Testimony on Behalf of Aon Hewitt

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Before

ERISA Advisory Council

to the Department of Labor

Successful Retirement Plan Communications for Various Population Segments

1. Introduction

Aon plc is the leading global provider of risk management, insurance and reinsurance brokerage, and human resource solutions and outsourcing services. We have 65,000 colleagues in 120 countries around the world. Aon has been named repeatedly as the world's best broker, intermediary, reinsurance intermediary, captives manager, and best employee benefits consulting firm by multiple industry sources.

In the global talent, retirement, and health solutions business, Aon Hewitt is the largest independent provider of administration services for retirement plans, serving more than 14 million retirement plan participants in the U.S. We have more than 7,500 retirement professionals dedicated to helping plan sponsors maximize retirement outcomes for their employees, manage risk, and control total plan costs. My name is Beth Boden, and I am the Practice Director for Aon Hewitt's North American Communication Practice. I am honored to be addressing the ERISA Advisory Council on successful retirement communication plan strategies that factor in the significant differences that exist among employees.

It's clear Americans are facing economic pressures that impact their ability to save for retirement. Unemployment and small or nonexistent pay increases, coupled with rising health care costs and volatile investment markets, certainly come into play. Mounting personal debt is another factor, with some turning to credit cards as a safety net, or worse, raiding their retirement savings to fill current income gaps.

At Aon Hewitt, we conduct significant research on employer retirement plans and employee behavior and outcomes in these plans. We find that seven out of 10 full-career employees will not have enough retirement income. In other words, they need more help taking the right steps to prepare for retirement.

In the large-employer market, we have seen a significant shift in the retirement program landscape. Our research shows that defined contribution (DC) plans are now the primary source of retirement income for Americans at three-quarters of employers.[1] Only one in four employers offers a defined benefit plan to newly hired employees, and one in six of those open plans is very or somewhat likely to look at closing the plan to new entrants.[2]

Employees are clearly the architects of their own destiny when it comes to retirement. Yet employers can lay the groundwork by using design and communication strategies to help employees act.

On behalf of Aon Hewitt, I applaud the Council for the work you are doing to understand various population segments of the American workforce with a goal to encourage retirement savings. You want to understand effective communication approaches and plan design options to help meet this goal. I plan to address many of the questions you have raised as I focus my testimony on three areas:

- The state of retirement income adequacy overall and the differences within population segments;
- Effective employer strategies that can improve employee retirement readiness; and
- Aon Hewitt's recommendations for improving the retirement outcome for American workers.

[1] Aon Hewitt, *2011 Trends & Experience in Defined Contribution Plans* (Lincolnshire, IL: Aon Hewitt, 2011), 15.
[2] Aon Hewitt, *2013 Hot Topics in Retirement* (Lincolnshire, IL: Aon Hewitt, 2013), 5 and 9.

2. Retirement Income Adequacy

Employer-sponsored retirement plans have made the shift to focus on asset accumulation in DC plans. Therefore, the retirement income adequacy question is whether employees will have accumulated enough savings by the time they retire to continue to meet their needs in retirement. Our analysis shows that only 29% of full-career American workers are projected to meet 100% of their needs in retirement.[3]

We find the average shortfall at an age 65 retirement is 2.2 times projected pay at retirement. This average masks a wide distribution of employee outcomes, with one out of five (21%) of full-career workers projected to have a shortfall of at least six times projected pay at retirement.[4] We see the following factors influencing outcomes:

- **Gender matters.** The average gap for full-career contributing men is 1.9 times projected pay at retirement, whereas the gap for women is 2.6 times projected pay. Why the difference? It comes from a multitude of reasons, including longer life expectancy that needs to be funded and gaps in savings prior to retirement.[5]
- **Type of retirement programs impacts outcomes.** Employees with a defined benefit plan in addition to their defined contribution plan have an average gap at age 65 of only 1.1 times projected pay at retirement vs. 3.8 times projected pay for those who have only a DC.
- **We assume a median life expectancy.** In an asset accumulation plan, individuals may need to self-insure for longevity. If they want to target an 80th percentile life expectancy (i.e., there is a 20% chance they will live longer than projected), they would need to accumulate an additional 2.4 times projected pay at age 65.[6]

Accumulating enough income for retirement requires an individual to start saving early and consistently over their career. We want to explore some notable differences among employees in both participation and savings rates and their likelihood of leaving money in the plan until retirement.

a. Participation and savings rates

In our analysis, we find that a total contribution rate (employer and employee) of 15% of an employee's pay each year will accumulate adequate income for a median life expectancy *assuming an employee starts saving at age 25.*[7] This finding underscores the importance of a strong, early savings rate.

Across the DC plans that Aon Hewitt administers, we find that 78% of employees participate with an average employee saving rate of over 7% of annual pay.[8] Yet behind these numbers are some significant differences:

- **Age is a significant factor.** Employees in their 20s have, by far, the lowest participation rate at only 50%, with an average savings rate of only 5.2% of pay.[9] As we have pointed out, this means younger participants are already falling behind when they miss the opportunity to begin saving early.

[3] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 6.
[4] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 6.
[5] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 37.
[6] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 10.
[7] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 6.
[8] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).

- **Income is an influence.** Only 65% of individuals making $20,000 to $40,000 participate, with average savings of 5.3% of pay.
- **Women save less for retirement than men** (6.9% of pay, compared with 7.6%).[10]
- **Differences exist by race/ethnicity.** Participation rates of African-Americans and Hispanics lag the participation rates of Whites and Asian-Americans (68% and 66% compared with 79% and 80%). Once in the plan, African-Americans and Hispanics have an average savings rate of under 6% of pay, and White workers save just over 7%, while Asian-Americans save, on average, nearly 9% of pay.[11]

Of particular concern are employees who don't receive the full company match because of their low savings rates. Overall, we found that about three out of every 10 savers contribute below the match threshold.[12] Naturally, the percentage is higher for certain segments of the population due to lower savings rates.

With the high need for savings in order to accumulate adequate retirement income, missing out on company contributions can be a significant setback in achieving retirement income adequacy. And there are no second chances for receiving company matching contributions.

General financial pressures can distract people from saving. Women are more likely than men to say other financial obligations interfere with their retirement savings compared with men, 12% vs. 6%, respectively. We also find many people recognize they are not saving enough for retirement, primarily due to day-to-day living expenses. This is an issue for about two-thirds of African-Americans, one-half of Whites, and less than one-half of Asian-Americans.[13]

b. Keeping savings for retirement

Even when employees cross the first hurdle and save in the plan, they have other hurdles to cross. A key one is to avoid the temptation to dip into those savings for immediate needs. The risk of "leakage"—taking funds out of retirement savings prematurely—is clearly a concern. Earlier this year, Aon Hewitt had the opportunity to testify before the U.S. Senate HELP Committee on this topic.

One source of leakage is particularly troubling—cash-outs at termination of employment. Over 40% of terminating employees take a cash distribution.[14] This is greatly influenced by the size of the balance, with higher cash-out rates for lower balances. For instance, 70% of balances under $1,000 are cashed out. As a result, younger employees, who tend to have smaller balances due to their service, are very likely to cash out their retirement savings if they change jobs.

We see significant differences in leakage rates based on race and ethnicity. For instance, African-Americans and Hispanics are much more likely to cash out their accounts upon termination of employment than Whites and Asian-Americans (63% and 57% compared with 39% and 34%).

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[9] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[10] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[11] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012), 6, 8.
[12] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[13] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012), 13.
[14] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).

When a cash-out occurs, the value of early savings—a critical factor needed to build adequate retirement income—is lost.

3. Employer Strategies

Employers are taking steps to improve the financial future of their workers through plan design strategies like adding automatic features, promoting smarter investing through simplified choices and investment help, and efforts to promote the program through effective participant communication.

a. Leveraging the potential of automation

Increasingly, employers are instituting plan design features that use automation to jump-start savings habits. Employees are being automatically enrolled in the plan at a set contribution rate, either at initial eligibility or through an annual sweep. Some plans take this a step further and use auto escalation to increase contributions over time.

Auto enrollment has been a positive influence on generating participation in savings plans. Plans that have automatic enrollment see an 85% participation rate compared to plans without automatic enrollment, which experience a 65% participation rate.

In particular, auto enrollment is shown to significantly improve participation among segments of the population that this Committee is addressing. Employees in their 20s—all in the millennial generation—are twice as likely to participate in their employer's plan when auto enrollment is used (82% vs. 41%). Automatic enrollment is extremely effective for lower-paid workers as well. For those earning under $20,000, we found participation jumped from 27% without automatic enrollment to 71% with automatic enrollment.

We also found that automatic enrollment significantly reduced the disparity in participation by race/ethnicity. Participation rates by race ranged from 82% to 89% (a spread of 7%) when automatic enrollment was in place compared with the nearly 20% spread (59% to 78%) for plans not subject to automatic enrollment. Automatic enrollment had the greatest impact on the segment that had the lowest participation rate—participation among Hispanics rose from 59% without automatic enrollment to 83% with automatic enrollment.[15]

By making savings automatic, we can see a significant impact on participation levels across all population segments, especially those that have been farthest behind. However, simply enrolling workers automatically does not ensure that they will save enough to meet their retirement savings goals. In fact, 40% of workers subject to automatic enrollment save below the company match threshold.[16] Employers can do more to leverage automation through automatic contribution escalation, or by defaulting workers at a higher rate. Most default workers to a savings rate of 3% of pay. Increasing that amount to 6% (the most common company match rate) or even higher could have a significant impact on employees' long-term savings.

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[15] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012), 7.
[16] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).

While auto enrollment is an effective way to bring employees into the savings plan, additional efforts are needed to ensure employees maximize their potential through additional automation (automatic escalation) and through strong, directive, targeted communication.

b. Offering professional investment help

Employers are also paving the way to better investing by offering various forms of investment help in their DC plans. This could be through target date funds, managed accounts, or online advice—or some combination of these. Offering easier ways to invest is important because many employees acknowledge that they do not have the skills to make smart investment decisions.

We see a significant difference in investing confidence based on gender. As an example, when women were asked specifically about investment knowledge (including topics such as mutual funds, asset allocation, and other investment topics), only 7% said they were very knowledgeable, compared with 24% of men.[17]

The use of professional investment help tools can make a substantial impact on retirement savings. A report from Aon Hewitt and Financial Engines found that participants who used some type of professional investment help experienced higher returns with lower risk than those who invested on their own. Two primary reasons behind the poor portfolio performance of those not receiving professional investment help are inappropriate risk levels and inefficient portfolios. In particular, participants using professional investment help solutions had median annual returns nearly 3% higher than other participants, net of fees—a significant difference, especially over the course of a career.[18]

One trend that has more people getting help is the emergence of target date funds. In 2011, we found that 81% of plan sponsors were offering target date funds (up from 58% in 2007) and a vast majority of plan sponsors (78%) are using target date funds as their default investment.[19]

Clearly the use of defaults and ease of investing are appealing to many people—including some of this Committee's target audiences.

- Younger participants and those with lower tenure were most likely to use premixed portfolios. Eighty-four percent of participants in their 20s invested in premixed funds.[20]
- Women were much more likely to use target date funds than men (66.8% vs. 62.9%) and allocated a larger portion of their portfolios to the target date fund.[21]
- We found that historical differences in equity exposure by race/ethnicity were offset by the increased use of target retirement date funds.[22]

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[17] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012).
[18] Aon Hewitt, Financial Engines, *Help in Defined Contribution Plans: 2006 Through 2010* (Lincolnshire, IL: Aon Hewitt/Financial Engines, 2011), 42.
[19] Aon Hewitt, *Trends & Experience in Defined Contribution Plans* (Lincolnshire, IL: Aon Hewitt, 2011), 50, 34.
[20] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[21] Aon Hewitt, *2013 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[22] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012), 16.

By moving more people to professional investment help—through target date funds and other means—employers are improving participant outcomes and eliminating some of the disparity we have historically seen when it comes to investments.

c. Successful communication strategies

While plan design is a powerful tool to increase retirement plan participation, boost contribution levels, and enhance investment results, employers need to do more to impact workers' retirement readiness. Lately, employers are taking note. Among large employers, 80% are somewhat or very likely to focus on financial well-being of employees in 2013. That is a significant increase from the prior year, when the number was only 74%.[23]

How employers are addressing financial well-being can be demonstrated by three case studies.

Case Study #1: Big box retailer drives 401(k) participation

A large retailer found that participation in their savings plan was low. They set out to get more people in the plan, which was easier said than done with a population of employees in their 20s and 30s. The company decided that getting employees' attention required more than the typical "why save" message, so they added an element of fun with a highly creative and visual campaign. They packaged the company match as a gift, kept all communication very simple, fun, highly visual, and "cool." Plus, they created a contest among store managers to raise awareness of the 401(k).

It worked. The company saw a 30% increase in 401(k) plan participation, which far exceeded their desired goals.

Why did this work?

- It was fun—an important element for this age group.
- It effectively leveraged a gain message by packaging the employer match as a gift, but it also used loss messages by visualizing—in a humorous fashion—the path you were on if you didn't start saving soon. We know from marketing that messages which get an emotional reaction—rather than messages that require cognitive skills—can be powerful, especially for younger audiences.
- It incorporated involvement—through the manager challenge and other employee-focused initiatives.

Case Study #2: Financial institution highlights "on track" accumulation

A large financial services client made significant changes to its retirement program, including freezing the pension, enhancing the savings plan, and adding automatic enrollment and automatic escalation. They also offered employees access to investment help through target date funds, online advice, and managed accounts. Even with these resources, the organization was concerned that employees were falling behind and wanted to do more to capture their attention.

The organization developed a personalized approach to demonstrate how each employee's current savings stacked up against a milestone savings amount to help bring immediacy to the need to build

[23] Aon Hewitt, *2013 Hot Topics in Retirement* (Lincolnshire, IL: Aon Hewitt, 2013), 7.

retirement readiness. This was followed by a retirement evaluation from their managed account provider that showed how they could improve their retirement outcomes.

As a result, they saw a near doubling of employees' use of professional management and a significant increase in the use of online advice.

What's clear from this story is that personalized milestones helped elevate employee awareness of the need to act now. As a result, they took notice of their retirement evaluations and were more likely to act.

Case Study #3: Large manufacturing firm creates 401(k) month

This large manufacturing organization made changes to its retirement program resulting in a strong shift from traditional pension plans to a defined contribution approach. They used plan design and professional investment help to create automated paths to better outcomes, but they saw a need to do more.

Very recently, they conducted *401(k) Month* using multimedia and a different message each week to help people see how to improve retirement outcomes. Employees received visual emails often targeted to their situations to raise awareness and encourage them to learn more. Each week had a short, marketing-oriented video accessible from a mobile device to promote the weekly topic. The campaign allowed employee self-selection based on individual situation and investor profile.

The results? While we are still measuring the behavioral outcomes, we have seen significant success in raising awareness. A high email open rate (about three out of every four emails were opened) led to a significant number of video views.

The power behind this campaign came from a few key elements:

- The consistency and frequency of the messages over a relatively short timeframe created a focus not found with a one-off effort.
- The presentation and messages were strong, engaging, and simple. This organization realized that they had information and resources available. The campaign was about raising awareness to drive action and use of the resources.
- The campaign was multimedia and engaged employees with print, posters, videos, and a microsite.
- The campaign included social aspects using stories and "words of wisdom" from recent retirees.

4. Recommendations

Action is needed to help American workers prepare for retirement. Retirement readiness should be supported publicly, through legislative means, and though employer action.

In other forums, Aon Hewitt has suggested legislative changes that may improve retirement outcomes. To address leakage, we've suggested changes to loan provisions to allow participants more time to repay rather than default upon plan termination. We'd like to see a simplified rollover process to encourage more money to stay tax-deferred. Or, better yet, encourage more money to be put into the plan by making it easier to roll money into a plan and/or allowing cash-ins of tax refunds so participants save them for retirement.

We strongly support the GAO's recommendations about rollovers and the need for participants to have unbiased advice when it comes to decisions about their retirement savings. In addition, we are excited to see that the DOL is exploring ways to help participants visualize what a DC plan balance may provide in lifetime income.

We'd like to focus this testimony on four opportunities to improve outcomes through employer-sponsored retirement programs along with suggestions to help eliminate perceived barriers to action.

a. Continue to support automation

As we've noted, our research proves that automation is an extremely powerful plan design feature. We believe employers should continue to look at adding automatic enrollment, automatic escalation, and investment defaults to professionally managed investments (target date funds, managed accounts).

b. Encourage a bias toward professional investment help tools when plan sponsors communicate investment choices to participants

Clearly, the value of professional investment help and the powerful way the QDIA rules helped move more American workers into a professionally managed investment approach have improved outcomes for many individuals. Yet, despite having identified a QDIA investment, some plan sponsors feel a need to stay neutral in presenting investment options and avoid showing a bias toward professional investment for most individuals.

As we've shown, most employees are not very confident when it comes to investing, and it shows in their outcomes: employees who invest on their own tend to get lower returns with higher risk. We'd like to see guidance so plan sponsors understand it's appropriate to promote some kind of professional investment help over a "do it yourself" investing approach. If a plan sponsor selects a QDIA as their default investment, then it should be reasonable for the plan sponsor to direct employees toward that QDIA when they communicate investments to plan participants. For instance, a plan sponsor could require a participant to attest to their readiness to use a core fund lineup or self-directed account because they have (a) outside professional help, (b) the knowledge, skills, and training to create their own investment mix, and/or (c) the understanding of the added risk of investing on their own and are willing to take that risk. In other words, the employer puts up the sign "Caution—proceed at your own risk" to employees who are not using the professional management made available through the plan.

Ongoing investment communication that points participants towards the QDIA could be encouraged by the DOL through some type of compliance assistance, or, if appropriate, technical guidance.

c. Require simple communication reminders

There have been a number of enhanced disclosure requirements for DC plans and support for the concept of disclosure. Unfortunately, sometimes the required disclosure distracts plan sponsors from what may be more effective communication to drive employee behaviors.

We recommend a new type of disclosure requirement that provides targeted groups of eligible participants with a single, relevant message. Non-savers could be reminded that they have a plan available. Participants contributing below the match could be reminded that by increasing their contributions, they'll get a higher employer matching contribution. While many plan sponsors do this already, the practice is not universal.

These messages will work only if they are short—with a word count limit and, perhaps, a reading level requirement. They should **not** try to cram in everything you need to know about the plan but direct employees to where they can learn more. And employees should receive this message once a year as a separate and distinct communication. In other words, it should not be buried in some other communication.

Plan sponsors should also receive some relief so they can focus on this new simple reminder requirement. Right now, fee disclosure needs to go all eligible participants, even if they are not saving in the plan. Perhaps the better first message to non-savers is the importance of saving. Employers can substitute the mailing of the fee disclosure piece with this new reminder mailing. Fee disclosure should not be lost, however, but it could instead be made available to eligible participants online or through other means.

d. Encourage and help employers focus on financial wellness

Clearly, plan sponsors are beginning to focus on financial wellness. Yet to tackle it fully requires an inventory of tools, resources, education, and marketing. Building this infrastructure to support financial literacy takes time and resources.

One action this Committee could consider is whether there are online educational resources that provide simple "how tos" and "what ifs" on topics that don't vary much from plan to plan or employer to employer. On some of these topics, the Committee may even look to outside organizations for support.

By making tools available for the topics that are relatively standard across organizations, plan sponsors can focus on the most critical aspect of a successful financial literacy campaign—motivating individuals to action and promoting these tools to help.

5. Conclusion

At Aon Hewitt, we recognize that ultimate accountability in preparing adequately for retirement falls on the shoulders of workers. Through our research we have seen what a challenging task this is for many Americans and the resulting gaps in retirement income adequacy. We also see the disparity behind the averages in terms of generation, income, gender, and race.

American workers look to their employer-sponsored programs as a primary vehicle to accumulate retirement income. Finding ways to make these programs more effective is an important avenue to improving retirement outcomes for individuals.

We are excited about the direction plan design has taken to leverage automation to get more people saving and investing effectively through the widespread adoption of target date funds and other types of professional help. That should continue. In addition, if we can enhance employer communication efforts through guidance on how investments are communicated, encouraging simple reminders, and providing a foundation that lets employers focus on motivating employees to action that will help drive outcomes.

We appreciate the opportunity to present to this Committee and offer our data, insights, and expertise to help improve retirement outcomes for the American worker.