Testimony

on Behalf of Aon Hewitt

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Before

U.S. Senate HELP Committee

“Can We Do More to Keep Savings in the Retirement System?”

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Mr. Chairman, Ranking Member Alexander and Members of the Committee, thank you for the opportunity to submit this statement for the record.

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.

As the global leader in human resources solutions, 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 Alison Borland, and I am the vice president of Retirement Solutions & Strategies at Aon Hewitt. I am honored to be addressing the Committee today to discuss retirement plan leakage and opportunities to improve the retirement security of Americans.

The employer-provided retirement system plays a critical role in helping Americans meet their financial needs. Our research of predominately large corporations shows defined contribution (DC) plans are now the primary source of retirement income for Americans at three-quarters of employers, up from 67 percent in 2009[1] and just 41 percent in 1999.[2] This has largely shifted the risk and responsibility of planning for retirement on to the shoulders of workers, which has proven to be a challenging task for many Americans.

Our research shows that only 29 percent of American workers are projected to meet 100 percent of their needs in retirement.[3] While many factors contribute to this savings shortfall, as more people rely solely on a DC plan for their employer-provided retirement income, the risk to individuals and society is growing.

Significant progress has been made to increase savings through techniques such as automatic enrollment and automatic contribution escalation. More employers are reducing fees for participants and hence, improving returns and offering solutions to improve the effectiveness of investments. Working against these efforts is leakage, or taking funds out of retirement savings prematurely. Leakage occurs in both defined benefit (DB) and DC plans, though there are increased risks in DC plans. It is undermining the efforts to help workers address the myriad challenges they face when planning for retirement. Leakage can be particularly damaging to specific segments of the population such as minorities, those who change jobs frequently and lower income workers. Leakage occurs primarily in three ways:

I. Withdrawals are taken during active employment.
II. Loans are taken out and not repaid in full.
III. Retirement savings are cashed out upon a job termination or change.

Plan sponsors have become increasingly focused on leakage and asset retention within their plans. Our data show 94 percent of plan sponsors are concerned about the use of loans, 85 percent are concerned about participants taking hardship withdrawals and three quarters are worried about participants cashing out.[4] As a result, employers are monitoring leakage behaviors. We regularly track and report these findings for our clients and actively work with them to find ways to reduce leakage. We have seen an increase in education about leakage and increased encouragement to roll dollars into qualified plans and retain dollars in plans after job termination or retirement.

Our testimony will discuss the different types of leakage and present tangible ideas about what can be done to curb it.

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[1] Aon Hewitt, *2011 Trends & Experience in Defined Contribution Plans* (Lincolnshire, IL: Aon Hewitt, 2011), 15.
[2] Aon Hewitt, *1999 Trends & Experience in 401(k) Plans* (Lincolnshire, IL: Aon Hewitt, 1999), 7.
[3] Aon Hewitt, *The Real Deal* (Lincolnshire, IL: Aon Hewitt, 2012), 6.
[4] Aon Hewitt, *Employer Perspectives on Defined Contribution Plan Leakage Survey* (Lincolnshire, IL: Aon Hewitt, 2010) 13.

I. Withdrawals

Withdrawals during active employment are of concern primarily for defined contribution (DC) plans. In-service withdrawals from defined benefit (DB) plans are allowed only in limited circumstances at or near retirement age. Withdrawing money early from a DC plan represents a permanent and irrevocable type of leakage that can significantly reduce long term savings accumulation, depending on the amount and frequency of withdrawals.

Withdrawals are permitted only under certain circumstances. The vast majority of plans (93 percent) allow hardship withdrawals, which are commonly restricted to very specific and dire needs.[5] Utilization of hardship withdrawals is low—only 2 percent of participants took a hardship withdrawal in 2012 and the reasons were sound; in 54 percent of cases, the withdrawal was taken to prevent eviction or foreclosure. Medical expenses ranked second (15 percent) and education expenses were third (13 percent). Only 18 percent of hardship withdrawals were for other reasons. The average hardship withdrawal was $5,160.[6]

Other permitted withdrawals generally include those for employees who have reached age 59.5, or those based on after-tax contributions. In some cases, employer dollars are available for withdrawal. Nearly 5 percent of active participants took a non-hardship withdrawal in 2012 and the average non-hardship withdrawal amount was $16,167.[7]

Our research shows that lower salaried participants are more likely to take hardship withdrawals than other participants. Those earning between $20,000 and $39,000 per year took hardship withdrawals at a rate of approximately 4 percent, compared to only 0.5 percent for workers earning over $100,000.[8]

Withdrawals by Salary

Salary	Percentage of Participants–Any type of Withdrawal	Percentage of Participants–Hardship Withdrawals	Percentage of Participants–Nonhardship Withdrawals
<$20,000	5.7%	1.4%	4.5%
$20,000-$39,999	8.4%	3.9%	5.0%
$40,000-$59,999	8.8%	3.2%	6.3%
$60,000-$79,999	6.4%	1.6%	5.2%
$80,000-$99,999	4.7%	0.9%	4.0%
$100,000+	3.2%	0.5%	2.8%

Columns do not add because small numbers of participants took multiple withdrawals.

When we view the issue of withdrawals through the lens of race and ethnicity, a more problematic perspective emerges. Our research shows that 9 percent of African-Americans and 3 percent of Hispanic participants initiated a hardship withdrawal during 2010, compared to just 2 percent of Whites and 1 percent of Asian-Americans. Even when contributing factors such as salary and age are held constant, African-Americans are 276 percent more likely and Hispanics are 47 percent more likely to take hardship withdrawals than Whites.[9]

[5] Aon Hewitt, *2011 Trends and Experience in Defined Contribution Plans,* 76.
[6] Aon Hewitt, 2013 *Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2013).
[7] Ibid.
[8] Ibid.
[9] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color* (Chicago, IL: Aon Hewitt/Ariel Investments, 2012), 11.

Gender within ethnic and racial groups also significantly impacts the likelihood of hardship withdrawals. Middle-income African-American women (those earning $30,000 to $60,000) are more likely to take a withdrawal than their male counterparts. Approximately 14 percent of African-American women in this group took withdrawals, compared to 9 percent of African-American males in this income level. Our survey shows that half of African-American women took loans to pay for unexpected emergencies, 30 percent for day-to-day living expenses and 28 percent to pay off debt. African-American men cited similar reasons.[10]

While the fact that the percentage of participants who are in dire financial straits is troubling, hardship withdrawals are not being abused today and remain a better alternative than eviction or foreclosure. Other withdrawals are unusual outside of those employees nearing retirement, which could be part of a phased retirement approach and those using after-tax savings in their plans. Withdrawals should be monitored and managed, especially for groups at greater risk, but should remain an important resource to employees in need. Our clients are closely watching trends in hardship and other withdrawals, and taking action to address the volume when appropriate. In some cases, this means changing the eligible reasons for a withdrawal. In others, it could be communication reinforcing the importance of avoiding withdrawals.

II. Loans

Loans are widely available in DC plans and are used frequently. They are not available in DB plans. Our data show that 94 percent of DC plans provide access to loans.[11] Standard repayment terms are five years, though 82 percent of plans also offer a loan strictly for a home purchase with a repayment term of between 10 and 30 years. Loans are generally available up to the smaller of $50,000 or 50 percent of the worker's total plan balance. In 2012, 27 percent of participants had at least one loan outstanding.[12] The average loan amount outstanding was $8,074, representing about 21 percent of participants' total account balance.[13]

To the extent that loans are repaid in full and participants continue to contribute money to the plan while they repay the loan, there is little impact on long-term financial security. Our research shows that in 2012, 81 percent of participants with outstanding loans continued to make contributions while repaying the loan via payroll deductions.[14] In this way, participants can access savings dollars while still benefiting from the employer match and continuing to accumulate retirement savings.

The primary risk to retirement security occurs when participants default on loans, which almost always follows termination of employment, not during active employment. The vast majority of plans require that if an outstanding loan is not repaid within 60 days, it is treated as a distribution, resulting in taxes and possible penalties that create a permanent loss—a leakage—from participants' retirement savings, in addition to a higher tax bill for that year. Nearly 69 percent of participants with loans who terminate employment default on the repayment following termination of employment.[15]

As with hardship withdrawals, minorities take loans at a higher rate and are more likely to default on their loans, creating greater risk for permanent loss of their retirement savings. Our data shows that almost half (49 percent) of African-Americans and 40 percent of Hispanics have outstanding loans, compared to 26 percent of Whites and 22 percent of Asian-Americans.[16] This disparity remains persistent across all income levels.

In our opinion, loans play an important role because they attract participants who may not otherwise contribute. This is especially true among minorities, where more than a third (34 percent) of African-Americans and 29 percent of Hispanics say the ability to take loans from their plans if they need the

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[10] Ibid., 12.
[11] Aon Hewitt, *2011 Trends and Experience in Defined Contribution Plans*, 81.
[12] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color*, 12.
[13] Aon Hewitt, *2013 Universe Benchmarks*.
[14] Ibid.
[15] Ibid.
[16] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color,* 12.

money is a “strong” influence on their decision to invest in a DC plan, compared to 17 percent of Asian-Americans and 13 percent of Whites.[17] Furthermore, loans enable participants—who continue to work—to access credit, possibly at lower interest rates than what they might receive from other sources, without permanently reducing financial security by missing employer matching contributions, or even worse, taking a withdrawal. The key to curbing leakage due to loans is to reduce defaults. Plan sponsors are closely monitoring loan activity, and some have taken action to reduce the number of loans. Examples include updating education and communication and providing it at point of need, adding a loan fee as a deterrent and reducing the number of loans available. We have not seen plan sponsors eliminating the loan provision.

III. Cash Outs

Cashing out of a retirement account occurs when plan participants take a full distribution from their plan, incurring tax liability and, depending on age, an additional 10 percent penalty. Cash outs are available from DC plans upon termination of employment and from DB plans when lump sums are available after termination of employment or retirement. Cash outs often represent a complete and total eradication of retirement savings and are the biggest threat to American’s retirement security when it comes to leakage due to high availability and utilization.

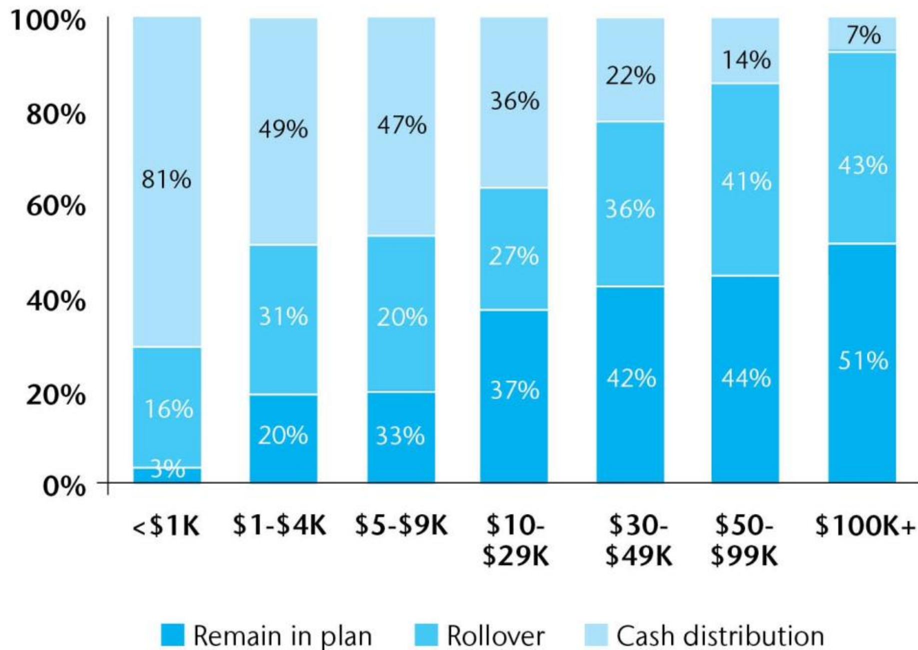
Cash Outs in Defined Contribution Plans

Among participants who terminated employment in 2012, 43 percent took a cash distribution.[18]

Participants with lower account balances are much more likely to cash out, so the 43 percent (above) can be misleading. Fully 81 percent of participants with less than $1,000 in the plan cashed out and 49 percent of those with balances between $1,000 and $5,000 did so.[19] However, only 7 percent of balances of more than $100,000 were cashed out.[20] The larger the balance, the more likely the dollars are to remain in the plan. Rollovers also increase with balance, though more gradually than the amounts remaining in the plan. It is worth noting that the plans in our database are large and benefit from significant scale, so participants with large balances are likely to recognize the value of lower fees, explaining the tendency to remain in the plan.

[17] Ibid. 12.
[18] Aon Hewitt, 2013 Universe Benchmarks.
[19] Ibid.
[20] Ibid.

Post-termination behavior by participants' plan balance is summarized in the table below:



Again, minorities are at a higher risk of leakage from cash outs. Upon termination, 63 percent of African-Americans and 57 percent of Hispanics cashed out their retirement plans, compared to 39 percent of Whites and 34 percent of Asian-American participants.[21] In terms of assets, African-Americans cashed out 19 percent of assets and Hispanics cashed out 17 percent, compared to just 7 percent of assets for Asian-Americans and only 6 percent of assets for Whites.[22]

Even when looking across ranges of account balances, we saw that the tendency to cash out remained markedly higher for African-Americans and Hispanics. Nearly three in 10 African-American participants with more than $100,000 in account balances cashed out their plans upon termination, compared to 16 percent of Hispanics, 15 percent of Whites and 11 percent of Asian-Americans.[23]

[21] Aon Hewitt, Ariel Investments, *401(k) Plans in Living Color,* 14.
[22] Ibid., 14.
[23] Ibid., 15.

Cash-out Rate for 2010 by Account Balance

Account Balance	African-American	Asian-American	Hispanic	White
$1,000-$2,499	18%	15%	21%	9%
$2,500-$4,999	28%	4%	23%	12%
$5,000-$7,499	38%	17%	26%	16%
$7,500-$9,999	31%	8%	30%	13%
$10,000-$19,999	30%	6%	16%	12%
$20,000-$39,999	34%	7%	26%	12%
$40,000-$69,999	21%	12%	29%	13%
$70,000-$99,999	35%	2%	20%	14%
$100,000+	29%	11%	16%	15%

Source: Aon Hewitt/Ariel Investments, *401(k) Plans in Living Color,* 2012. The findings are based on year-end 2010 information from 60 of the largest U.S. organizations across a variety of industries and sectors. The data represents 2.4 million participants.

The threat to participants' financial security from cashing out can be significant, as illustrated in the example below. While very large balances are less likely to cash out, many workers change jobs throughout their career, with a low account balance each time. The accumulated impact of these potential cash outs can be devastating to long-term financial security.

Example of Cash Out Effects
Consider the impact of three cash outs on a worker who saves for 30 years and retires at age 65. Let's assume she saves 8 percent of pay before tax per year, receives a match of 5 percent of pay per year, earns 3 percent annual salary increases on a starting salary of $50,000, and earns 7 percent in investment return per year.

After factoring in taxes, penalties, and lost interest, if the individual cashed out benefits each time, she would accumulate only $189,000 in her account by age 65, whereas, had she kept the money in the plan, she would have $872,000 in her account at age 65. Cash outs, the largest of which was just over $60,000 after taxes and penalties, cost this individual almost 80 percent of her ultimate nest egg.

In our experience, cash outs from DC plans receive the least attention and focus from plan sponsors compared to loans and withdrawals. While providers do include ample communication and education throughout the experience to discourage cash outs, there are few specific initiatives and changes occurring specifically targeting cash out behavior. Because terminated employees no longer have the relationship with the plan sponsor, plan sponsors are generally less likely to invest time and money in helping them preserve their financial security. Where we do see activity that can help curb cash outs is from the new employers. Plan sponsors are increasingly interested in encouraging participants to "cash in" their prior plan balance by rolling the money into the new employer's plan.

Cash Outs in Defined Benefit Plans
Leakage through cashing out is also a threat for participants with DB plan benefits and the risk is growing as plan sponsors consider adding or expanding lump sum opportunities for participants.

According to the Employee Benefit Research Institute about 73 percent of retirement-aged people take the lump sum option when it is offered.[24] According to our 2012 recordkeeping data, more than half (56 percent) of lump sum payments were cashed out, with the remaining lump sums rolled into another tax deferred vehicle. We see a similar trend with respect to the lump sum value as we see with DC plans, with lower amounts being cashed out at much higher rates than larger amounts. The average size cash out from a pension plan in 2012 was about $14,000, compared to the average rollover of almost $47,000. Once again, the larger the balance, the more likely the participant is to remain in the tax-preferred system.

Lump sum windows also continue to grow in popularity. This option provides a brief period of time, usually 60 days, during which terminated participants can elect a lump sum pension payout that would otherwise not be available. These windows are most often limited to terminated vested participants who leave the organization for another job, though in certain cases plan sponsors are considering offering lump sum payments to retirees already in payment status. Nearly four in 10 (39 percent) of companies reported that they are “very likely” or “somewhat likely” to add or liberalize lump sum options through a window approach in 2013.[25] When this option is offered to participants, our research shows the average lump sum election rate is 55 percent, with the alternative being retention of an annuity form of payment.[26]

We see little additional effort to specifically target cash out behavior in DB plans. However, for plans that offer lump sum windows, we are working with many plan sponsors to provide online help, communications and special call center support designed to help participants make informed, smart decisions about their distribution.

While most conversations and research on leakage focus on DC plans, leakage does and has always occurred from defined benefit plans as well. Any efforts to curb leakage should consider possibilities for both.

IV. Recommendations to Decrease Leakage

Leakage is, without question, eroding the financial security of American workers. At the same time, providing workers with access to funds in certain situations is a benefit that encourages more robust plan participation. To provide some perspective, based on a sample of DC plans totaling about $300 billion in assets, the amounts contributed to plans in 2011 totaled about five times the amount that leaked out. While savings plans are growing and significant assets are being accumulated, a careful balance is required.

Ideas that would decrease abusive leakage while retaining the needed balance are as follows:

Modify the availability of loans and withdrawals. There is room to restrict access to certain funds while retaining sufficient flexibility and access for workers. For example, loans and withdrawals could be permitted only on employee savings, not employer contributions. Or, loans and withdrawals could be available only upon documentation of need, similar to hardship requirements today.

Limit dollars available for loans and withdrawals. While the average loans and withdrawals are relatively small compared to limits in place, reducing the maximum allowable amounts would eliminate some of the largest loans and withdrawals.

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[24] Banerjee, Sudipto, *Annuity and Lump-Sum Decisions in Defined Benefit Plans* (Washington, D.C.: EBRI, January 2013)1.
[25] Aon Hewitt, *2013 Hot Topics in Retirement* (Lincolnshire, IL: Aon Hewitt, 2013), 10.
[26] Aon Hewitt, *Pension,* 2.

Add waiting periods. To discourage repeat borrowers, incorporate a 12 month waiting period before participants can take a loan following repayment of the prior loan and consider a similar waiting period for hardship withdrawals. This will add another deterrent before workers request the distribution.

Enable easier repayment following termination. Most employers currently do not accept loan repayments after employment termination because payroll deductions can no longer be made. To solve this problem, participants could be allowed to continue to make payments through the term of the loan from personal accounts. This is allowable today through employer action. Additional flexibility could be considered for involuntary terminations.

Increase the penalty for withdrawing money from the tax-preferred system. Unless participants receiving a lump sum from a DC or DB plan keep their money within the retirement system by leaving it in the plan, or roll those dollars into other DC plans or IRAs until retirement eligibility, they would incur an increased tax penalty of 15 percent or more. There could be exceptions to this penalty provided only for hardship or other dire need. A variation could be to apply this concept only to employer funded amounts.

Allow defined benefit plan sponsors to eliminate lump sum options. Under today's legislative structure, the lump sum form of payment is protected and cannot be eliminated. Ironically, only for certain plans that fall below the funded threshold, lump sum payments are limited or eliminated altogether. Other sponsors do not have this flexibility. In spite of the increasing prevalence of lump sum payments and windows, some plan sponsors might be interested in eliminating the lump sum option, if permitted. In fact, more plan sponsors might consider such an approach in exchange for increased funding flexibility or decreased PBGC premiums.

Encourage lifetime income. Whether from a DB plan, DC plan, or annuity, steady lifetime income provides increased security by mitigating risks such as investment risk and longevity risk. By encouraging solutions offering lifetime income within employer plans, to both plan sponsors and workers, you will promote financial security and reduce leakage.

Promote the employer system. While in a qualified employer plan, participants often benefit from lower prices, professional investment management, tools and education, advice and fiduciary protections.

By educating workers about the benefit of retaining dollars in their employer plan after employment termination and/or encouraging rollovers into employer plans and by combating contrary marketing messages, we will reduce leakage that results from higher retail fees and biased advice that can occur when participants move money outside of the qualified plan system. Critical to this effort is simplifying the process of rolling dollars from one qualified plan to another, or from IRAs into qualified plans. For example, regulators have an opportunity to streamline the process by reducing the paper and certification required.

Provide education and resources. As many employers are already doing today, providing education and promoting financial literacy can, over time, make a positive and significant impact on leakage.

V. Conclusion

Employer retirement plans play a key and necessary role in the financial security of American workers. Plan sponsors, legislators and regulators have the opportunity to take actions that can help Americans achieve an adequate, financially secure retirement by strengthening these plans and programs for those who have them and offering alternatives for those who do not. Reducing unnecessary leakage from withdrawals, loans and cash outs is a critical part of these efforts— regardless of the plan design—and can especially make an impact for minorities who face an increased risk.

We appreciate the opportunity to share our recommendations with the Committee and are pleased to offer our data, resources and expertise to continue efforts that will help improve retirement security for all Americans. Thank you.