

RESEARCH HIGHLIGHTS: How Well Are Employees Saving and Investing in 401(k) Plans 2005 Universe Benchmarks

For more and more employees of large companies, the defined contribution plan is either the main or the only employer-sponsored retirement vehicle. Indeed, in Hewitt's 2005 *Trends and Experience in 401(k) Plans* survey, 64 percent of plan sponsors stated that the 401(k) plan is their primary retirement vehicle, which was up from 55 percent in 2003.

As 401(k) plans play an increasingly prominent role in retirement income adequacy, there is an even greater need for employees to save and invest well in their plan. Are employees up to the challenge? Are some plan sponsors' efforts to improve plan utilization—such as targeting communication, offering lifestyle funds and third-party investment advice, and automating certain features of the 401(k) plan—meeting with success?

The 2005 *How Well Are Employees Saving and Investing in 401(k) Plans* research report answers these questions and more. The analysis examines the savings and investment behavior of more than 2.5 million eligible employees and over 1.6 million active participants. It seeks to understand employee 401(k) saving and investment behavior by examining quality of participation, plan balances, account activity, investments, and demographics.

In the aggregate, the 2005 report provides a mixed picture of the extent to which employees are taking ownership of their retirement savings.

Key Findings

In 2004, workers made some progress in their 401(k) savings.

- The average plan in the Hewitt Universe had a participation rate of 70.3 percent in 2004. This compares to 2003's average of 69.8 percent and 2002's average of 68.2 percent.
- At the end of 2004, the average total plan balance for participants in defined contribution plans was approximately \$69,000.

- Across comparable participants, balances in 2004 increased by an average of 21 percent from 2003. A fair amount of this increase came from growth in account value: the median participant's 2004 personal rate of return was 10.1 percent.

Still, the results show many pockets of workers who are not making enough financial progress toward retirement.

- Approximately 30 percent of workers are not participating in their 401(k) plan.
 - Only 46 percent of workers ages 20 to 29 actively participated in their 401(k) plan last year.
 - 46 percent of workers who had been with the company more than one year, but who had not reached their second anniversary, participated in the plan in 2004.
 - 40.2 percent of workers who earned less than \$20,000 annually participated in their 401(k) plan in 2004.
- Savings levels were often far from robust.
 - More than one in five participants (22.1 percent) left money on the table last year by failing to contribute enough to obtain the full company match.
 - 31 percent of participants contributed **only** enough last year to obtain the full company match.
 - Nearly a quarter of workers (23.6 percent) contributed in a nominal way to their 401(k) plan in 2004—deferring just 1 percent to 4 percent of pay on a before-tax basis.
- The median participant's total plan balance was much lower than the average in 2004—at \$25,640.
- At the end of 2004, nearly one in four (23.1 percent) defined contribution participants had a total plan balance of less than \$5,000, which indicates a large presence of nominal retirement savings in defined contribution plans.

The diversification picture is decidedly mixed.

- As in prior years, company stock was the single largest holding for the average 401(k) participant in 2004, with large U.S. equity and GIC/stable value coming in a distant second and third, respectively.
 - At the end of 2004, company stock averaged 26.5 percent of the typical participant's total plan balance; this percentage is in line with 2003 levels.
 - About one in four (27.1 percent) participants held half or more of their total defined contribution plan balances in their employer's stock. Indeed, among participants holding company stock, the average company stock balance was 40.8 percent at the end of 2004—about the same as in 2003.
- At the same time, the number of funds held by participants in 2004 edged up to an average of 4.2 funds, from 4.1 funds in 2003 and 3.6 funds in 2002.

- Likewise, the number of participants holding only one or two asset classes has decreased to 32 percent, from 34 percent in 2003 and 39 percent in 2002.
- Lifestyle fund usage is on the rise—and is also helping diversification.
 - In 2004, 39.3 percent of participants who had lifestyle funds available in their plan elected to invest some or all of the balances in lifestyle funds. This figure is up from 37.1 percent in 2003.
 - The typical lifestyle fund participant has less allocated to company stock and GIC/stable value than the typical 401(k) participant.

Other Findings

- The average before-tax contribution rate among employees actively participating in their 401(k) plan in 2004 was fairly consistent with past years.
 - Participants, on average, contributed about 7.9 percent to their 401(k) plan in 2004.
 - Across comparable participants, this percentage is essentially unchanged from 2003 levels.
- Defined contribution participants have more of their balances in equity funds than in previous years.
 - At the end of 2004, the average defined contribution participant had 69.6 percent of his or her total plan balances in equity investments; this average is up from 67.9 percent at the end of 2003.
 - Since the end of 2002, the equity allocation of the typical defined contribution investor has risen approximately 4 percent.
- Both rebalancing and market timing are uncommon in 401(k) plans.
 - In 2004, approximately one out of six (16.7 percent) 401(k) participants made one or more trades in their defined contribution account. This proportion has been about the same for the past three years.
 - Just 15.4 percent of participants who transferred their defined contribution balances made more than four trades, and just 5.2 percent made more than ten trades during the year (down from 6.1 percent in 2003).
- Loan-taking remains at consistent levels and does not appear to have a significantly detrimental effect on contribution levels.
 - Nearly a quarter of active participants had an outstanding loan in 2004 (23 percent). This figure is consistent with the proportion of outstanding loans in prior years.

— As might be expected, participants taking loans—on average—contribute less to the plan than participants who do not have outstanding loans: 6 percent versus 7.5 percent respectively. However, there is little difference in the proportion of participants with or without loans who stopped contributing altogether in 2004 (versus 2003).

A copy of the complete report can be obtained for \$350 from:

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