For More Information:
MacKenzie Lucas
Aon Hewitt—847-442-2995
mackenzie.lucas@aonhewitt.com

Merrillyn J. Kosier
Ariel Investments—312-726-0140
mkosier@arielinvestments.com

New Study Reveals Retirement Plans of African-Americans and Hispanics Hit Especially Hard During Tough Economy

The Ariel/Aon Hewitt study highlights disparities in 401(k) saving and investing behaviors by race and ethnicity following the Great Recession

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(Chicago, Illinois, April 3, 2012) – Continued economic uncertainty has led all workers to dip into their retirement savings, but minorities have been the hardest hit, according to a new study from Ariel Education Initiative and Aon Hewitt. Compared to their Asian and white counterparts, African-American and Hispanic employees are eroding their retirement savings at an alarming rate.

The Ariel/Aon Hewitt study, 401(k) Plans in Living Color II, examined the defined contribution (DC) plans of 60 large U.S. organizations, representing 2.4 million employees. It was conducted by Ariel Education Initiative, the nonprofit affiliate of Ariel Investments, and Aon Hewitt, the global human resources business of Aon Corporation (NYSE: AON). The Joint Center on Political and Economic Studies and The Raben Group also collaborated on the study.

The Impact of the Great Recession on Retirement Plans

According to this groundbreaking report, the prolonged economic crisis and resulting financial challenges led many employees to tap into their retirement savings to alleviate short-term financial stress. In fact, more than two-thirds of workers who took a withdrawal in 2010 reported they needed the money for an unexpected emergency, debt or day-to-day living expenses. That said, **African-American employees took hardship withdrawals more than any other ethnic group.** Fully 8.8 percent of African-Americans took hardship withdrawals in 2010, compared to 3.2 percent of Hispanics, 1.7 percent of whites and just 1.2 percent of Asian workers.

Percentage of Participants Taking Hardship Withdrawals

Year	African-American	Asian	Hispanic	White
2007	6.3%	0.7%	2.0%	1.1%
2010	8.8%	1.2%	3.2%	1.7%

While most workers consider the ability to take a loan from their DC plan a desirable feature, doing so also significantly impacts their ability to adequately save for retirement. While not surprising that more people take loans during tough economic times, the disparity between racial and ethnic groups is alarming. **Half of all African-Americans and 40 percent of Hispanic employees carried a loan balance at the end of 2010, compared to just 22 percent of Asians and 26 percent of whites.**

In response to the study, Mellody Hobson, president of Ariel Investments, remarked, "The Great Recession caused many employees to tap into their 401(k) plan. This has been especially true of African-American and Hispanic workers who have been hit the hardest by the recession. Since 401(k) plans have become the primary way Americans save for their golden years, this study dramatically shows how much is at stake."

The vast majority of workers who leave their employers with a loan outstanding—80 percent of African Americans, 76 percent of Hispanics, 71 percent of whites and 67 percent of Asians—subsequently default on them. Because loans account for an average of 20 percent of a worker's balance, those who default suffer a significant financial set back.

Cashing Out and Never Catching Up

Aside from loans and withdrawals, cashing out is one of the most significant issues putting retirement savings at risk—particularly for African American and Hispanic employees. **Two-thirds (63 percent) of African-Americans and 57 percent of Hispanics who left their employer in 2010 cashed out their balances. In comparison, 39 percent of white employees, and just over a third (34 percent) of Asian workers did the same.**

"Most employees who cash out their savings will never be able to rebuild their balance," explained Hobson. "Minority workers disproportionately affected by layoffs feel like they have no choice other than drain their retirement savings in order to make ends meet while unemployed."

The Role of Automation

One of the primary, and most basic, pitfalls of saving for retirement is getting workers to participate in a savings plan. Ariel and Aon Hewitt found there is a racial gap in DC plan participation. Just two-thirds of Hispanics and 68 percent of African Americans contributed to a DC plan in 2010, while 79 percent of whites and 80 percent of Asian workers did so. **Even when**

adjusting for factors such as age, salary and tenure, African-American and Hispanic employees were significantly less likely to have established a DC plan account.

In an effort to encourage all workers to participate, employers have increasingly adopted automatic enrollment features. More than two-thirds (67 percent) of employers in the study automatically enroll new hires, up from 58 percent in 2007. This push toward auto enrollment is making a difference. **Across all racial and ethnic groups, participation in DC plans dramatically increases when you compare those who are subject to automatic enrollment versus those who are not.** When auto enrolled, 82 percent of African-American employees participated in a DC, compared to just 64 percent of those not subject to auto enrollment. The story is similar for Hispanic workers—83 percent participated in their employer's DC plan when auto enrolled, compared to just 59 percent that were not automatically enrolled. Automatic enrollment essentially closed the racial gap across participation levels and racial groups.

Auto Enrollment Plan Participation Rates

Enrollment Type	African-American	Asian	Hispanic	White
Subject to auto-enrollment	82%	89%	83%	85%
Not subject to auto-enrollment	64%	78%	59%	77%

While automatic enrollment is effective at increasing *participation* rates, it may actually negatively affect *contribution* rates among all races and ethnicities. African-American workers who are auto enrolled, contributed 4.3 percent of pay, compared to 6.3 percent for those not automatically enrolled. Similarly, Hispanic employees contributed 4.4 percent of pay when automatically enrolled, versus 6.6 percent of pay when they were not subject to auto enrollment. White employees who were auto enrolled contributed 5.2 percent of pay on average to their DC plans, those who were not contributed 8.0 percent of pay. The contribution rate for Asian employees was 7.3 percent of pay, compared to 9.4 percent for those who self enrolled in the plan.

"Automatic enrollment is a great way to encourage workers to save," said Alison Borland, vice president of Retirement Product Strategy at Aon Hewitt. "However, it's not a silver bullet. Employers can do more to help workers maximize their savings such as establishing a default at a higher savings rate or adding automatic contribution escalation features."

Employers that automatically enroll their workers, tend to set contributions at a very low rate. Half of the plans in the Ariel/Aon Hewitt study enrolled employees at rates between 1-and-3 percent of pay, while another quarter auto enrolled workers at 4-or-5 percent of pay. Just 23 percent set contributions at more than 6 percent. Further, fewer than half (42 percent) of workers automatically escalate savings over time, meaning that many workers remain at these low contribution levels for long periods of time – or forever.

“We know from past research that DC investors are incredibly passive,” explained Borland. “Very few actively manage their portfolio, let alone adjust their contribution rates through the time that they’re actively contributing to the plan. This has been exacerbated by the economic downturn and this passivity can be absolutely damaging to their ability to save adequately for retirement.”

The Ariel/Aon Hewitt study outlines key recommendations for policy makers and employers to help minority workers adequately prepare for retirement.

1. **Know your employees.** Understand your demographics beyond just the averages. Segment and assess participant behaviors by multiple perspectives, including race.

2. **Use Automation to its full potential.** Expand auto-enrollment to all nonparticipants on a one-time or periodic basis. Employers should consider setting contribution rates at a level equal to the company match and/or using higher rates of 4 percent to 6 percent of pay. Contribution rates should also be auto-escalated by 1-2 percent a year.

3. **Don’t forget about communication opportunities.** Defined contribution plans are complex and participants take on huge responsibilities when they save and invest in their plans. While plan design is critical, helping participants better understand these complex topics should not be overlooked.

4. **Ease loan repayment**. Employers should extend the time a terminating employee has to pay back a loan from 60 days (the typical repayment period) to a minimum of twelve months. A grace period for loan repayments should also be allowed while an individual is collecting unemployment benefits. Additionally, after termination, a loan should be allowed to be repaid from personal financial accounts rather than payroll deductions. Finally, loans should be portable to allay the hurdle of near-immediate repayment.

5. **Deter early withdrawals**. The penalty for taking a non-hardship, early withdrawal should be increased from 10 percent to 15 percent to deter withdrawing funds for non-critical needs.

“Armed with facts and an action plan, the government and employers have the power to ensure all Americans can have a secure and comfortable retirement,” concludes Borland.

To download the *401(k) Plans In Living Color II: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups—The Ariel/Aon Hewitt Study*, please visit www.arielinvestments.com or www.aonhewitt.com.

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