

W I N T E R
2008

Building Futures: A Report on the Defined Contribution Industry

▶ Loans & Hardship
Withdrawals

Usage of loans and hardship withdrawals worth monitoring

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Exhibits and conclusions in this report are based on Fidelity plan-base data as of September 30, 2008.
(Plans sponsored by Fidelity Investments for the benefit of its own employees were excluded from this analysis.)

Executive summary

This edition of *Building Futures* examines loan and hardship withdrawal activity within the defined contribution (DC) industry. The report continues the shift toward shorter, more frequent, and focused analysis of a single topic, which began with the previous release: *Building Futures: Asset Allocation*.

One of the many positive features of a DC plan is the option for participants to borrow against or withdraw their savings should they need to. However, as helpful as this may be for many people, it goes against the primary objective of the plan: to enable participants to prepare for the financial needs they'll face after they retire.

Under ideal conditions, no participant would ever have to borrow against or withdraw from his or her retirement savings. In reality, needs arise that simply leave many participants with nowhere else to turn. Therefore, plan sponsors must weigh the pros and cons of offering provisions for loans and hardship withdrawals—their value, as well as their risk—to participants in their quest for financial security in retirement.

Across our participant base, Fidelity has not seen the dramatic increases in loans and withdrawals that some media reports have suggested. While Fidelity has seen an increase in hardship withdrawals, there has been a slight decrease in loan initiations among the plans we service.

Key findings:

1. Loan initiation has remained relatively flat, declining slightly year over year.
2. Hardship withdrawals, while relatively rare, have increased somewhat, but a very small percentage of assets is actually leaving the defined contribution system.
3. Educational efforts aimed at the responsible use of plan loan features can make a positive difference and should be continued.

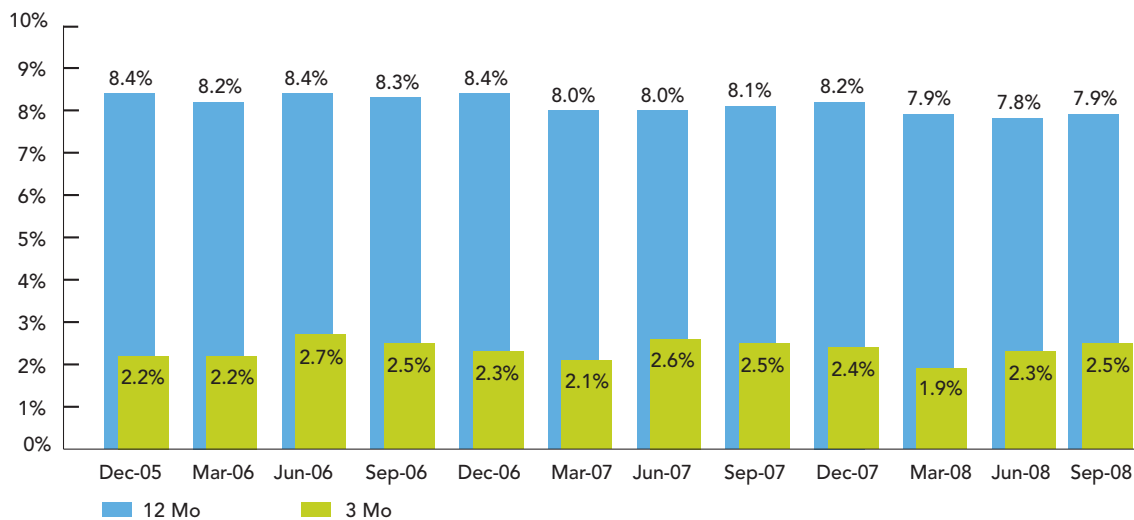
Building Futures: Loans and Hardship Withdrawals encompasses the breadth of the entire Fidelity plan base, which includes 18,000 plans sponsored by both corporations and tax-exempt organizations. These plans include 14.5 million participants and more than \$660 billion in recordkept DC assets. This is the industry's most comprehensive proprietary collection of defined contribution plan and participant information and represents approximately 20% of the DC market.

Loan usage

Loan initiation declines slightly

The percentage of participants initiating a loan has remained relatively flat, with a downward trend year over year (Exhibit 1). The Q3 12-month figures for 2006, 2007, and 2008 show a decline, with 8.3% of participants initiating a loan during the 12-month period ending in September 2006, 8.1% a year later, and 7.9% as of September 2008. The September 2008 12-month figure represents a modest decline in loan initiation over the previous two years. A three-month view seems to reflect cyclical trends with higher loan requests in the second and third quarters, and highlights that loan initiations in the third quarter have remained flat at 2.5%.

Exhibit 1: Percentage of active participants initiating a loan



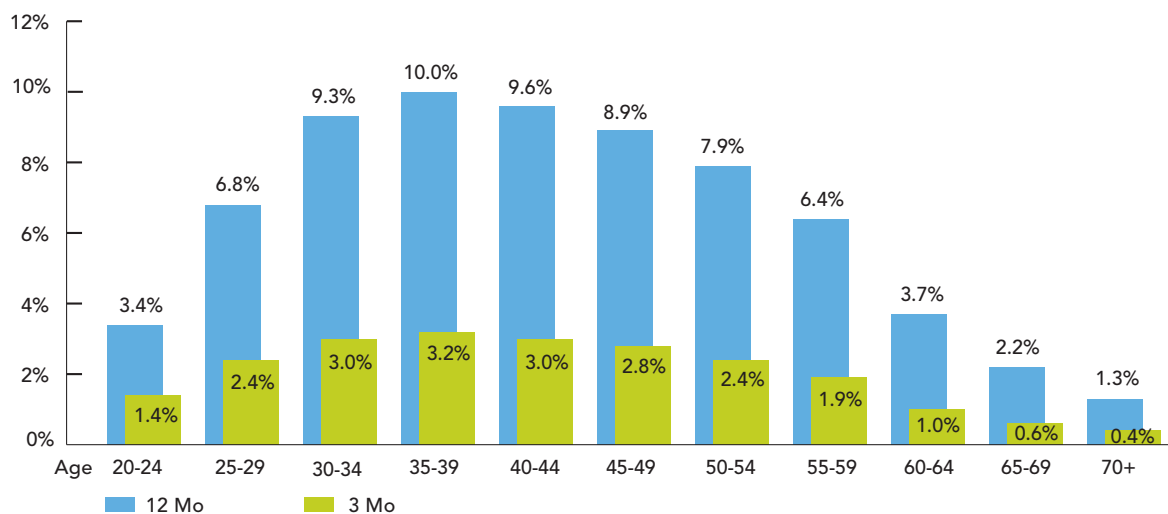
Loan initiation rises in mid-career

Although the initial analysis within this paper has focused on trends over time, we may arrive at more meaningful observations and conclusions by examining demographic trends (Exhibit 2). These may provide clues as to why participants initiate loans. Based on loan initiation activity in the period ending September 30, 2008, active participants age 30 to 50 were more likely to initiate loans than younger or older participants. To understand why, let's consider the typical concerns that people experience as they go through life's stages.

Employees in their early 20s, entering the workforce, typically aren't yet focused on saving for the future, and if they are participating in their employer's DC plan, they tend to have small account balances.

Conversely, individuals in their 30s and 40s are more likely to have been participating in their workplace savings plan longer—potentially resulting in a higher available account balance.

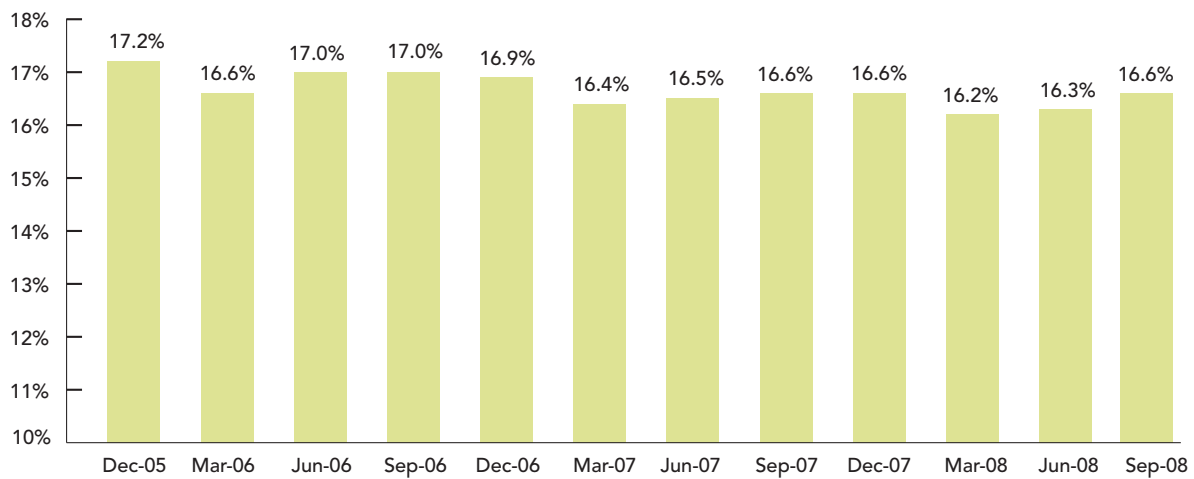
Exhibit 2: Percentage of active participants initiating a loan



Loans outstanding

Perhaps as important as a slight decline in loan initiation is the overall percentage of participants who have a loan outstanding. Over the past few years, while the portion of active participants with an outstanding loan has remained relatively flat, our data shows that this portion is also relatively small, at 16.6% of the population (Exhibit 3).

Exhibit 3: Percentage of active participants with a loan outstanding



Looking at the averages

Overall, changes to the average amount requested or the loan's duration have been minimal. The average requested loan amount is up slightly, from \$8,000 in September 2007 to \$8,400 in September 2008, while the average loan duration has remained flat since 2005, at 3.3 years (Exhibit 4).

Exhibit 4: A typical loan by the numbers

	Average requested loan amount	Average duration	Percentage of participants with an outstanding loan	Average account balance for participants with loans
Total Averages	\$8,400	3.3 years	16.6% have an outstanding loan	\$55,600

Hardship withdrawals

Hardship withdrawals small but rising

A retirement plan may provide for hardship distributions, but it is not required to. Unlike plan loans, hardship withdrawals cannot be repaid. The money is taken permanently out of the participant's account, which could have long-term ramifications on an individual's financial security in retirement.

Qualifying reasons for obtaining a hardship are determined by the plan rules, which are generally based on the following IRS safe harbor guidelines: The employee must have an immediate and heavy financial need and the amount withdrawn cannot be more than the amount needed to satisfy the financial burden (although hardship distributions may be "grossed up" for tax purposes).

Expenses deemed to be immediate and heavy financial needs under IRS rules include:

- Certain non-reimbursed medical expenses
- Costs relating to the purchase of a principal residence
- Postsecondary tuition and related educational fees and expenses
- Payments necessary to prevent eviction from, or foreclosure on, a principal residence
- Burial or funeral expenses
- Certain expenses for the repair of damage to the employee's principal residence

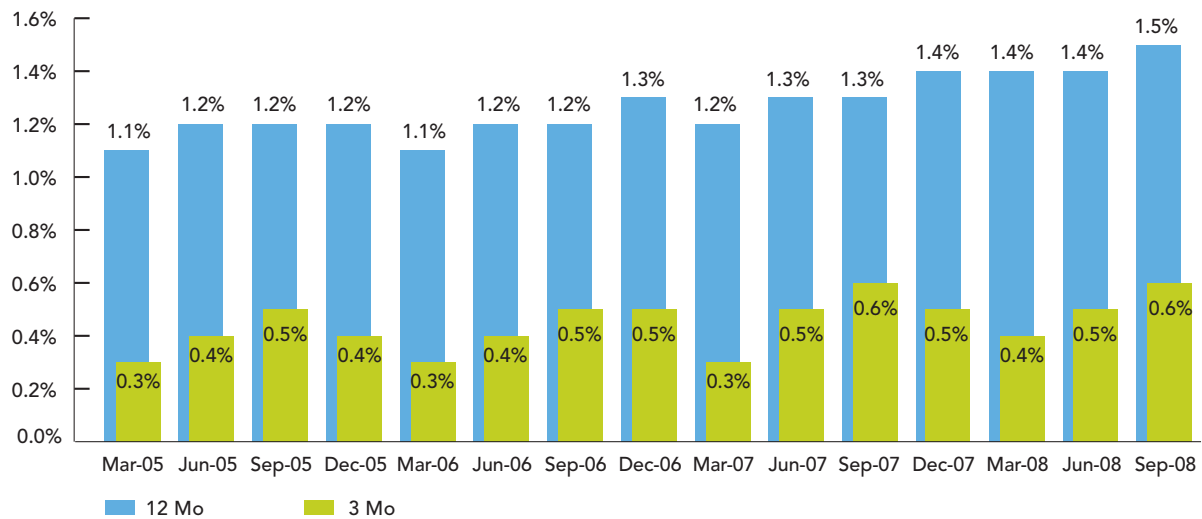
Percentage of assets leaving the DC system

The percentage of all active participant assets that are liquidated in the form of a hardship withdrawal is relatively minimal. During the 12-month period ending September 30, 2008, only 0.17% of assets were withdrawn in the form of a hardship. Although this trend has increased slightly over the past few years, overall less than one sixth of 1% of the assets in Fidelity's recordkept plan base have left the DC system in the form of hardship withdrawals.

Small percentage of the population requesting hardships

Although requests for hardship withdrawals have increased slightly over the past two years (Exhibit 5), the overall percentage of workers requesting them remains quite low. Over the previous 12-month period, only 1.5% of all employees with a balance in their workplace savings account initiated a hardship withdrawal as of September 30, 2008. Looking at the data quarter over quarter, we note a more cyclical trend, with fewer requests in the first quarter of a given year and an increase in requests in the third. The average hardship amount requested has actually decreased to \$4,500 as of September 30, 2008—down from \$4,700 in September of 2007.

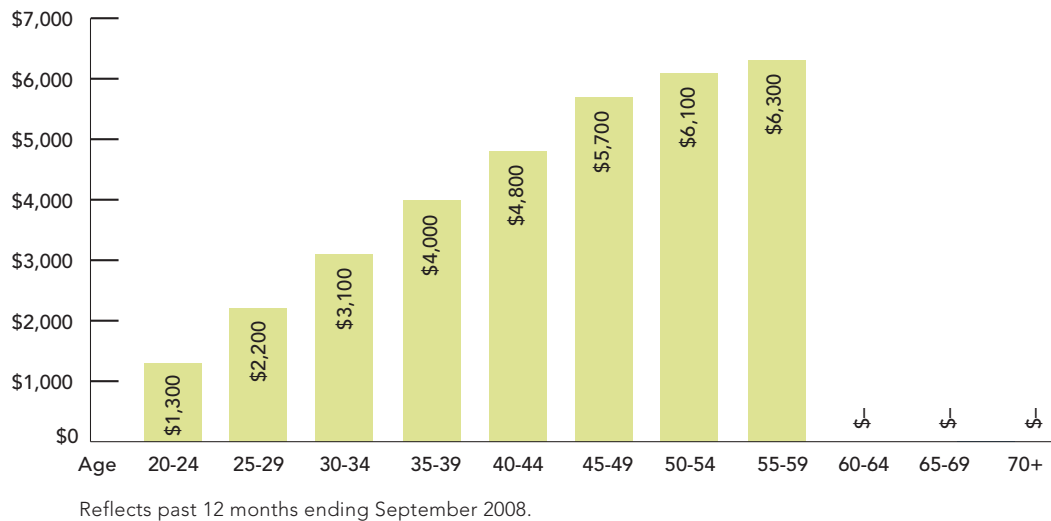
Exhibit 5 : Percentage of active participants with a hardship withdrawal



Hardship withdrawal amounts rise with age

As with plan loans, hardship withdrawal amounts seem to be largely affected by the age of the participant, with the average amount requested increasing with age (Exhibit 6). Just as with loan initiation, there may be several possible explanations or interpretations for this marked trend. One may be that as employees go through life's stages, their overall financial responsibilities grow, as do their account balances. Accordingly, both the financial need and the available resources within a savings account grow and the dollar amounts involved are higher. Expressed as a percentage of total assets, the hardship withdrawal amounts are highest for the youngest participants.

Exhibit 6 : Average hardship withdrawal amount (per HW) (12 mo)



This *Building Futures* report provides a look into the level of assets leaving the DC system due to participant-requested loans and hardship withdrawals. We believe our data (as of September 30, 2008) shows that the situation is not as extreme as has been reported elsewhere in the marketplace, and is impressive in light of the economic challenges that many employees are facing. Retirement plan fiduciaries should continue to work with their service providers to monitor participant behavior in this critical area.

Savings in a workplace retirement plan should be used as a last resource for cash prior to retirement. Workplace savings plans are a powerful retirement vehicle that combines the advantages of potential tax-deductible contributions and tax-deferred growth with the power of compounding.

Workers need to understand the implications of initiating a loan or taking a hardship withdrawal. The opportunity cost of not having their savings invested over time can have significant negative long-term consequences on their retirement savings.

Fidelity will continue to monitor participant behavior and will work with plan sponsors to provide ongoing communications and education regarding keeping participants' assets invested as much as possible. As a plan sponsor, here are some steps you may want to consider:

1 Loans

Action step

- Evaluate loan and hardship use.**
Identify whether additional targeted communications and education are needed.
- Consider allowing only one outstanding loan at a time.**
This would allow participants access to their savings for extreme situations, while helping to prevent abuse or overuse.

2 Hardship Withdrawals

Action step

- Review the number and/or percentage of participants in your plan who are requesting a hardship withdrawal.**
 - How does the number compare with other plans of similar industry or size?
 - If the number in your plan is above the norm, perhaps your employees could benefit from renewed efforts and attention on retirement education.
- Identify whether the same people are taking hardship withdrawals repeatedly.**
If so, they might benefit from one-on-one financial counseling aimed at resolving their current situation and building positive long-term financial habits.
- Point to alternatives to loans and hardship withdrawals.**
There may be ways for participants to resolve short-term financial needs without borrowing from their retirement savings.
- Make sure your employees understand the risk of loans and withdrawals.**
Penalties and taxes can apply to withdrawals—and to loans if not repaid in a timely manner.

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