

## Cashing Out: Helping Employees with Retirement Plan Distribution Decisions

By Carolyn Hirschman, *December 2005*

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The baby boomers are starting to retire. Young employees are leaving work for new jobs or school. Decades apart in age, both face a common decision: what to do with the money in their employer-sponsored retirement accounts.

They often use the money for living expenses, new cars, fancy vacations and other needs, both desired and real. That's a mistake, retirement experts say, because the retirees risk outliving their savings, and the job-changers risk not saving enough for retirement.

"There's a lack of education about the impact of cashing out. No one talks about it enough," says Reginald Bowser, chief executive of Rollover Systems Inc., of Charlotte, N.C., which helps participants roll over their money into individual retirement accounts (IRAs).

The cashout problem—taking lump-sum distributions instead of preserving money in retirement accounts—isn't new, but it's regaining urgency as the nation's baby boomers begin to face 20, 30 or more years in retirement. The oldest baby boomer this year turned 59.5, the minimum age at which tax-free 401(k) withdrawals can be made.

Traditionally, employers have focused their financial education efforts on helping employees accumulate savings through a 401(k) or other defined-contribution plan. Now it's time to pay more attention to distribution, some industry experts say.

To help ex-employees make decisions about their 401(k) assets, some plan sponsors are turning to new ideas and practices, including:

- Better financial education about distribution options
- Simpler, plain-English distribution paperwork
- The use of rollover companies and other "shoppers" to find the best deals for employees
- More flexible annuities

### Preventing Problem Cashouts

Participants generally have four options when they leave a defined contribution plan. They can:

- Take a lump-sum distribution.
- Roll over their assets into an IRA.
- Roll over their assets in a new employer plan (if the employer allows it).
- Keep their money in the old employer's plan.

Less common are annuities, which are trying to make a comeback, and installment payments, in which a certain amount per month is withdrawn from a defined contribution account.

A July [study by Hewitt Associates](#) found that 45 percent of nearly 200,000 participants in 401(k) plans elected cash distributions when they left their jobs. Only 32 percent kept their savings in employer plans, and 23 percent rolled over into IRAs or other retirement plans. (Most employers must automatically roll over into IRAs accounts of \$1,000 to \$5,000 unless participants choose otherwise.)

Likewise, a December [study from the Employee Benefit Research Institute](#) (EBRI) found just over 43 percent of lump-sum recipients rolled over all of their distributions into an IRA or another employment-based plan. On a brighter note, that was up from 19 percent from 1993.

Most likely to cash out are workers in their 20s and those with balances of less than \$10,000, the Hewitt study shows. "It's like a windfall for them," says Tricia Brambley, president of [Resources for Retirement Inc.](#), a consulting firm in Newtown, Pa. EBRI found that nearly 60 percent of those receiving a lump-sum distribution were ages 21 to 40.

Most people save at least some of their lump sums, research shows, but many do not. "Temptation and need are the barriers," says David Wray, president of the [Profit Sharing/401\(k\) Council of America](#) in Chicago. Some people need the money—to pay the mortgage after a layoff, for example—but many treat their retirement assets as "fun money," adds Rick Meigs, president of [401khelpcenter.com](#) in Portland, Ore.

It's easy to blame participants for cashing out, but other factors contribute to the problem, experts say. Distribution paperwork is hard to understand. Small accounts are hard to maintain. Rollovers take several weeks to process. Add it all up, and you get a lot of confused participants. Wray says: "They just don't understand how favorable it is to keep this money [tax] deferred."

### **Educate, Educate, Educate**

Some employers try to stem the leakage with more targeted financial education, says Liz Davidson, chief executive of [Financial Finesse](#), a financial education firm in Manhattan Beach, Calif.

For retirees, that means understanding longevity and inflation risks and how to make their savings last a lifetime. For job-changers, it means understanding the value of long-term compounding and the tax consequences of cashing out. (Participants can withdraw money from

401(k) accounts tax free at age 59.5; younger workers have 10 percent of their distributions taxed as income unless they roll over into other tax-deferred retirement accounts.)

Employers and service providers traditionally have focused on pre-retirees, who have more money and make more desirable customers. They get loads of pre-retirement workshops, personal financial counseling, calculators and other help.

Meanwhile, job-changers are mostly ignored—and that's fine, some say. Why help an ex-employee who might be going to work for your competitor? "It's not the employer's problem," Wray says.

But Davidson notes a trend toward programs that address all segments of the workforce. "What people really need to change their behavior is an ongoing coaching relationship...to stay motivated and stay on track," she says.

[Principal Financial Group](#), based in Des Moines, Iowa, has kept the cashout rate to 15 percent in the 45,000 retirement plans it manages with one-on-one financial counseling, says sales officer Dean Schmitz.

"We send [ex-participants] a letter inviting them to call us to help decide what to do," he explains. After reviewing a caller's financial situation and 401(k) options, trained counselors help them decide what to do with their account balances.

Employers could also help by giving departing employees easier-to-understand paperwork that clearly explains their distribution options. The current, legalistic notices are "just not readable," Wray says. Some service providers "pre-populate" forms to simplify them and reduce processing time.

## **Shop Around**

The 2001 tax law that enacted automatic rollovers for small 401(k) accounts spawned rollover companies, which plan sponsors and service providers hire to help employees roll over their money into IRAs.

"We remove the administrative burden from the plan participant and the employer," says Bowser of five-year-old Rollover Systems. "All they have to do is send us a data feed, and we'll do everything else."

It works like this: For up to \$1,000, plan sponsors and service providers send Rollover Systems a list of workers who've left in the past month, along with their account balances, addresses and other information. The company mails these workers a letter explaining their options and the advantages of rollovers. After employees complete a short questionnaire on Rollover Systems' web site, the company presents five IRA offers that match their needs, then routes the paperwork to the IRA provider of choice. Rollover Systems receives fees from the 14 financial institutions whose IRAs it brokers.

Also in their infancy are similar services that help retirees shop for annuities, insurance products that convert all or part of a 401(k) account into a guaranteed, lifetime stream of monthly

payments. Only 20 percent of plan sponsors offer annuities as distribution options, according to Hewitt.

Most employers don't want the fiduciary liability associated with selecting a vendor or choosing an annuity," says Keith Hyland, vice president of institutional income annuities at MetLife Retirement & Savings.

With conventional annuities, buyers pay a fixed amount in return for guaranteed payments. Unlike installment payments, there's no risk of outliving one's savings. But once the annuity is purchased at a certain interest rate, there are no refunds or changes.

Insurance companies are trying to change annuities' reputation as complicated and expensive by making the products more flexible and employee-friendly. "We see a very large market for this," Hyland says.

On the market now are products that allow buyers to annuitize their income gradually over 10 or more years instead of spending all their money at once. Also available are annuities that offer fixed annual increases or that are tied to the consumer price index to offset the effects of inflation.

Every employee who participates in a retirement plan eventually becomes an ex-employee. To help them make critical decisions about their retirement savings, employers can provide more education, simpler paperwork and services to help people find the next home for their money.

Carolyn Hirschman is a business writer in Rockville, Md., who specializes in HR and benefits issues.

## **Related Resources**

[Experts: Automatic Features, Managed Accounts and Advisory Services Must Transform 401\(k\)s](#), Comp & Benefits Focus Area (11/05)

[Pension Issues: Lump-Sum Distributions and Retirement Income Security](#), Congressional Research Service (8/05)