Hewitt

Survey Findings

The Erosion of Retirement Security From Cash-outs: Analysis and Recommendations

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About This Research

Given the increasing importance of defined contribution plans, the choices that individuals make regarding the preservation of retirement wealth upon termination from their employment have substantial ramifications on their ability to retire. This report seeks to analyze this behavior further.

This study examined terminated participant behavior across various demographics such as age, tenure, gender, and plan balance. Data is as of December 31, 2008, and it evaluates the behavior of 170,000 individuals who terminated from their employer between January 1, 2008 and September 30, 2008. This time period allows for the fact that balances of terminated employees may be forced out, typically within 90 days (if balances are less than or equal to $1,000 or $5,000). Distributions and balances are both considered through year-end. Since terminated participants take distributions throughout the year, assets are adjusted (based on a 60 percent equity/40 percent fixed income split) to make dollar amount comparisons at year-end.

In terms of options upon termination, depending on plan rules, workers may be able to leave their 401(k) savings in their plan, roll over their savings into another qualified plan or IRA, or take a distribution in cash. Notably, the majority of plans do not permit terminated participants to leave their money in the 401(k) plan if they have less than $1,000.

Executive Summary

Retirement security is becoming a hard-to-reach goal for many individuals. According to Hewitt research, *Total Retirement Income at Large Companies: The Real Deal*, only 19 percent of employees were projected to satisfy at least 100 percent of their retirement needs at the end of 2007. Adding on to this, the financial crisis in 2008 had a significant impact on participants' 401(k) savings—where half of 401(k) participants experienced a portfolio loss of greater than –28 percent. While defined contribution plans are increasingly important in reaching long-term goals, many workers access these monies upon termination of employment, well before their retirement date. In fact, this study found nearly half of terminated employees took a cash distribution in 2008.

The behavior of terminated employees was greatly influenced by their plan balance, age, and gender. Further, available fund options—and the prevalence of institutional fund options in the core lineup—led to meaningful differences. Conversely, automatic enrollment did not significantly impact results. Additional details are provided below, and the body of the report provides in-depth findings[1].

Key Findings

- Among all workers who terminated from employment in 2008, 46 percent took a cash distribution, 29 percent left their assets in the plan, and 25 percent rolled assets over to another qualified plan or IRA.
  - Participants with lower balances are far more likely to cash out their retirement account. Among workers holding \$5,000 to \$10,000, nearly 40 percent took a cash distribution—versus fewer than 10 percent of workers with balances in excess of \$50,000.
  - Younger workers generally have smaller balances and were more apt to cash out. Sixty percent of 20- to 29-year-olds accessed their retirement monies in cash.
  - Across gender, women were less likely to cash out their savings and more likely to roll their savings over to another qualified vehicle. This finding was true across all plan balance levels.

- Interestingly, the presence of automatic enrollment did not have a significant effect on results. Holding things equal by plan balance, those participants subject to automatic enrollment did not have greater cash-out behavior than those participants who actively enrolled.

- Given that higher-balance individuals are less likely to cash out their balance, in total, the bulk of assets remained in the retirement system. Leaving money in the plan was most prevalent (55 percent of assets), followed by rolling assets into another retirement account (39 percent).

- Access to lower-cost institutional funds appears to encourage participants to remain in the plan. When more than two-thirds of investment options offered were institutional, nearly 60 percent of assets remained in the plan (versus only 50 percent for plans with fewer institutional funds).

[1] If a participant decides to take a cash distribution after termination, he or she has 60 days to roll it over into an IRA or another qualified plan.

Recommendations

Cashing out from retirement programs has a significant impact—permanently impairing retirement savings and jeopardizing future retirement security. Even a seemingly small cash distribution can cost tens of thousands of dollars at retirement, not to mention the immediate penalties and taxes that are incurred. As defined contribution plans increase in importance and as the workforce becomes increasingly mobile, it is clear that this issue must be addressed to ensure future retirement readiness. As regulators and plan sponsors work to help remedy this issue, the following solutions may be considered:

- Limit access to retirement monies at termination. Regulators could meaningfully deter access to retirement savings by modifying rules to delay workers' ability to access all monies until age 59½, allowing only hardship withdrawals, loans, and rollovers of monies before that age.

- Simplify the rollover process. Instead of the long, paper-intensive procedure currently used by many employers, companies could adopt a Web-based, paperless rollover process. Doing so would eliminate much of the confusion and frustration many employees feel when trying to roll their assets over into another qualified plan or into an IRA.

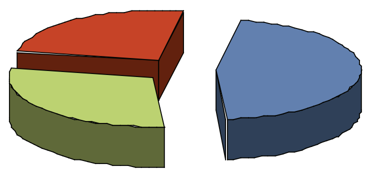
- Educate and communicate with workers about the negative effects of taking a cash distribution. Employers can include on their participant Web sites information about the long-term consequences of cashing out. For example, companies could provide terminated workers with modeling tools that project their account balance under different scenarios: leaving their assets in their prior 401(k) plan, rolling their assets over into an IRA, or cashing out in the form of a lump sum distribution.

Detailed Findings

The study found nearly half (46 percent) of workers took a cash distribution upon termination of employment in 2008. This trend has remained relatively the same since 2002. The average cash-out amount was $5,600.

In contrast, 29 percent of employees left their money in their 401(k) plan at termination, while the remainder (25 percent) rolled over their balances into either another 401(k) plan or an IRA. Across plans, the results varied significantly. Clearly, many factors influence this, including plan provisions and demographics.

Post-Termination Behavior—Percentage of Employees



Even after excluding participants with smaller balances of less than $1,000 (since most of them were forced out of the plan), 28 percent of participants took cash distributions in 2008. In addition, the average cash-out amount increased to $11,000 among these employees.

Plan Balance Size Is a Meaningful Differentiator

Cash-out rates are strongly driven by plan balance size—with smaller plan balances very likely to be taken out in cash. Among those workers with balances below $1,000, 85 percent took a cash distribution in 2008. By comparison, only 18 percent of individuals did so with balances between $30,000 and $49,999.

Post-Termination Behavior—Percentage of Employees by Plan Balance

Balances	Leave Money in Plan	Rollover	Cash Distribution
<$1,000	3%	12%	85%
$1,000 to $4,999	31%	24%	45%
$5,000 to $9,999	40%	22%	39%
$10,000 to $29,999	42%	29%	29%
$30,000 to $49,999	45%	37%	18%
$50,000 to $99,999	47%	42%	11%
$100,000+	46%	46%	8%

Of course, specific plan provision rules can impact this behavior as cash-out rates are heavily impacted by the automatic distribution rule. In 2005, new force-out provisions became effective, requiring balances greater than $1,000 and less than or equal to $5,000 to either be allowed to remain in the plan or be automatically rolled into an IRA[1]. This has had a meaningful impact on the number of participants cashing out in that range compared to previous analysis. That said, participants with lower balances are still far more likely to cash out versus those with higher balances, regardless of the automatic distribution threshold.

Younger Workers More Likely to Cash Out

Younger participants are more prone to take a cash distribution at termination compared to older participants, in large part due to their relatively smaller balances. Six in ten people in their twenties took cash distributions in 2008, nearly twice the rate of those ages fifty and older.

Post-Termination Behavior—Percentage of Employees by Age

Age	Leave Money in Plan	Rollover	Cash Distribution
20–29	21%	18%	60%
30–39	30%	23%	47%
40–49	32%	25%	43%
50–59	35%	31%	34%
60–65	32%	38%	31%
65+	32%	37%	31%

Of course, a cash withdrawal greatly affects participants' accumulated wealth, and it is especially meaningful for younger employees given the greater potential for future compounding. As job tenure declines, it is critical that savings maintain a retirement focus[2]. A 25-year-old employee who takes a $5,000 cash distribution at termination may only receive around $3,500 after taxes and penalties. However, the amount of retirement wealth forfeited by consuming the distribution today would be nearly $75,000. It is easy to see that if the cash-out behavior continues with each job change, an individual could be near retirement with little savings accumulated.

[1] Among plans that allow automatic rollover force-out (for balances greater than $1,000 and less than or equal to $5,000), most of them allow participants 60 days to make a determination. However, if no decision is made, their balances are forced out.

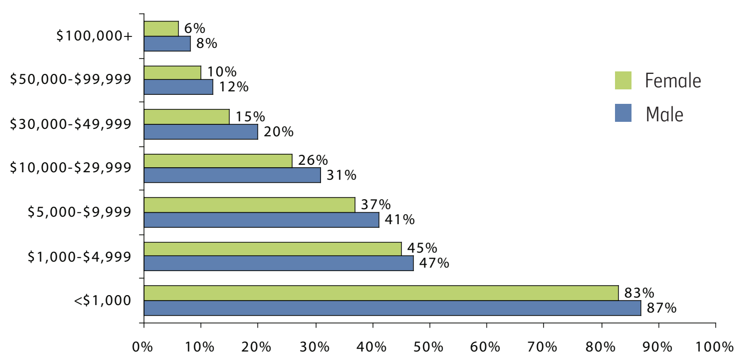
[2] The 2008 survey from Bureau of Labor Statistics showed that the median number of years that all workers had been with their current employers was 4.1. The median tenure for workers age 25 to 34 was 2.7 years.

Inertia From Automatic Enrollment Seems to Extend to Termination
Automatic enrollment has proved to be a powerful tool for plan sponsors to encourage participation in defined contribution plans. There is some speculation that participants subject to automatic enrollment may be more likely to cash out, given it was not an active decision on their part to save. However, when analyzed by the size of the balance accrued, there is no indication that automatic enrollees are any more apt to cash out than active enrollees.

Women Less Likely to Cash Out

Behavior across gender was different, with women slightly less likely than men to cash out their 401(k) balance post-termination. This was the finding across all balance levels.

Cash-Out Activity Post Termination—Percentage of Employees by Plan Balance and Gender

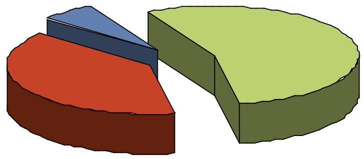


This difference equated to more women rolling over their accounts when balances were over $5,000 and thus preserving retirement wealth. For example, when plan balances were between $30,000 and $49,999, 40 percent of women rolled over their assets versus 35 percent of men. There were no significant differences among gender where no action was taken, and assets remained in the 401(k) plan.

Most Assets Remain in the Plan, More So When Institutional Investments Available

When looking across the assets of terminated workers, more than half of total assets (55 percent) remained in the 401(k) plan during 2008. This was true across all age groups. The difference between this result and the results above are explained by larger balances remaining in the plan, while small balances are much more likely to be cashed out.

Post-Termination Behavior—Percentage of Total Assets



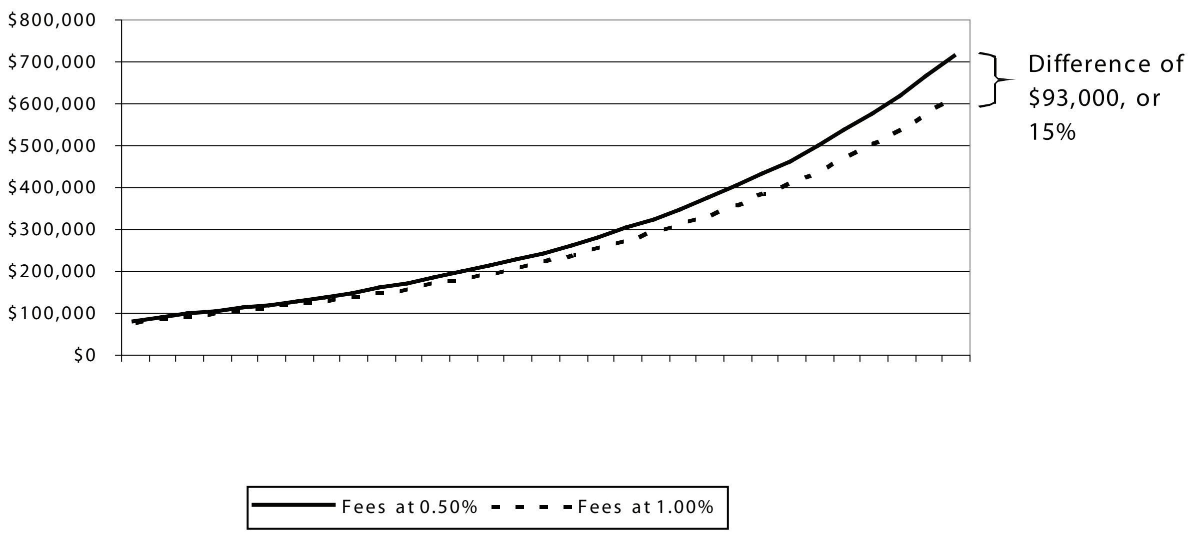
In spite of marketing efforts arguing otherwise, there are some tangible benefits to participants of retaining assets in their qualified plan, especially in midsized to large plans. Within the defined contribution system, plan participants generally have access to high-quality investment options at reasonable prices (through lower-cost institutional fund products such as collective trusts and separate account vehicles) and benefit from fiduciary protections. Workers cannot obtain these benefits individually in the retail market. While inertia is likely playing a role in the retention of assets in the plan, some participants may in fact leave their monies in the plan to take advantage of these benefits.

In fact, this study found that among plans offering lower-cost institutional funds, participants with larger balances were more likely to leave assets in the plan compared to plans with retail options, suggesting that these participants may recognize the value of the lower-priced options. When more than two-thirds of investment options offered were institutional, nearly 60 percent of assets remained in the plan (versus only 50 percent for plans with fewer institutional funds).

Hewitt's data shows that even a small decrease in fund fees can amount to a significant increase in a participant's account balance. The following example shows how a difference of 0.50 percent in fund fee can translate into $93,000 at retirement, which represents 15 percent of total assets at retirement[1].

[1] For purposes of this example, we assume there are no additional contributions and with assets growing at 8 percent per year gross of fees.

Wealth Value Over Time



Plans and All Participants Benefit From Retention of Terminated Workers' Assets

For plan sponsors, closely monitoring fees is critical to helping participants reach their retirement goals. Fund selection represents the greatest opportunity for plan sponsors to manage costs on behalf of participants. Through the aggregation of assets, larger employers may have access to institutional fund vehicles, including separate accounts and collective trusts. These fund vehicles are often offered at discounted prices to the retail marketplace. By leveraging the assets of active and terminated plan participants, lower fees may be achieved for the entire population—with active and terminated workers benefiting.

Conclusions

Cash-outs erode retirement security far more than loans and withdrawals due to their prevalence and magnitude. With nearly half of terminated workers accessing retirement monies prematurely, cash-outs pose a tremendous risk to the retirement readiness of American workers. With fewer and fewer workers remaining at a single employer until retirement, it is essential that employees view their 401(k) monies as long-term retirement benefits rather than as consumable income at termination. To combat these issues, the industry will need to continue to evolve and will require support from regulators and plan sponsors to drive better long-term results.

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