To raise retirement security, ban DC cash-outs: EBRI

By Editorial Staff *Wed, Jul 9, 2014*

Getting rid of cash-outs during job changes could mean that 38.3% more of the poorest Americans would have saved enough to replace 60% of their pre-retirement income (when combining DC savings and Social Security), according to the Employee Benefit Research Institute.

Unlike many other advanced countries, the U.S. has a voluntary employer-based defined contribution savings system. Under our system, people have the option to cash out their DC balances when they change jobs. And, despite the tax consequences of cashing out, many do.

But if regulations were tweaked to eliminate the “cash-out” option, significantly more Americans would likely end up with adequate savings when they reach retirement, according to research submitted at a Congressional hearing last June 17 by the Employee Benefit Research Institute’s research director, Jack Vanderhei.

The elimination of cash-outs during job changes would mean that 38.3% of the people in the lowest income quartile who would not otherwise have saved enough to replace 60% of their pre-retirement income in retirement would have reached that threshold when they combined their DC savings and Social Security benefit.

Though the impact of eliminating cash-outs was weaker for higher replacement rates and higher income quartiles was not as pronounced, it was still significant. For instance, it enabled 15.6% of the people in the highest quartile who would have fallen short of a 70% replacement rate to reach it.

Eliminating cash-outs had a much bigger effect, in fact, than eliminating either loans or hardship withdrawals from DC plans, according to the data. Vanderhei used the proprietary EBRI Retirement Security Projection Model to produce the results.

The model assumed a population of workers currently ages 25 to 29 who would have more than 30 years “of simulated participation in a 401(k) plan,” who retired at age 65, and who used their DC savings to buy an inflation-adjusted life annuity at a purchase prices of $18.62 per $1 of monthly lifetime income.

Plans were also assumed to have automatic escalation with a three percent default contribution rate and an annual increase in contributions equal to one percent of annual compensation. Employees are assumed to revert their level of contributions to the default rate when they participate in a new plan and opt-out of automatic escalation.

The EBRI findings, entitled “The Impact of Leakages on 401(k) accumulations at Retirement Age.” They were submitted at a hearing on Lifetime Participation in Plans that was held by the ERISA Advisory Council of the U.S. Department of Labor in Washington, D.C., in June.