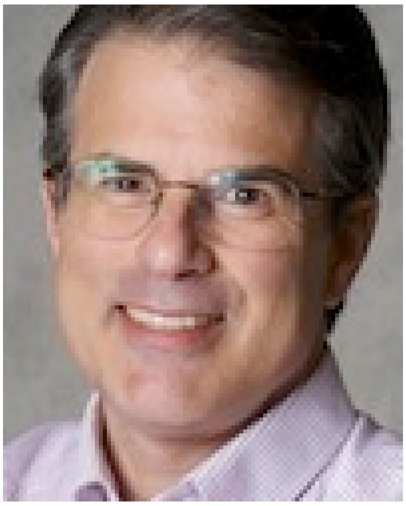
Please Don’t Raid Your Retirement Account

By Kerry Pechter *Thu, Apr 16, 2020*

It would be smart, not paternalistic, to ease today’s financial pain without contributing to an even bigger retirement funding crisis down the road.



“First chill, then stupor, then the letting go.”

The poet Emily Dickinson described death by exposure that way. She’s referring to the three stages of hypothermia. In the last stage, the body’s core heat migrates outward, creating a feverish delirium.

I felt a chill after reading that the CARES Act would allow Americans who’ve lost their jobs because of the coronavirus to withdraw up to $100,000 from 401(k) plans or IRAs without penalty. Sounds like a recipe for financial hypothermia in retirement.

It makes sense not to punish anyone for taking withdrawals from retirement accounts during the pandemic. But why encourage withdrawals (up to $100,000) that will only reduce future security? Most won’t have time to replenish their accounts before they retire. If they don’t pay back the money in three years, they’ll owe income tax on it.

The measure also seemed at odds with other federal government COVID-19 relief measures, like enhancing unemployment insurance benefits, offering forgivable payroll loans to businesses, and sending out $1,200 checks ($2,400 to couples filing jointly and $500 to minor children), all of which should help prevent raids on long-term savings.

People who work on retirement security are evidently as perplexed by the measure as I was.

“My hope and expectation is that only those individuals with no other options will tap their 401(k)/IRA balances during this crisis,” Alicia Munnell told *RIJ*. She’s the widely-published and widely-quoted director of the Center for Retirement Research at Boston College.

“Those who are lucky enough to keep their jobs should have no need to tap their accounts, and probably recognize that they would lock in their losses by selling at the bottom of the market. Those who lose their jobs, hopefully, would explore every other option, including unemployment insurance, the $1,200 payment, or borrowing from parents or children, to avoid tapping their 401(k),” she said.

“For those forced to tap their 401(k), I am glad that they will not have to pay a penalty. But the size of the penalty-free amount—$100,000—is worrisome. The median 401(k)/IRA balances for households approaching retirement (55-64) is $135,000. The lower-paid, most financially hard-pressed holders of 401(k)s may think they’ve been given a green light to essentially empty their accounts. Even though the law allows re-contributing the withdrawn amounts, these vulnerable households are never going to have the financial wherewithal in the next three years to put $100,000 into a retirement plan.”

“It’s a bit of a mixed message,” said Linda K. Stone, a pension expert in Bryn Mawr, Pa., in an interview this week. “Plan sponsors have spent a lot of money on getting people to enroll in their plans and to prevent leakage.

“Now some 401(k) companies are waiving the fees they normally charge for withdrawals to make it easier for people to get their money. But the assets are depressed right now, so they’ll be selling at a low point. And most people have saved very little to begin with. You have to think of your future self. Your future self will want that money to stay in your retirement account.”

Jack Towarnicky, a former executive director of the Plan Sponsor Council of America, also regretted the new law. He’d have preferred loans or emergency lines-of-credit from retirement plans, not withdrawals.

“Unsurprisingly, we have sown the seeds of unpreparedness for the next crisis,” he told *RIJ* in an email. “Instead of changes that would create liquidity without triggering leakage, we enabled cash-outs for tens of thousands, perhaps millions who have not lost employment. COVID-19 in-service withdrawals will be the ‘liar loans’ of 2020.

“The CARES Act’s provisions do not limit distributions to specific needs nor require proof of economic loss, while concurrently allowing employees to self-certify that they are qualified individuals. The Bipartisan Budget Act, the SECURE Act and the CARES Act all create incentives and new options encouraging leakage for workers who have not lost employment.

“A more thoughtful approach would have created liquidity without leakage. Almost all who have a need due to separation or layoff already have full access/liquidity to their retirement savings,” he said, referring to rollovers to IRAs. In his email, Towarnicky recommended this:

Plan sponsors should consider making the following changes (all possible today):

1. Eliminate hardship withdrawals
2. Change the loan structure to a “line-of-credit” basis (minimum $500 or $1,000) so participants can rely on access
3. Improve plan loan processing to 21st-century functionality by:

- Upon initiating a loan, require participants to enter into a “commitment bond” to repay the loan, acknowledging that they are the borrower, and that the lender is their “future self.”
- Add electronic banking so that funds can be disbursed promptly to a bank account as needed, and so loans can be repaid and initiated during furloughs, leaves of absence, layoffs, and post-separation.

Congress could facilitate this by removing arbitrary barriers to liquidity without leakage. It could index the loan limit [to inflation], which has been $50,000 since the passage of ERISA in 1974, when the average assets per defined contribution plan participant were only $6,431.

If 401(k) plans were still what they were 35 or 40 years ago—profit-sharing plans that accompanied defined benefit pensions—then dipping into them for emergencies would do little or no long-term damage. But now that millions of Americans rely on the savings in their 401(k)s and rollover IRAs (and Social Security) as their primary source of retirement income, it makes less sense. Paying for current hardship with future hardship is obviously short-sighted and potentially self-defeating.

Ironically, COVID-19 strikes the retirement industry at a time when financial wellness programs have just begun to address the need for emergency “side-car” funds in workplace retirement plans. Although heads-of-households know that they should keep several months of living expenses in cash, research by Munnell and others has shown that most Americans have little or no financial buffer.

You might object that the federal government shouldn’t tell people how to save or spend at all, and not be paternalistic. But we’re talking about tax-deferred accounts that are designed to produce retirement income. It would be smart, not paternalistic, to ease today’s financial pain without contributing to an even bigger retirement funding crisis down the road.