Research Highlights:

How Well Are Employees Saving and Investing in 401(k) Plans

2009 Hewitt Universe Benchmarks
Research Highlights

2008 was a year with rapid changes in the 401(k) legislative and regulatory environment. It was also marked with record losses in the stock market. How did 401(k) participants react to the changes? The analysis below illustrates that most participants’ savings and investing behavior remained unchanged.

**Quality of Participation**

Despite the unprecedented financial crisis in 2008, the participation rates in 401(k) plans remained flat at 74 percent in 2008. Although nearly five percent of savers dropped out during the year, many new hires enrolled into a 401(k) plan due to the prevalence of automatic enrollment, which offset the decline.

The participation rates of younger, lower-tenured, and lower-salaried workers continued to steadily increase (since 2005), due to the higher adoption of automatic enrollment. However, the participation rates of these workers are well below the universe average in 2008.

Contribution rates for active participants declined only marginally throughout 2008, from 7.7 percent to 7.4 percent of pay, on average. The small decline was attributable to some workers decreasing their rates, as well as the influx of new participants through automatic enrollment at lower savings rates. Younger participants were most likely to stop contributing or decrease their contribution rates.

Total contributions into defined contribution plans, including employee and employer contributions, comprised nearly 11 percent of pay, 3.7 percent coming from employer contributions during the year.

As the Roth 401(k) became a more popular feature in 401(k) plans, nearly eight percent of active participants contributed to a Roth 401(k) when available. Younger, lower-tenured, and male participants were more likely to utilize the option.

**Plan Balances**

The market losses in 2008 had a substantial impact on participants’ retirement assets. The average 401(k) participant’s total plan balance was $57,150 at the end of 2008, declining from $79,570 in 2007. Those aged 30 to 50 experienced the largest decline. Comparatively, participants in their 20s had relatively smaller balance deterioration, due to the more conservative nature of their portfolios, as well as the relatively bigger impact of new contributions.

As for investment returns, the median rate of return earned by participants was -28.3 percent across the universe in 2008 (the S&P 500 Index lost 37 percent). For the year, 44 percent of participants had a return lower than -30 percent. Another quarter had a return between -20 to -30 percent. Only 11 percent of savers were able to break even or achieve a positive return during the year. Again, those aged 30 to 50 had lower balances.
investment returns (median loss of -30 percent), due to the group’s larger equity allocation compared to other age groups. However, even for more conservative older participants near retirement age, their assets were largely impacted by the market last year. More than half of those participants over 60 experienced investment losses of more than 20 percent.

**Investment Behavior**

Participant asset allocation changed throughout the year due to both inaction and action. Two views of asset allocation are reviewed—equally weighted by participant, and asset-weighted. Both show substantial changes. While overall equity exposure declined substantially, use of premixed portfolios increased and company stock exposure decreased.

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<th>Key Findings:</th>
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<td>■ Three largest asset class exposures equally weighted were: Premixed portfolios (23.0 percent), GIC/Stable Value (20.4 percent) and Large U.S. Equity (15.9 percent). Company stock allocation declined to only 10.1 percent.</td>
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<td>■ Participants’ average equity allocation declined by 8.7 percent to 59 percent at year-end.</td>
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<td>■ When available, 49.6 percent of participants invested in a premixed portfolio. Quality of usage also improved with over one-third of these participants fully invested in a single portfolio. Target-date portfolios were more likely to be used as a turn-key solution than target-risk.</td>
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The equally weighted asset allocation illustrates continued shifts in asset class weightings. In 2005, the top three asset class holdings among participants were company stock, large U.S. equity, and GIC/stable value, each comprising over 20 percent of assets, on average. By comparison, in 2008, company stock dropped dramatically and premixed portfolios moved into the top three. The average allocation to company stock across the entire universe was only 10.1 percent by the end of 2008, which was a major drop, nearly 12 percent, in just three years.

The changes in asset weighted allocations were largely influenced by participants with larger assets. At the end of 2008, the holdings in GIC/stable value and bonds were up 11 percent and four percent from 2007, respectively. The largest decline appeared in international equities.

Overall, participants’ average equity allocation declined significantly, by 8.7 percent, to 59.0 percent at the end of 2008. The decline was mainly due to the loss of value in equities; however, transfers were also a factor. On average, workers in their 20s continued to invest more conservatively with fewer assets in equities than those in their 30s and 40s. Participants over the age of 50 had the largest decline in equities.

Allocations in premixed portfolios have grown due to the increase in prevalence, as well as the use of funds as investment defaults under automatic enrollment. By the end of 2008, the average participant allocated 23 percent of assets to premixed portfolios, which represented the largest holding among all asset classes. Half of participants invested in a premixed portfolio when available in the plan, an increase of 9.3 percent from 2005. Younger and lower-tenured participants were most likely to use premixed portfolios, and also experienced the largest increases in usage due mostly to the impact of automation.

The quality of usage within premixed portfolios has continued to improve. By year-end, 34.9 percent of participants who held premixed portfolios invested their entire balance in one portfolio, an increase of 15 percent from 2005. Target-date funds were used more often as a turnkey solution than target-risk funds.

**Account Activity**

While market volatility was at record levels, throughout 2008 only 19.6 percent of participants made any sort of fund transfer. This is up only marginally from 2007. However, when transfers were made by participants, the volumes were significantly larger than historical levels, which imply participants were moving larger portions of their balances.
In 2008, 23.1 percent of active participants had a loan outstanding, which has remained consistent since 2000. Middle-aged and middle-income participants were most likely to have outstanding loans. Participants taking loans, on average, had slightly lower contribution rates than participants who did not.

During 2008, 5.9 percent of participants took a withdrawal, which was slightly higher than that of previous years. In terms of the number of withdrawals, hardship withdrawals were up by 18 percent from last year.

**Conclusion**

Despite the significant decline in the stock market during 2008, most participants did not change their saving and investment behavior throughout the year. Overall participant rates across the universe remained flat from last year. Contribution rates declined slightly. Only one in five participants made a transfer in 2008, similar to last year. There was an increase in overall withdrawals, and specifically hardship withdrawals, but little change in loans.

The increasing prevalence of automatic enrollment proves to be increasing participation rates among younger, lower-tenured, and lower-paid workers. The use of premixed portfolios is also increasing at a rapid rate, and the quality of usage has improved.

However, the market decline in 2008 did result in a significant drop in participants’ average plan balances and equity allocation. For those who did trade, the direction of the transfers was away from equities and toward fixed income investments.

To assist participants through this difficult time and get better prepared for retirement, consider the following:

- **Continue to use automatic tools in tandem with more robust defaults.**
  - Automatic enrollment, with contribution escalation and target-date portfolios is a strong combination.
  - Default participants at contribution levels equal to or greater than the employer-match rate to ensure better outcomes.

- **Have a dialogue with employees—utilize different communication techniques:**
  - Targeted messages, more personalized, can impact low-savers.
  - Adjust messaging to reflect diversity of population, not all participants are the “average.”

- **Remind participants of the need to have an investment plan.**
  - Default participants to simplified tools such as target-date or managed accounts.
  - For “do-it-yourselfers,” reminders of tools available to support them such as guidance, advice, and automatic rebalancing.

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**Key Findings:**

- 19.6 percent of participants made a fund transfer during the year. Higher salary, higher balance, and male participants were more likely to make a trade.
- 23.1 percent of active participants had a loan outstanding, consistent with previous years.
- 5.9 percent of participants took a withdrawal in 2008. While a smaller piece of total withdrawals, hardship withdrawals were up 18 percent.