face serious workforce issues because employees are prevented from retiring, as they are unprepared financially. Employees have even greater retirement planning challenges, which are magnified by an uncertain U.S. economy and rising retiree medical costs. Recent Hewitt research shows not only that many employees are significantly unprepared for retirement, but also that there are meaningful and quantifiable differences in retirement savings levels between men and women, as well as disparities in retirement savings across races and ethnicities.

A recent Hewitt study[1] of 2.1 million employees analyzed the projected amount of assets they need to accumulate by age 65 in order to meet their income needs in retirement and how much they are projected to have to meet those needs. In our analysis, we assumed employees would continue their pre-retirement standard of living and that subsidized medical benefits were **not** available through an employer plan. In projecting medical costs, we assumed that post-retirement medical inflation would continue to occur at a higher rate than general inflation.

We started by looking at what we consider a "best case" scenario—employees who have a pension plan, work a full career, and make contributions to their savings plan. Our analysis found that the *average* employee needs 15.7 times their final pay in retirement resources to meet their financial needs in retirement, assuming they retire at age 65. Of the 15.7 times final pay, Social Security is expected to

[1] Hewitt Associates, Retirement Income Adequacy at Large Companies: The Real Deal Study, 2010.

provide a value of 4.7 times final pay, leaving employees responsible for accumulating the remaining value of 11 times final pay from other sources such as company-provided plans and personal savings.

However, just 18 percent of employees in this “best case” scenario are expected to achieve this goal. On average, these employees are on track to accumulate just 13.3 times their final pay (including Social Security), leaving a shortfall of 2.4 times pay. In other words, they are expected to meet just 85 percent of their financial needs in retirement. Of the remaining 82 percent who are not on track, 19 percent are expected to have a significant shortfall of five times final pay or more at retirement.

The situation becomes much bleaker for employees who are not covered by a defined benefit plan. On average, workers who rely solely on a defined contribution plan to fund their retirement are projected to have an average shortfall of 4.3 times pay when they reach age 65. This means they will only meet 74 percent of their needs in retirement—compared to 91 percent for employees who are also covered by an active or frozen defined benefit plan.

Income Adequacy by Race/Ethnicity

Hewitt has also looked at retirement income adequacy indicators between race and ethnic groups. In 2009, we partnered with Ariel Education Initiative, the nonprofit affiliate of Ariel Investments, to publish “401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups.” This study, based on 2007 information collected from nearly 3 million eligible employees working for 57 of the largest U.S. companies, found significant differences in the savings behaviors of African-American and Hispanic employees compared to white and Asian employees. Those differences—including lower participation rates, contribution rates, and higher loans and hardship withdrawals—added up to measurable differences in retirement savings.

When looking solely at account balances, an African-American or Hispanic employee making between $30,000 and $60,000 had an average 401(k) account balance in the low $20,000s. In contrast, the account balance for an Asian or white employee in that same pay category was in the low- to mid-$30,000s. We found significant variation in these account balances even after factoring out potential demographic disparities, including age, tenure, service, income, and gender.

Income Adequacy by Gender

As mentioned above, the average full-career contributing employee had a shortfall of 2.4 times pay. When we break this out by gender, we found a significant disparity between the income adequacy levels of men and women. Women had an average shortfall of 3.1 times pay, while men had an average shortfall of only 1.8 times pay.

Another way to analyze income adequacy by gender is through 401(k) plan balances. In a separate Hewitt analysis of 401(k) data[2], we find that women, on average, have only accumulated 80 percent of pay in their savings plan. On the other hand, the average man has accumulated an account equal to 100 percent of his pay.

II. Contributing Factors to Differences in Retirement Readiness

There are many contributing factors to the differences we see in retirement income adequacy levels among women and minorities—including how (and if) a person saves and contributes to their 401(k) plan, and their tendency for taking out savings prematurely.

[2] Hewitt Associates, How Well Are Employees Saving and Investing in 401(k) Plans: Hewitt Universe Benchmarks Study, 2010.

Savings Behaviors by Race/Ethnicity

Through our research, we've seen significant differences in how groups save for retirement. Two clear indicators of how money accumulates are through participation rates and contribution rates.

Regardless of age and income, African-American and Hispanic workers are less likely to participate in their company 401(k) plans. Compared to whites, African-Americans are 7 percent less likely to participate and Hispanics are 6 percent less likely to participate.

Those African-American and Hispanic employees who do participate contribute at a considerably lower rate compared to whites and Asians. Whites had an average contribution rate of 7.9 percent and Asians had an average contribution rate of 9.4 percent, compared to 6.0 percent for African-Americans and 6.3 percent for Hispanics. The lag in African-American and Hispanic participation rates, combined with lower average contribution rates, contributes significantly to the lower plan balances of these participants.

Savings Behaviors by Gender

As noted earlier, women are projected to have a higher shortfall in retirement resources than men. There are several factors—both financial and socioeconomic—driving these differences. In general, women are more likely to:

- **Make less and live longer.** While women's income has increased 63 percent in the past 30 years[3], Hewitt's research shows the average woman earns just $61,000 a year compared to $79,000 for the average man. In addition, women are expected to live two years longer than men, which means they need to save more to make their retirement savings last over a longer stretch of time. And because medical costs after retirement are the same regardless of pay level, these costs will consume a higher percentage of women's retirement assets than men's will.

- **Save less assertively.** Most women have less money saved in their 401(k) plans than men do. Hewitt's research shows that the average 401(k) plan balance for women is $53,000—nearly $32,000 less than men. Women also tend to contribute less (6.8 percent of pay versus 7.8 percent for men) to their 401(k) plan. These lower contribution rates mean that women are more likely to miss out on employer-provided matching contributions—32 percent of women contribute at a rate below the full match threshold compared to 26 percent of men.

- **Invest less aggressively.** Our research also shows that women are less aggressive than men with respect to investing in their 401(k) plans. Women typically have lower equity exposure (68 percent for women compared to 73 percent for men) and are less likely to actively manage their investments[4].

- **Have spotty saving patterns.** Women are more likely to be in and out of the workforce for family reasons. This can result in hundreds of thousands of dollars in missed earnings, promotions, raises, and benefits over the course of a career and can contribute to larger deficiencies in retirement savings over time.

The cumulative impact of these differences is significant. The average 401(k) plan balance for women age 60 and over is almost $80,000 less than that of men in the same age bracket.

[3] Suze Orman, Women & Money: Owning the Power to Control Your Destiny (Spiegel & Grau, 2007).

[4] Hewitt Associates, How Well Are Employees Saving and Investing in 401(k) Plans: Hewitt Universe Benchmarks Study, 2010.

Taking Out Savings Prematurely

Retirement savings can be significantly eroded when they are being used before a person actually retires. This "leakage" can have severe detrimental effects to employees and can counter employer efforts to improve participation and contribution levels. While leakage can occur in different ways, we will focus our testimony on two specific types:

1. Loans that are taken out and not repaid in full; and

2. Withdrawals, including hardship withdrawals, taken during active employment.

1. Loans Taken Out and Not Repaid in Full

Loans are not necessarily detrimental to retirement savings. In fact, they may encourage some people to participate in a 401(k) plan because they know they have access to their money if they need it. People who take a loan and repay it in full while continuing to contribute to their plan can generally preserve their retirement savings. Hewitt's research shows that 85 percent of participants with outstanding loans do repay promptly and continue to make their pre-loan contributions.

However, participants who don't repay their loan according to plan rules are risking their retirement security. This is particularly true for those employees who have lost their jobs. The vast majority of 401(k) plans today require an outstanding loan to be repaid promptly (e.g., within 60 days) upon termination of employment. If the loan is not repaid promptly, it is treated as a distribution, resulting in taxes and possible penalties that create a permanent loss from an employee's retirement savings.

The Ariel/Hewitt study shows that African-American and Hispanic employees are most likely to have 401(k) loans. Nearly two of every five African-American workers and almost a third of Hispanic workers had borrowed from their retirement accounts, compared to just one in five white workers. This means their exposure to these adverse risks is higher and may be exacerbated if minorities experience higher rates of unemployment as data from the Department of Labor indicates as true.

While there is no silver bullet to this issue, modifying the loan requirements in 401(k) plans could decrease the likelihood of default. In the Ariel/Hewitt study, we noted this as an option to help all employees, with perhaps the greatest potential benefit for those most at risk. Three specific ideas that can help include:

- **Make loans portable.** If a 401(k) account balance plus the outstanding loan against it could be easily rolled over to another plan or to an IRA, employees may be encouraged to roll over their loan and continue repayments. This option would be a much better alternative to cashing out the account altogether.

- **Extend the "cure period" for loans upon involuntary termination.** Suspending the loan repayment requirement for a longer period (e.g., up to 12 months) upon involuntary termination would give impacted participants more time to repay the loan or roll it over before the taxable distribution occurs.

- **Encourage plan sponsors to allow loan repayments after termination.** Currently, most employers do not accept loan repayments after employee termination, largely because payments can no longer be made via payroll deductions. Instead, employees could be allowed to continue to make payments through the term of the loan from their personal accounts at financial institutions.

2. Withdrawals Taken During Active Employment

Like unpaid loans, withdrawals can significantly impair employees' overall retirement accumulations. One type of withdrawal offered by nearly all 401(k) plans is the hardship withdrawal, which is limited to specific needs, such as medical expenses, preventing foreclosure, pursuing education, or purchasing a home.

Employees often request a large amount of money in a hardship withdrawal, which can significantly deplete their retirement savings and hamper their ability to meet retirement goals. However, the total impact to the employee's retirement savings goes beyond the withdrawn amount. They must often pay a penalty and lose out on the compounding value of those assets over his or her career.

In the Ariel/Hewitt study, we found that 7.8 percent of African-Americans and 3.4 percent of Hispanics took a hardship withdrawal, compared to 2.1 percent of whites. We also found differences by gender in a separate Hewitt study[5], with women being more likely to take a withdrawal of any kind, particularly at pay levels below $60,000.

Three ideas to reduce leakage due to withdrawals include:

- **Allow participants to recontribute hardship withdrawals to their accounts.** Currently, a participant has no way to remedy a hardship withdrawal if he or she is subsequently able to secure funds through other sources or sees the hardship alleviated. We believe the 401(k) rules should be amended to allow participants to recontribute hardship withdrawals within a certain window of time to give them the ability to restore some of the harm done to their retirement savings.

- **Modify the availability of hardship withdrawals.** The hardship rules should be amended to limit the hardship withdrawals available under the plan to the six safe harbor hardship reasons.

- **Restrict availability of other in-service withdrawals.** Plan distribution rules should be revised to prohibit all other non-hardship, in-service distributions of pretax and Roth dollars before age 59½.

III. Recommendations on Actions the Federal Government Can Take to Illuminate This Issue

Based on our research and work with employers, we believe employers should collect more data, on a regular basis, to analyze differences in retirement income adequacy among women and minorities. The federal government could facilitate this data collection and analysis by:

- Encouraging employers to voluntarily collect and report their 401(k) plan data by participant gender, race, and ethnicity. The types of data to be collected could include account balance, contribution rate, equity exposure, percentage with loans, and percentage taking hardship withdrawals.

- Providing guidelines for the data collection process, such as what measures to use, how to collect data, and the frequency for collecting data. Additionally, if these data were compiled across participating companies, they could be used for benchmarking purposes, and employers could compare their own results with others in their industry and beyond.

Some employers express concern with collecting this data about their employees and plan participants. They believe that public analysis of their data, even when aggregated with other employers' data, will be negatively misconstrued. The federal government could provide safe harbors for employers so that data collection and analysis do not unnecessarily expose employers to the risk of litigation.

[5] Hewitt Associates, How Well Are Employees Saving and Investing in 401(k) Plans: Hewitt Universe Benchmarks Study, 2010.

Once a process is established to regularly collect the data, there is little-to-no additional cost for employers. If the necessary codes are added in conjunction with other data or a change in providers, the additional effort is negligible, even at the time of implementation. Today, behaviors are generally benchmarked by age, tenure, pay, gender, and other factors such as job status, location, or department. Adding one more dimension—such as race and ethnicity—is an important and easy change.

The U.S. Office of Personnel Management (OPM) has already shared participation rates in the Federal Thrift Savings Plan (TSP) by ethnicity and gender. The federal government could also encourage data collection in other [non-401(k)] tax-deferred employee retirement plans. For example, they could encourage data collection by gender, race, and ethnicity of participants in 403(b) tax-deferred employee retirement plans offered to employees in the nonprofit sector. Similarly, the providers of plans for employees of state and local governments could be encouraged to do the same for their 457 plans. Knowledge of the depth of differences will be a step toward lessening the gender, racial, and ethnic gaps in retirement security for all workers in the United States.

IV. Design Features Employers Should Consider for Improving Retirement Income Adequacy

Hewitt recognizes that numerous changes must occur to address these retirement savings gaps across gender and minority populations. Employers, the government, and individuals all bear responsibility for taking action. Employers should consider plan designs that benefit a broad, diverse employee base. For example, employers can:

- Implement automatic 401(k) plan enrollment for new employees. Hewitt's research shows that automatic enrollment is effective at maintaining high participation rates. The participation rate among automatically enrolled workers is 86 percent compared to 65 percent for those who are not automatically enrolled. Additionally, employers can do a one-time sweep to add non-participants into the 401(k) plan, unless they have previously opted out.

  It's important to note that automatic enrollment will not guarantee retirement income adequacy for all employees. This is for several reasons:

  - Some participants opt out and still do not save.
  - The default savings rate many employers choose for automatic enrollment—commonly 3 percent of compensation—sets a savings pattern in place that often does not help employees achieve adequate income. Participants who start saving later in their career are especially underserved by low default rates.
  - Hewitt's research shows that the majority of employers (80 percent) that implement automatic enrollment only apply the practice to new hires, meaning that existing employees are not impacted.
  - As noted, the usage of loans and hardship withdrawals among minorities, and other factors specific to women, negatively impact retirement savings levels even when automatic enrollment is in place.

- Set a default contribution rate for employees automatically enrolled in a 401(k) plan so that employees get the full company match, and automatically increase employee contribution rates over time so participants can eventually exceed the match threshold.

- Offer investment advice and various tools for investing to meet the needs of all participants. Investment advice can be effective at providing guidance for people with different needs. Possible tools for investing can range from simple suggestions to detailed recommendations to turning over a portfolio to an investment professional.

- Allow loan repayments after termination (as mentioned in the recommendations to reduce leakage).

V. Conclusion

While there is more research that needs to be done, there are many actions employers, the DOL, and individuals can take to help 401(k) plan participants achieve an adequate retirement income. Based on our research, women and minorities are at higher risk, and ignoring the challenge will lead to much larger social problems in the future. Specific changes to regulations and plan design will close the gaps between women and minority populations and other plan participants and improve retirement income adequacy for all participants. As a part of the response, we encourage continued data collection and analysis, supported by federal government guidelines and enactment of safe harbors.

We appreciate the opportunity to share our ideas with the Council, and volunteer our data and experience to continue conversations about improving retirement security for all Americans.

About Hewitt Associates

Hewitt Associates (NYSE: HEW) provides leading organizations around the world with expert human resources consulting and outsourcing solutions to help them anticipate and solve their most complex benefits, talent, and related financial challenges. Hewitt consults with companies to design and implement a wide range of human resources, retirement, investment management, health management, compensation, and talent management strategies. As a leading outsourcing provider, Hewitt administers health care, retirement, payroll, and other HR programs to millions of employees, their families, and retirees. With a history of exceptional client service since 1940, Hewitt has offices in over 30 countries and employs approximately 23,000 associates who are helping make the world a better place to work. For more information, please visit www.hewitt.com.