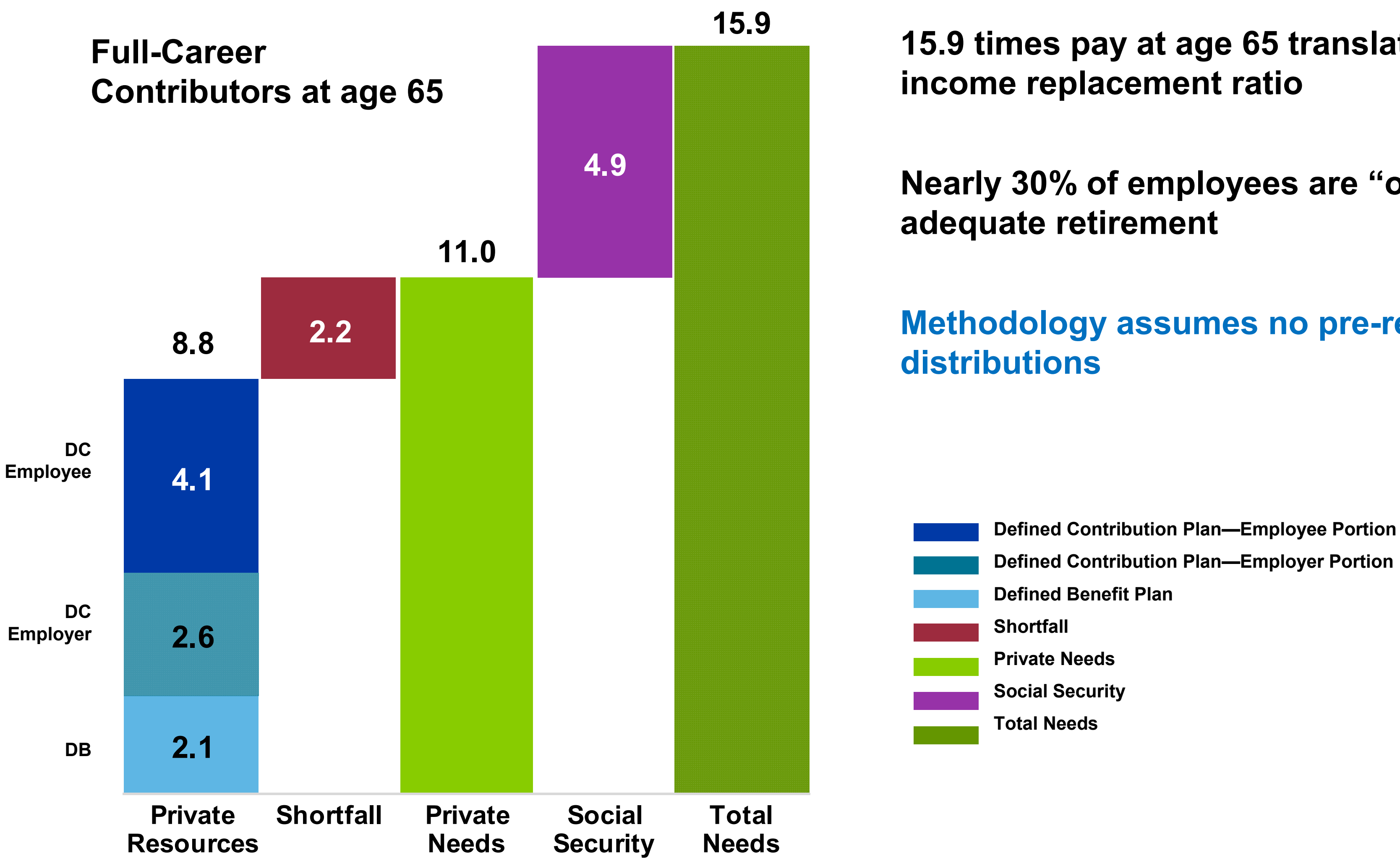
Retirement Plan Leakage—Cause For Concern And Action

Prepared by Consulting
Retirement

Presentation to ERIC

Aon Hewitt

State of Retirement: Many Employees are on a Rocky Road



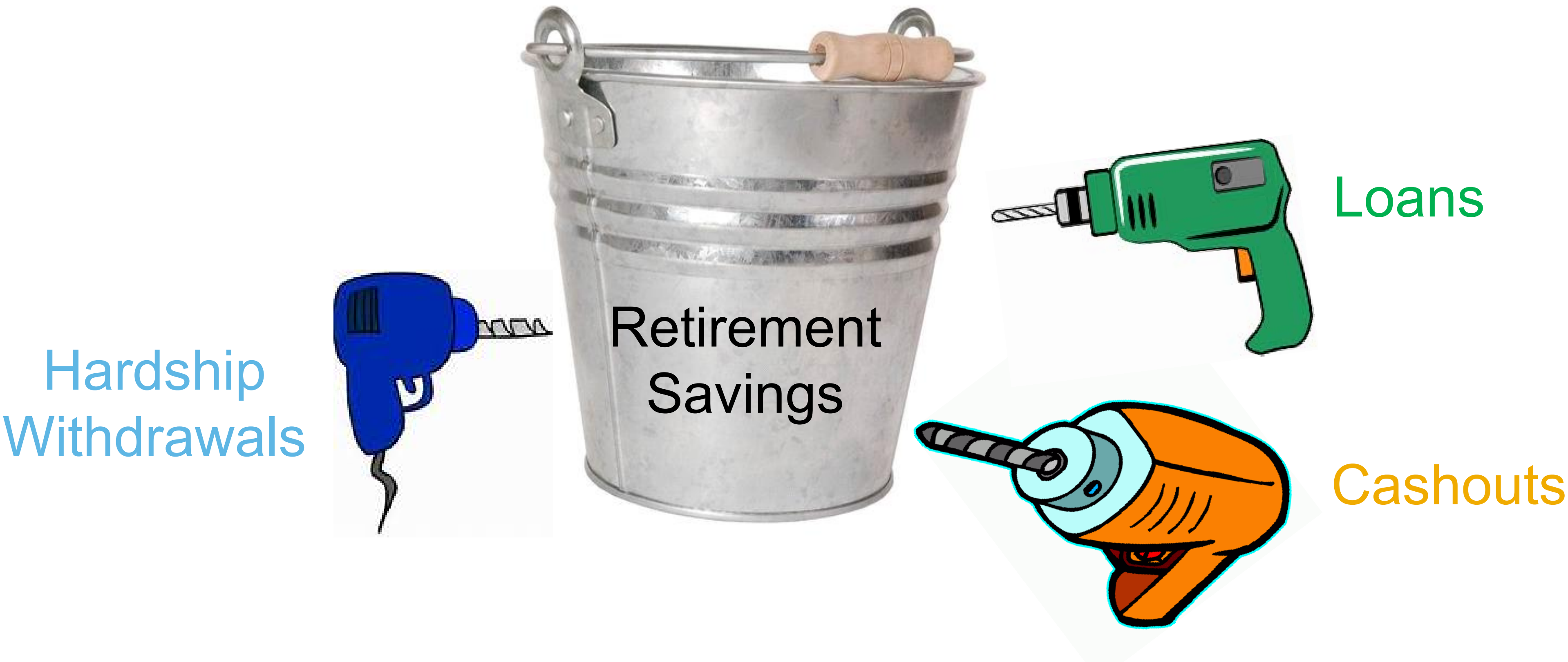
15.9 times pay at age 65 translates to 85% income replacement ratio

Nearly 30% of employees are "on track" for adequate retirement

Methodology assumes no pre-retirement distributions

Source: Aon Hewitt study *The Real Deal—2012 Retirement Income Adequacy at Large Companies*

Retirement Plan Leakage: The Pothole on the Road to Retirement



Over **25%**

of DC participants use savings for non-retirement purposes

Source: Hello Wallet study *The Retirement Breach in Defined Contribution Plans*

Retirement Plan Leakage: The Pothole on the Road to Retirement

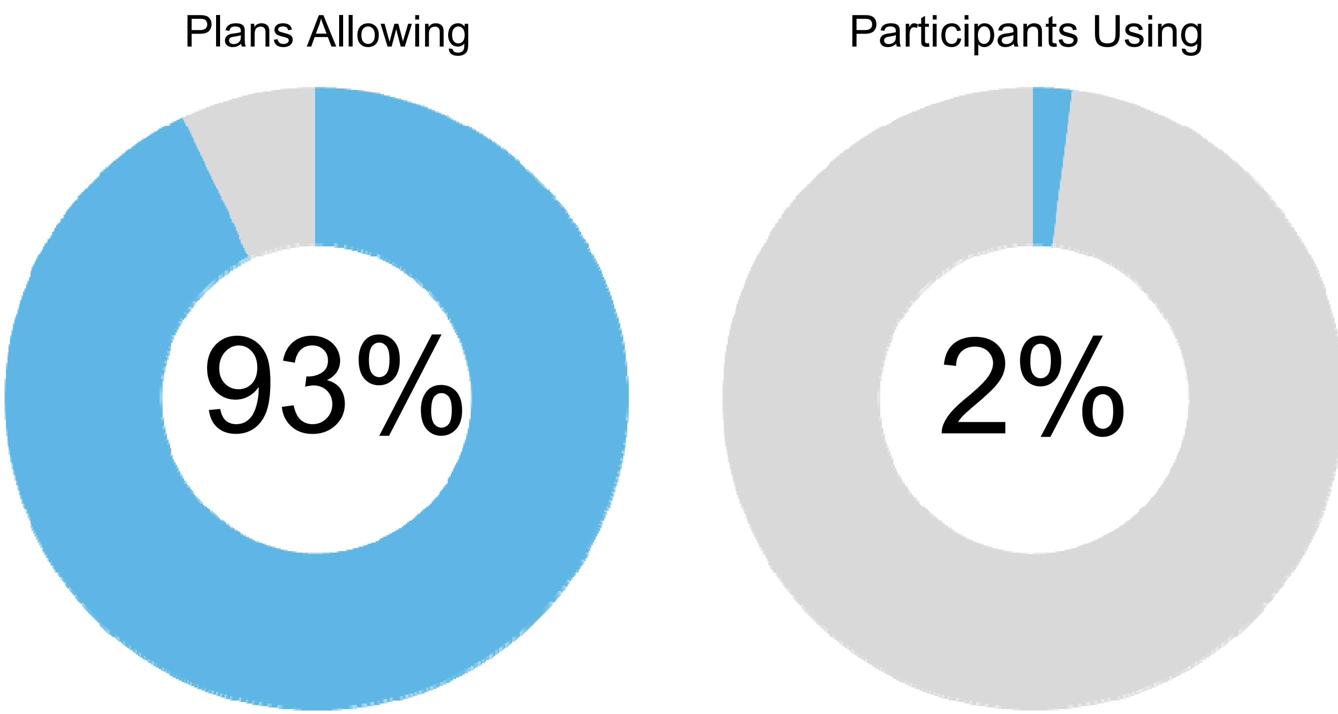
Employers contribute $118 billion every year

Employees contribute $175 billion every year

$70 billion removed for non-retirement purposes

Source: Hello Wallet study *The Retirement Breach in Defined Contribution Plans*

DC Leakage: Hardship Withdrawals

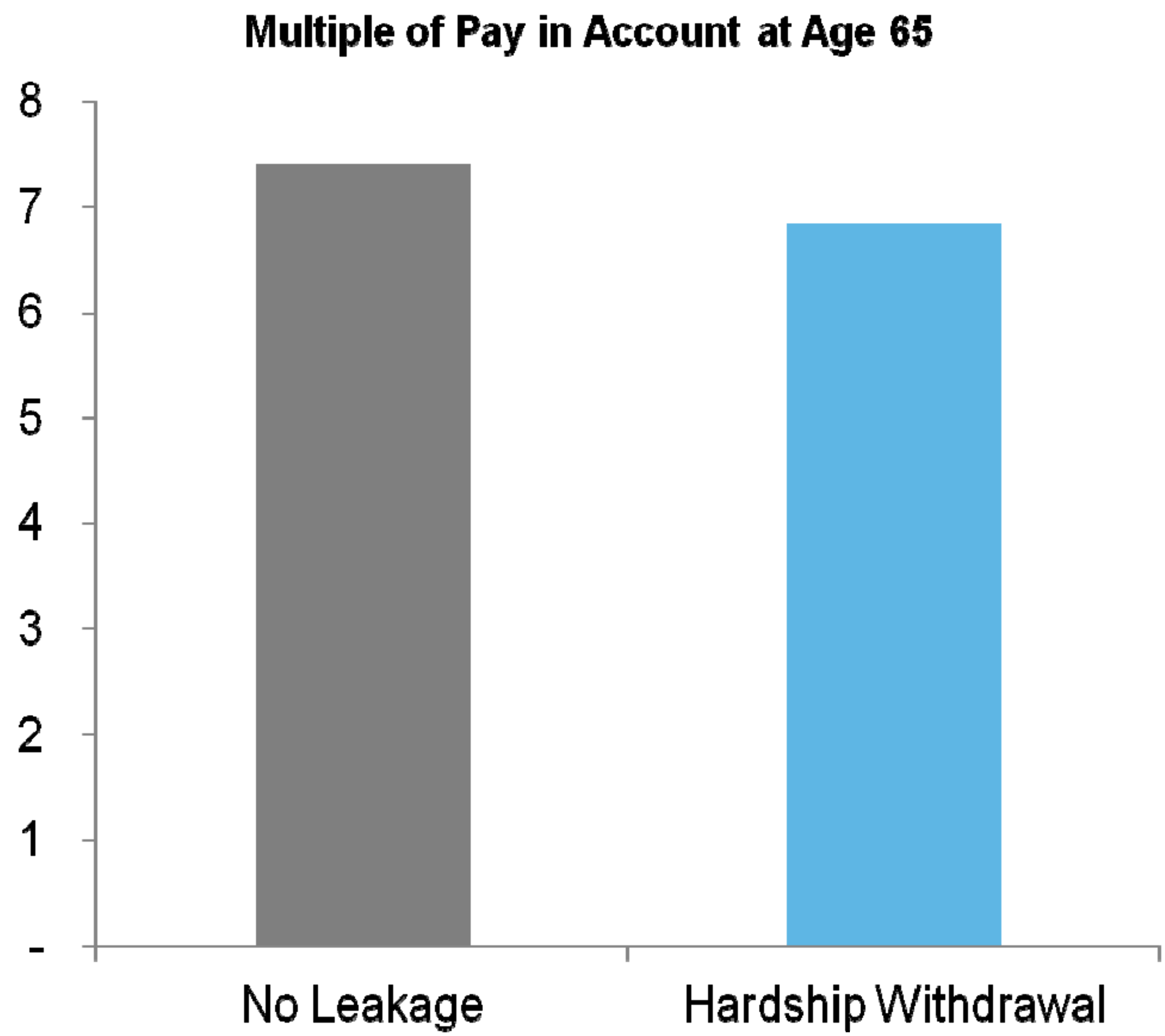


Average Hardship Withdrawal:

$5,160

Sources: Aon Hewitt study *2011 Trends and Experience in 401(k) Plans,* Aon Hewitt study *2013 Universe Benchmarks*

Sample Impact of Hardship Withdrawals on Retirement Income



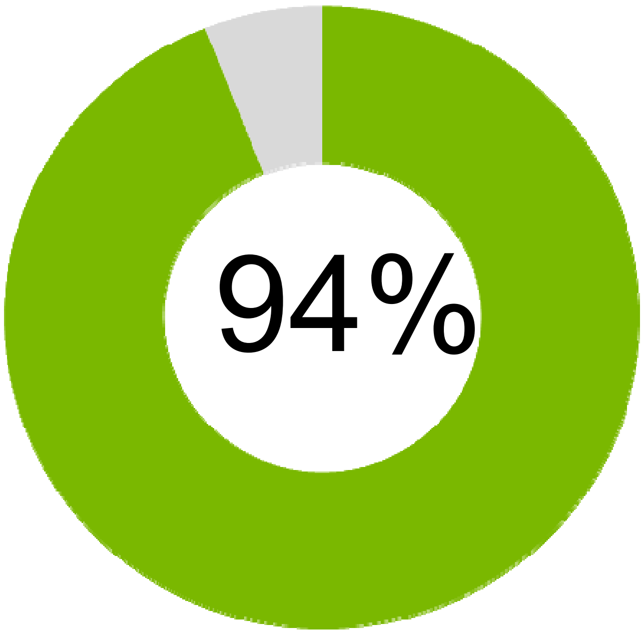
The hardship withdrawal scenario assumes the individual takes one $5,000 withdrawal at age 40 and ceases making contributions for 1 year thereafter.

The total impact reduces the age 65 account by nearly 0.5x pay.

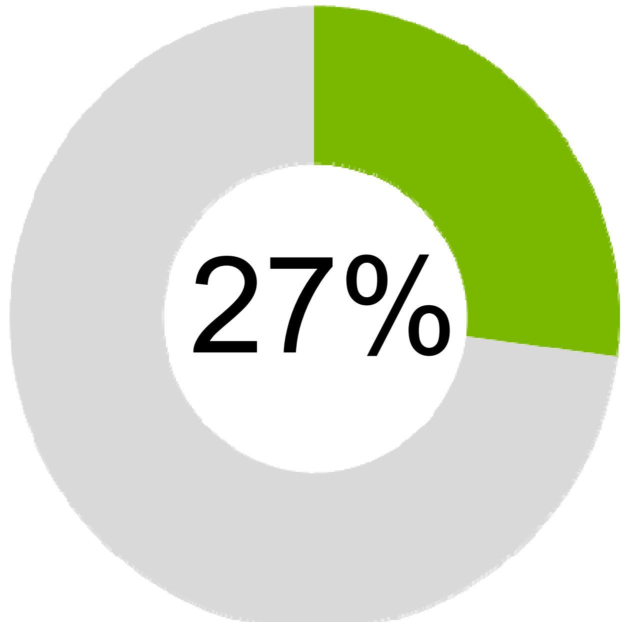
Assumptions: Individual earning $50,000 starts saving at age 30 and has total contributions to the plan (employee and employer) equal to 13% of pay. Pay grows at 3% per year and investments earn 7% per year.

DC Leakage: Loans

Plans Allowing



Participants Using



Average Loan Outstanding:

$8,074

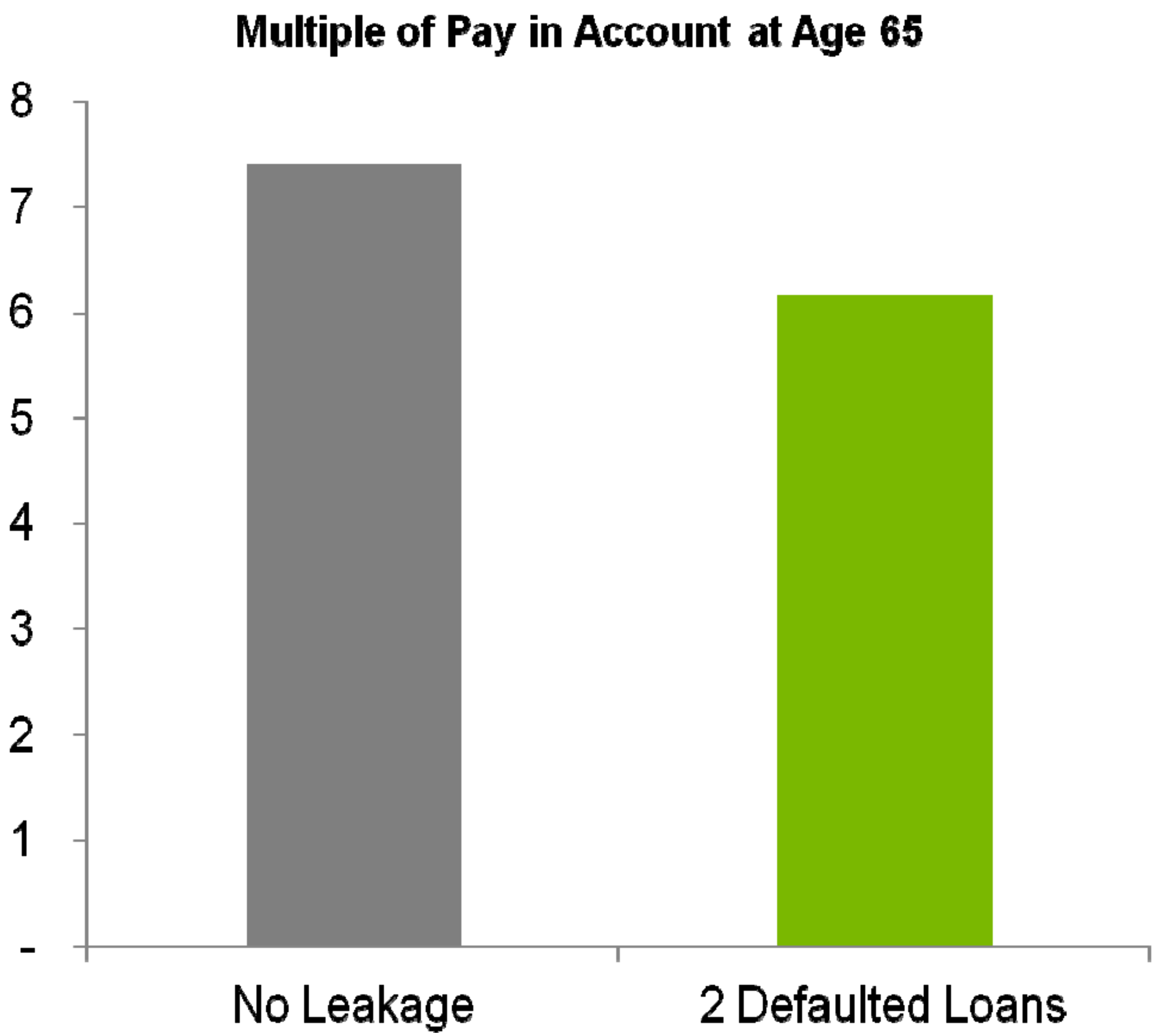
Percent of Balance:

21%

Advantages	Disadvantages
Encourages plan participation	69% of participants default when terminating
81% of participants continue contributions	Minorities are more likely to default

Sources: Aon Hewitt study *2011 Trends and Experience in 401(k) Plans,* Aon Hewitt study *2013 Universe Benchmarks,* Aon Hewitt and Ariel Investments study *401(k) Plans in Living Color,*

Sample Impact of Loans on Retirement Income



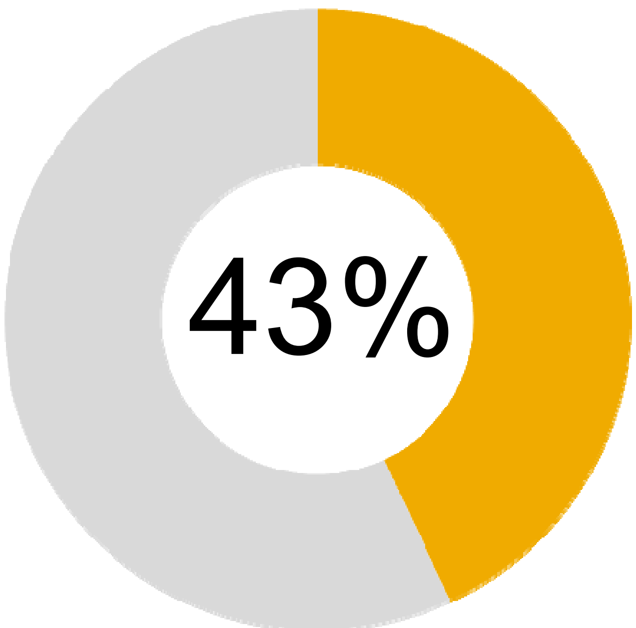
The loan default scenario assumes the individual takes one loan of $8,000 at age 40 and another loan of $8,000 at age 45. Both loans default due to termination.

The total impact reduces the age 65 account by nearly 1.25x pay.

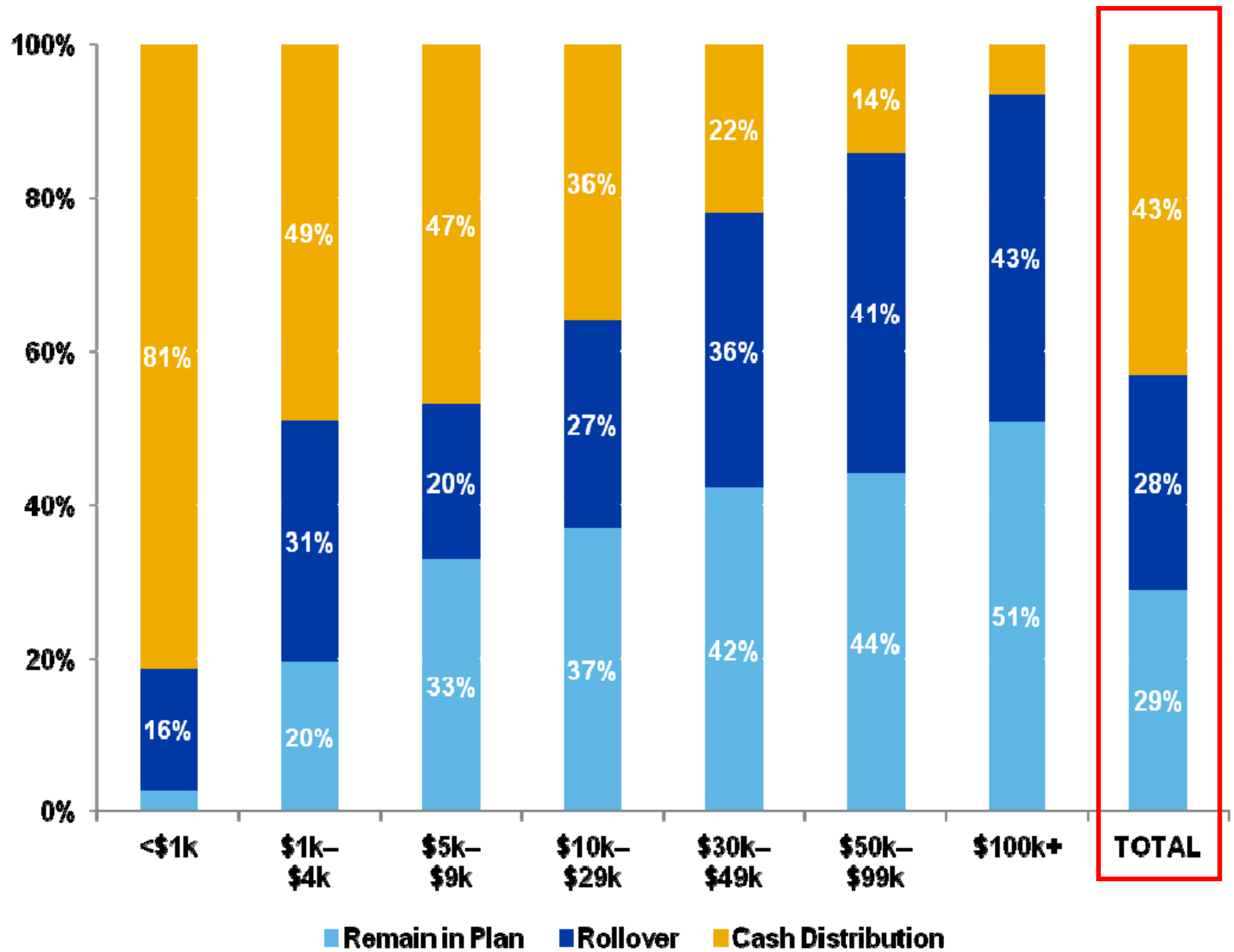
Assumptions: Individual earning $50,000 starts saving at age 30 and has total contributions to the plan (employee and employer) equal to 13% of pay. Pay grows at 3% per year and investments earn 7% per year.

DC Leakage: Cashouts

Cash Distributions from DC Plans

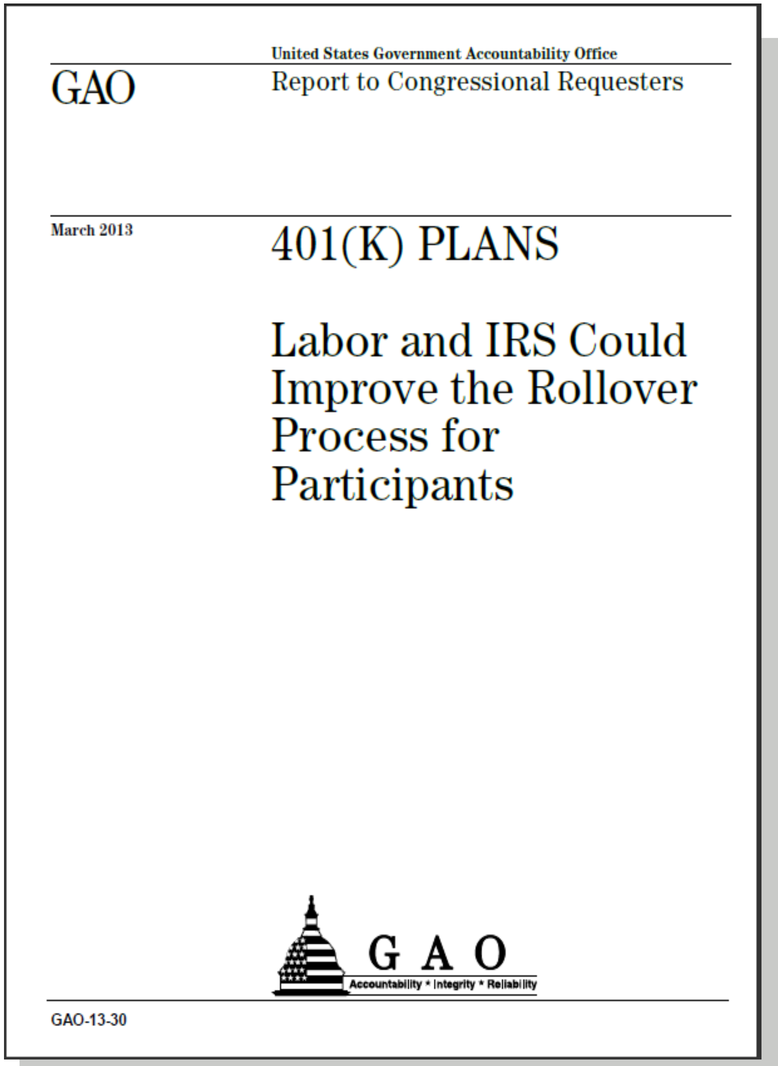


Post Termination Behavior from DC Plan Participants



Source: Aon Hewitt *2013 Universe Benchmarks*

DC Leakage: GAO Rollover Report


United States Government Accountability Office

GAO

Report to Congressional Requesters

March 2013

401(K) PLANS

Labor and IRS Could Improve the Rollover Process for Participants

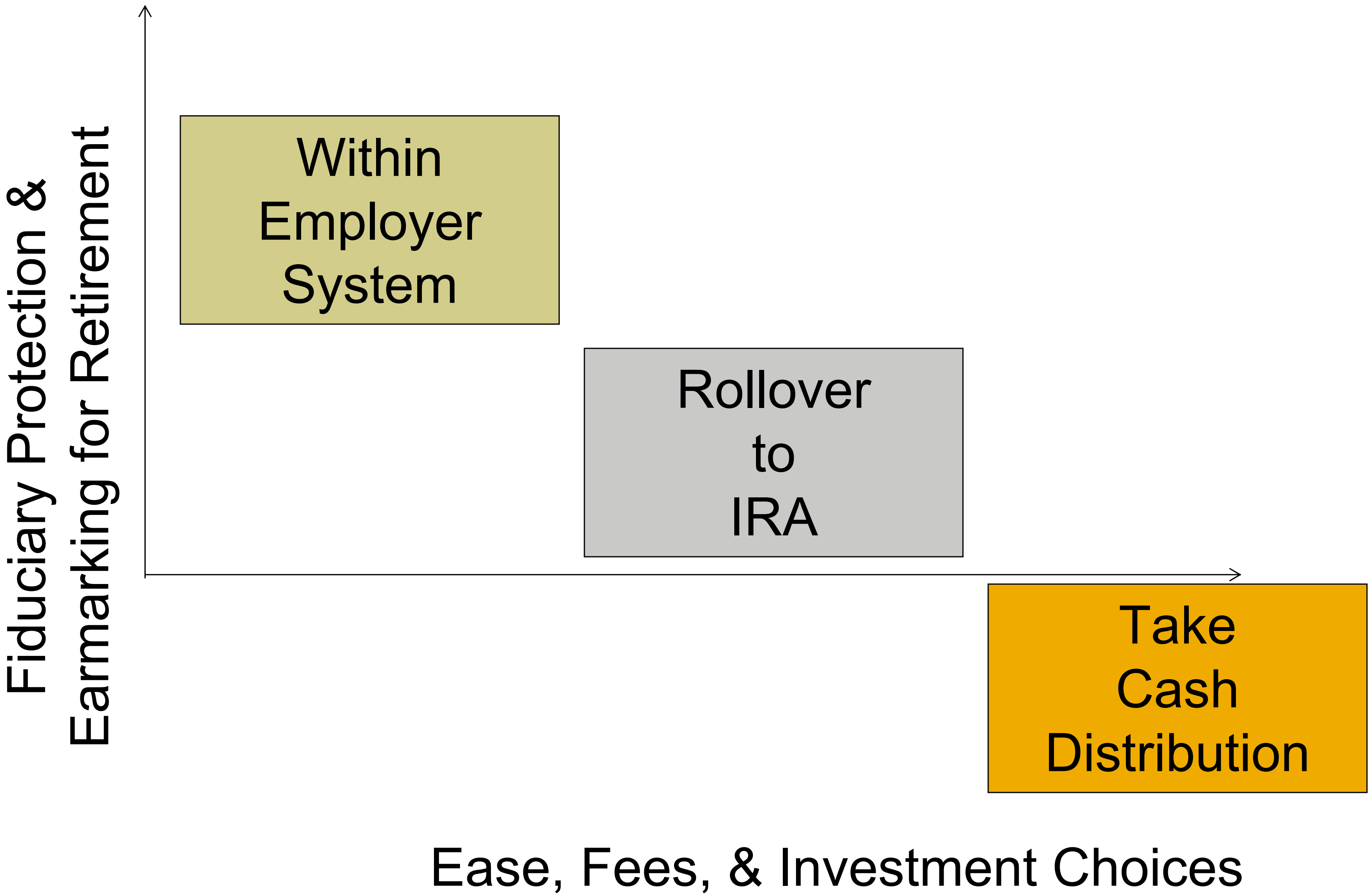
G A O

Accountability * Integrity * Reliability

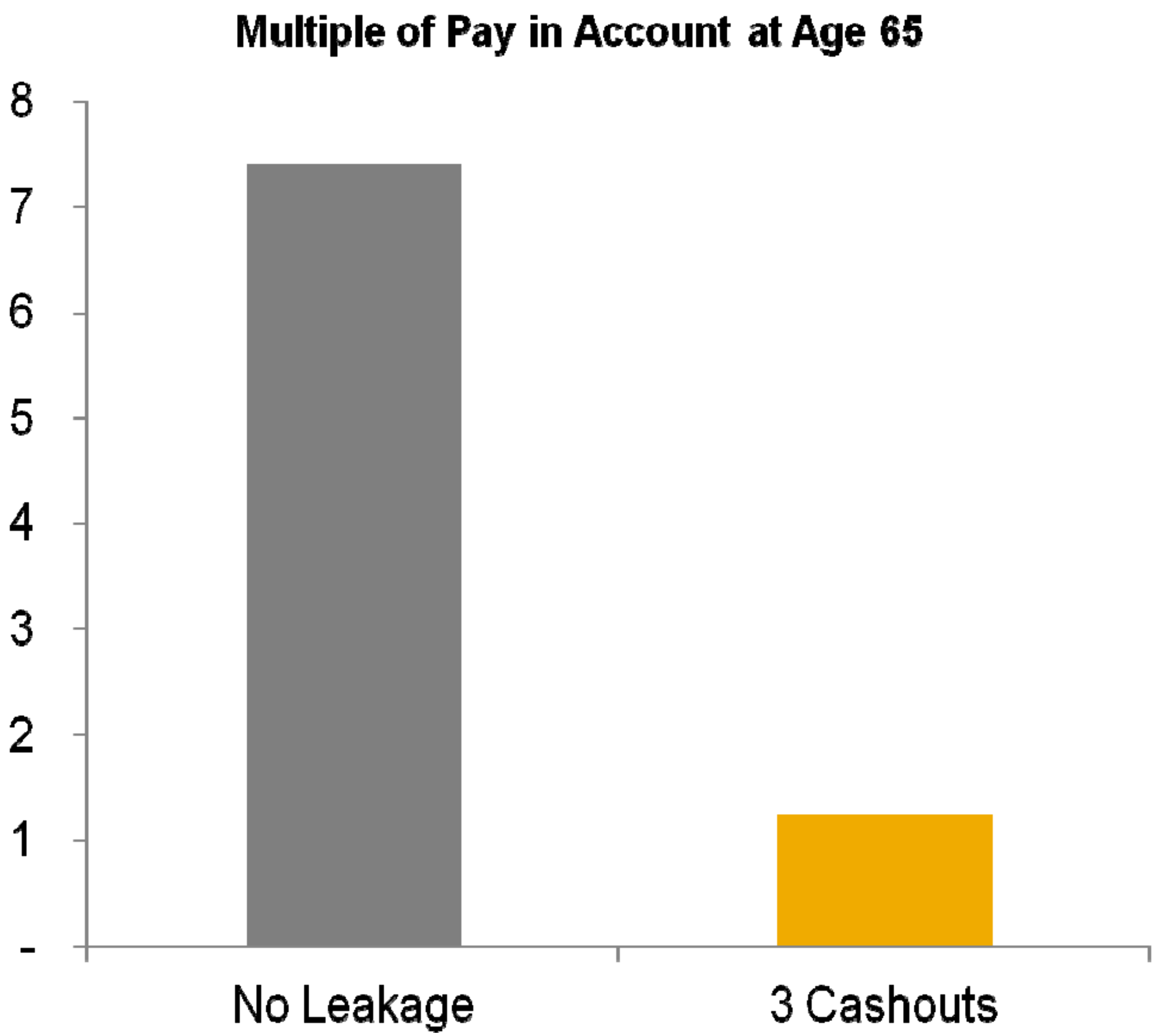
GAO-13-30

- **Finding**: Inefficient post-termination processes and IRA marketing pressures participants into often unsuitable IRAs
- **Recommendation**: DOL and IRS should encourage disclosures and activities that promote plan-to-plan rollover

Retirement Security Threat: Post-Termination Options



Sample Impact of Cashouts on Retirement Income

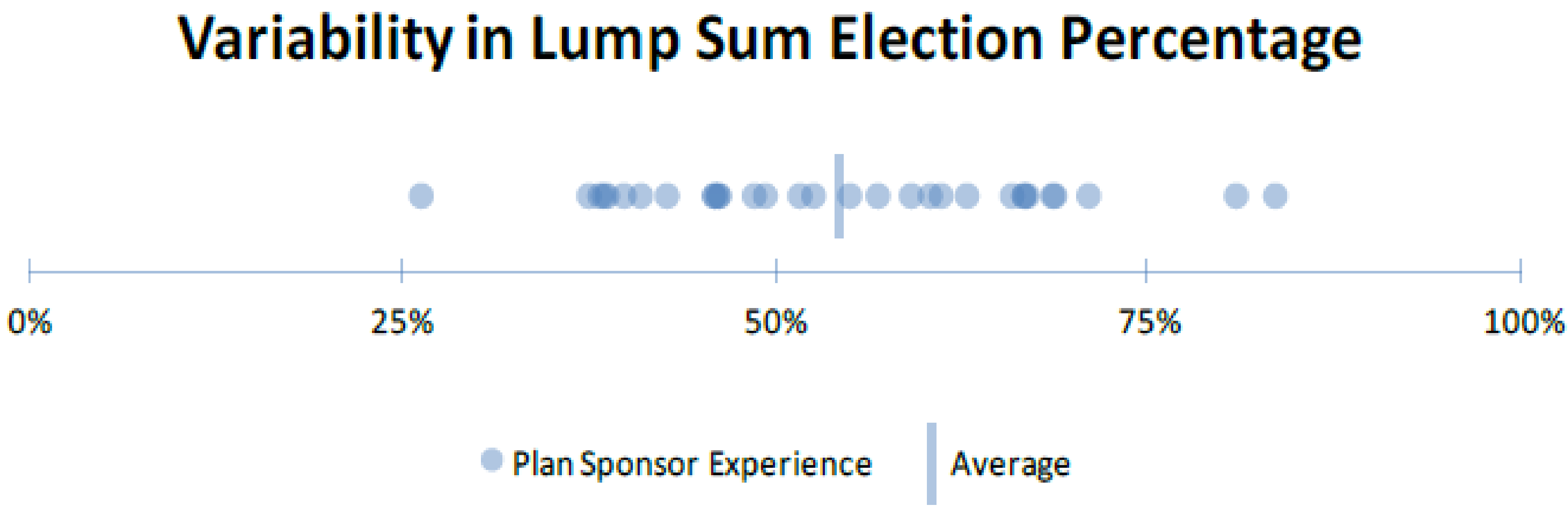


The cashout scenario assumes the participant takes a cash distribution of the retirement assets and does not earmark the money for retirement purposes. The cashouts occur at age 42, 50, and 57.

The total impact reduces the age 65 account by over 6x pay to only 1.25x pay.

Assumptions: Individual earning $50,000 starts saving at age 30 and has total contributions to the plan (employee and employer) equal to 13% of pay. Pay grows at 3% per year and investments earn 7% per year.

DB Leakage: Lump Sum Windows

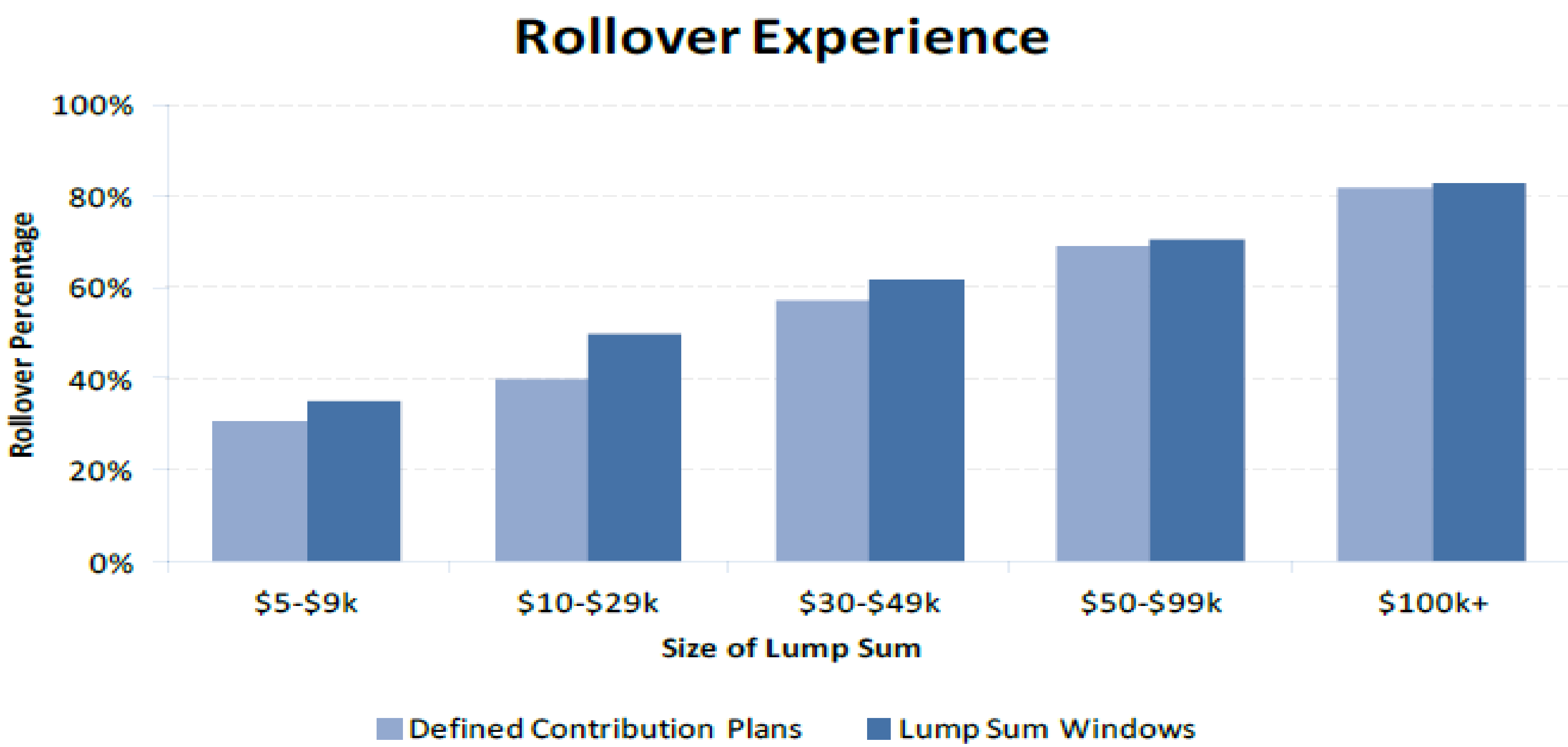


- **Average lump sum election rate of 55%**
- **Lump sum election rate is 45% when calculated on a dollar-weighted basis**
- **2013: 39% of sponsors very or somewhat likely to add or liberalize a lump sum window**

Source: Aon Hewitt study of 30 lump sum windows in 2012, see "Pension Settlements Through Terminated Vested Lump-Sum Windows" for additional information and Aon Hewitt *Hot Topics in Retirement 2013*

DB Leakage: Lump Sum Windows

- Participants with lower account balances are more likely to take a lump sum
- Younger participants, who generally have lower balances, are more likely to take lump sums



Source: Aon Hewitt study of 30 lump sum windows in 2012, see "Pension Settlements Through Terminated Vested Lump-Sum Windows" for additional information

DB Leakage: Impact of Different Variables on Lump Sum Election Percentages

Had Significant Impact

Size of Lump Sum Amount

As the lump sum increased, the election percentage decreased.

Length of Window

Ideal election period was 45-60 days. Anything less had lower election percentage.

Permanence

Plans that permanently added the feature had lower election rates (≈20%)

Follow-up Calls

Companies who made calls had 62% election vs. 45% election without calls

Had Little Impact

Gender

Females had a 2% higher election rate than males.

Age

After excluding automatic cash-outs, all ages had similar election percentages.

Union Status

Non-Union participants had a 1% higher election rate than union participants.

Pay Structure

Salaried participants had 1% higher election rate than hourly participants.

Source: Aon Hewitt study of 30 lump sum windows in 2012, see "Pension Settlements Through Terminated Vested Lump-Sum Windows" for additional information

Aon Hewitt's Thoughts on Reducing Leakage

1. Modify the availability of loans and withdrawals

2. Limit the dollars available for loans and withdrawals

3. Add waiting periods before a second loan or withdrawal can be taken

4. Support easier loan repayment following termination

5. Increase the penalty for removing money from the tax-preferred system

Aon Hewitt's Thoughts on Reducing Leakage

Allow DB sponsors to eliminate lump sum option

6

Encourage lifetime income

7

Promote the employer system

8

Simplify the rollover process

9

Educate to promote financial literacy

10

Let’s Hear From You

1. How much of a concern is leakage to plan sponsors?

2. Is the form of leakage a concern?
   - Stay in the employer plan or roll over to a new employer plan?
   - Roll over to an IRA?
   - Purchase an annuity?

3. Should DB and DC plans be treated the same from a public policy perspective?

4. Should this issue be addressed during the current tax/budget discussions in 2013?