

Large Plan Lump-Sums: Rollovers and Cashouts

EBRI
 EMPLOYEE
 BENEFIT
 RESEARCH
 INSTITUTE®

Issue Brief

- This *Issue Brief* analyzes data provided by Hewitt Associates regarding lump-sum distributions and benefit preservation, with a particular focus on trend analysis and data breaks by distribution size and recipient age.
- Forty percent of distributions to job changers were rolled over into other qualified retirement plans in 1996, up from 35 percent in 1993. Rollover percentages are higher when examined by the dollars distributed, reflecting the fact that larger distributions are more likely to be preserved. Seventy-nine percent of all dollars distributed in 1996 were rolled over, compared with 73 percent in 1993.
- In 1996, 20 percent of distributions of less than \$3,500 were rolled over, compared with 95 percent of distributions over \$100,000. The findings for dollars distributed are analogous: among distributions of less than \$3,500, 27 percent of the dollars were rolled over, while among distributions over \$100,000, 96 percent of the dollars were rolled over. The likelihood of rollover is also positively correlated with recipient age.
- From a retirement income security perspective, there is good news in these data. The propensity to roll over lump-sum distributions has been increasing, and over three-quarters of the dollars distributed are preserved via rollover.
- At the same time, the data indicate areas of shortfall. Most distributions are not rolled over: among job changers, 60 percent of distributions were cashed out in 1996. It can be argued from a financial planning perspective that even relatively small sums can compound into nontrivial contributions to a retirement nest egg over a period of decades. Furthermore, the importance of preservation of seemingly small balances is enhanced by the fact that individuals may receive a number of these “small” distributions over the course of a career.
- The Hewitt data also allow analysis of distributions to those who retired or became disabled. In 1996, 52 percent of distributions to retired or disabled individuals resulted in a rollover, and 87 percent of the dollars distributed were rolled over. Unfortunately, the data allow no further analysis concerning the ultimate uses of these funds, especially with regard to annuitization.

Table of Contents

Introduction	3
Previous Research	4
Worker Rollovers	6
(chart 1, chart 2, chart 3, chart 4, chart 5, chart 6)	
Implications	7
(chart 7)	
Retirement Lump-Sums	9
(chart 8, chart 9, chart 10, chart 11)	
Distributions on Death	11
Conclusion	12
References	12
Appendix Charts	13

Charts

Chart 1, Benefit Preservation Among Job Changers, by Percentage of Distributions, 1993 versus 1996	6
Chart 2, Benefit Preservation Among Job Changers, by Percentage of Dollars Distributed, 1993 Versus 1996	6
Chart 3, Benefit Preservation Among Job Changers, by Percentage of Distributions, 1996	7
Chart 4, Benefit Preservation Among Job Changers, by Percentage of Dollars Distributed, 1996	8
Chart 5, Benefit Preservation Among Job Changers, by Percentage of Distributions, 1996	8
Chart 6, Benefit Preservation Among Job Changers, by Percentage of Dollars Distributed, 1996	8
Chart 7, Rollover Accumulations from \$3,500 Distributions at Ages 25, 35, 45, and 55	9
Chart 8, Benefit Preservation Among the Retired/Disabled, by Percentage of Distributions, 1996	10
Chart 9, Benefit Preservation Among the Retired/Disabled, by Percentage of Dollars Distributed, 1996	10
Chart 10, Benefit Preservation Among the Retired/Disabled, by Percentage of Distributions, 1996	11
Chart 11, Benefit Preservation Among the Retired/Disabled, by Percentage of Dollars Distributed, 1996	11
Chart A1, Benefit Preservation Among Job Changers, by Percentage of Distributions, 1993	13
Chart A2, Benefit Preservation Among Job Changers, by Percentage of Dollars Distributed, 1993	14
Chart A3, Benefit Preservation Among Job Changers, by Percentage of Distributions, 1993	14
Chart A4, Benefit Preservation Among Job Changers, by Percentage of Dollars Distributed, 1993	14

Chart A5, Benefit Preservation Among the Retired/Disabled, by Percentage of Distributions, 1993	15
Chart A6, Benefit Preservation Among the Retired/Disabled, by Percentage of Dollars Distributed, 1993	15
Chart A7, Benefit Preservation Among the Retired/Disabled, by Percentage of Distributions, 1993	16
Chart A8, Benefit Preservation Among the Retired/Disabled, by Percentage of Dollars Distributed, 1993	16
Chart A9, Benefit Preservation Among Death Beneficiaries, by Percentage of Distributions, 1996	16
Chart A10, Benefit Preservation Among Death Beneficiaries, by Percentage of Dollars Distributed, 1996	17
Chart A11, Benefit Preservation Among Death Beneficiaries, by Percentage of Distributions, 1996	17
Chart A12, Benefit Preservation Among Death Beneficiaries, by Percentage of Dollars Distributed, 1996	17
Chart A13, Benefit Preservation Among Death Beneficiaries, by Percentage of Distributions, 1993	18
Chart A14, Benefit Preservation Among Death Beneficiaries, by Percentage of Dollars Distributed, 1993	18
Chart A15, Benefit Preservation Among Death Beneficiaries, by Percentage of Distributions, 1993	19
Chart A16, Benefit Preservation Among Death Beneficiaries, by Percentage of Dollars Distributed, 1993	19

EBRI thanks Hewitt Associates for providing the data analyzed in this *Issue Brief* and for providing comments and insights during the writing of it.

This *Issue Brief* was written by Paul Yakoboski of EBRI with assistance from the Institute's research and editorial staffs and members of Hewitt's staff. Any views expressed in this article are those of the author and should not be ascribed to the officers, trustees, members, or other sponsors of EBRI, EBRI-ERF, or their staffs. Neither EBRI nor EBRI-ERF lobbies or takes positions on specific policy proposals. EBRI invites comments on this research.

Introduction

emergence of cash balance arrangements and other hybrid retirement plans, and the growing availability of lump-sum options in traditional defined benefit pensions, issues of retirement benefit portability and preservation continue to interest retirement plan sponsors, plan service providers, and policymakers.

On leaving a job, workers who have participated in an employer's retirement plan may have the option of receiving the value of their vested¹ benefit accumulation in the form of a lump-sum distribution.² With lump-sum distributions, the cash value of vested benefits is portable on job termination, offering the participant the opportunity to preserve these funds for retirement. The funds can be preserved by "rolling over" the distribution into a tax-qualified saving vehicle, such as an individual retirement account (IRA) or a new employer's plan, or by opting not to receive a distribution and leaving the money behind in a former employer's plan. This decision is completely up to the individual, who may decide not to preserve all or part of the distribution and instead use it for consumption and/or non tax-qualified saving.

Public policy has sought to encourage the preservation of retirement money accumulated on a tax-deferred basis in employment-based plans. A participant who receives a distribution prior to age 59^{1/2} must pay regular income tax plus a 10 percent penalty tax on any taxable portion of the distribution that is not preserved in a tax-qualified vehicle. The 10 percent penalty tax is

With the continued growth in the number of 401(k) plans and other defined contribution plans, the

not imposed if the worker has died, become disabled, reached age 59^{1/2}, or reached age 55 in the year employment terminated. The Unemployment Compensation Amendments of 1992 required that, beginning in January 1993, employers provide departing workers the option of having their distribution directly transferred to an IRA or to a new employer's plan. Also, since that date, if a worker does not use this option and does not leave the money in the former employer's plan, but instead receives a cash distribution, the distribution is subject to a 20 percent withholding requirement.³ In this case, the individual has 60 days to roll over the distribution and avoid income and penalty taxes. If he or she does not roll over the funds, the 20 percent withheld is applied toward the taxes owed. If rollover does occur, the individual is credited for the 20 percent when filing income taxes for that year.⁴

After summarizing previous research regarding lump-sum distributions and benefit rollover/preservation, this *Issue Brief* presents a new analysis based on data provided by Hewitt Associates regarding distributions from plans in one of the databases of plans for which Hewitt is a service provider. This database is a subset of plans for which Hewitt provides defined contribution recordkeeping services, as distinct from the large and growing number of plans of very large employers for which Hewitt provides total benefits administration. This particular subset of plans was selected because the database readily permitted a thorough analysis of the kinds of benefit distribution and preservation issues that are of current policy interest, and in particular because it allowed trend analysis and data breaks by the distribution's size and the recipient's age.

¹ Vesting is the process in a qualified retirement plan that allows participants to earn a nonforfeitable right to accrued benefits (under a defined benefit plan) or account balances (under a defined contribution plan) by completing years of service as specified under the plan's provisions. Participants on separation from service forfeit nonvested benefits. Employee contributions are immediately vested.

² For sufficiently small benefit accruals, i.e., \$3,500 or less, the law permits the plan to cash out such amounts rather than incur the additional administrative expense of retaining small account balances of former participants.

³ For example, if the individual's vested account balance is \$1,000, he or she would receive a check for \$800.

⁴ Note that an individual will owe income and penalty taxes on the 20 percent withheld unless this amount is rolled over. This means that to completely avoid taxation on the distribution, the individual must come up with the equivalent of the 20 percent withheld and roll that amount over in addition to the 80 percent received.

Previous Research

An earlier *EBRI Issue Brief*⁵ presented data on the number and amounts of lump-sum total distributions made

from retirement programs and also on the number and amounts of rollover contributions made to IRAs for 1987–1990. These data were based on Internal Revenue Service (IRS) tabulations of filings of Form 1099-R, Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.,⁶ and Form 5498, Individual Retirement Arrangement Information.⁷

Employee Benefit Research Institute (EBRI) analysis of the IRS tabulations showed that the number of lump-sum total distributions rose from 11.4 million in 1987 to 12.2 million in 1988 and then declined to 10.8 million in 1990. While the number of distributions declined over this period, the amount distributed in-

creased steadily from \$80.3 billion in 1987 to \$125.8 billion in 1990. Twenty-nine out of every 100 lump-sum total distributions in 1990 resulted in an IRA rollover contribution, indicating that more than 70 percent of all distributions were not even partially rolled over into an IRA in that year. Focusing on the funds involved, 57 percent of all money distributed in a lump-sum total distribution was rolled over into an IRA.

In a thorough analysis of income generated by employment-based pension plans, Woods (1996) critically analyzed the IRS Form 1099-R data. He correctly pointed out that \$107.2 billion in non-IRA/SEP total distributions was often referred to as lump-sum distributions from pension plans or from defined benefit and defined contribution plans in the *EBRI Issue Brief*. As Woods explained, this is incorrect because the non-IRA/SEP total includes five types of distributions that cannot be classified as lump-sum payments from employment-based plans. Adjusting for these factors, EBRI estimates lump-sum distributions from defined benefit and defined contribution plans in 1990 amounted to \$81.6 billion.⁸

⁵ Paul Yakoboski, "Retirement Program Lump-Sum Distributions: Hundreds of Billions in Hidden Pension Income," EBRI Issue Brief no. 146 (Employee Benefit Research Institute, February 1994).

⁶ This form is filed by plan trustees for each person to whom any designated distribution that is a total distribution has been made from profit-sharing or retirement plans, IRAs, annuities, etc. A total distribution is one or more distributions within one tax year in which the entire balance of the account is distributed. Lump-sum distributions are a subset of total distributions, accounting for 90 percent of total distributions and 79 percent of the funds distributed. (See footnote 15 in EBRI Issue Brief no. 146.)

⁷ This form is filed by plan trustees for each person for whom an IRA or simplified employee pension (SEP) is maintained. Information reported includes regular contributions, rollover contributions, and fair market value of the account.

⁸ Woods correctly maintains that the \$107.2 billion figure is not the true amount of lump-sum distributions from pension plans or from defined benefit and defined contribution plans because the non-IRA/SEP total includes five types of distributions that cannot be classified as lump-sum payments from employment-based plans: IRC sec. 1035 exchanges (a tax-free exchange of one annuity contract for another), excess contributions to tax-qualified plans (amounts that exceed the limits established in pension law), total distributions from privately purchased individual annuity contracts, the value of loans in excess of \$50,000 from qualified employment-based plans or tax-sheltered annuities, and the cash surrender value of life insurance policies when they include any portion that is taxable.

Using the EBRI Issue Brief, Woods placed the value of IRC sec. 1035 exchanges at \$8.6 billion. Reference by EBRI to the original IRS tabulations reveals an actual figure of \$8.0 billion. Using the EBRI Issue Brief, Woods placed the value of excess contributions at \$17.2 billion. However, reference to the original IRS tabulations reveals an actual figure of \$0.2 billion. Apparently, Woods assumed that distributions reported as "without coding" were excess contributions; however, as noted in footnote 17 of the EBRI Issue Brief, excess contributions were part of the "other" category in the EBRI Issue Brief and the "other" category accounted for only 1 percent of distributions. Using other sources, Woods estimated a figure of \$16.5 billion for the final three types of distributions that are not lump-sums from employment-based plans. He correctly noted that these categories were not separately identified on the 1099-R form in 1990. Given how close Woods' estimate of \$16.5 billion was to the \$17.4 billion reported as "without coding" in the IRS tabulations, it is this author's conclusion that the distributions reported in the EBRI Issue Brief as "without numeric code" are the final three types of distributions identified by Woods.

Therefore, using the IRS tabulations to make the correction suggested by Woods to derive an estimate of lump-sum distributions from defined benefit and defined contribution plans in 1990 results in a figure of \$81.6 billion (in addition to the five distribution types cited in the text, this figure controls for distributions as a result of PS 58 costs (\$0.02 billion) and prohibited transactions (\$0.07 billion)), compared with Woods' estimate of \$64.9 billion and the \$107.2 billion figure originally presented in the EBRI Issue Brief.

12.4 million persons reported ever having received a lump-sum distribution from a retirement plan on a previously held job. The mean amount of the most recent distribution received was \$10,795 (1993 dollars), with a median of \$3,507.

The Current Population Survey (CPS) employee benefit supplement asks a series of questions regarding the receipt and disposition of lump-sum distributions among current workers. The last supplement was conducted in 1993.⁹ According to EBRI tabulations¹⁰ of these data, in 1993, 12.4 million persons reported ever having received a lump-sum distribution from a retirement plan on a previously held job. The mean amount of the most recent distribution received was \$10,795 (1993 dollars), with a median of \$3,507.

Among distribution recipients, 41.5 percent reported using at least some of their most recent distribution for tax-qualified financial saving (i.e., rollover), and 17.0 percent reported using a portion of the distribution for non tax-qualified saving. The larger the distribution, the older the recipient, and the more recent the year of receipt, the more likely it was to have been used at least partially for tax-qualified saving. Over 30 percent of recipients reported using at least some of their distribution to pay off debt, purchase a home, or start/purchase a business. Three percent used some of their distribution for educational expenses. Thirty-eight percent of recipients used at least some of their distribution for consumption.¹¹ Nineteen percent of lump-sum distribution recipients reported using the entire distribution for tax-qualified saving, 8 percent reported using it entirely for non tax-qualified saving, and 5 percent used it all for both types of saving.

Scott and Shoven (1996) used the CPS data from 1993, 1988, and 1983 to analyze lump-sum distribution trends over time. They conclude that, while lump-sum availability has increased over time, the propensity for plan participants to cash out their distributions instead of rolling them

over on job change has actually fallen slightly over the period 1983–1993. This decrease in cashout propensity was more pronounced for women than for men but was pervasive at all preretirement age levels. Furthermore, the size of the typical cashout, when it occurs, has actually fallen slightly over time. From a retirement income security perspective, such findings are encouraging. However, it could still be argued that, while the trends are encouraging, the levels may not be satisfactory.

The 1996 Retirement Confidence Survey¹² (RCS) addressed for the first time the issue of benefit preservation among workers receiving a lump-sum distribution.¹³ This survey asked current workers whether, within the past three years (changes in the law regarding lump-sum distributions became effective in 1993), they had received a lump-sum distribution from a retirement plan on leaving a job before retirement. Ten percent of workers responded that they had received a distribution within the past three years.¹⁴ Among those receiving a distribution, 50 percent reported spending some or all of the money distributed. Therefore, at least 5 percent of all current workers have experienced some degree of benefit

⁹ The employee benefit supplement will no longer be fielded as part of the Current Population Survey. Instead, it is being merged with an analogous topical module in the Survey of Income and Program Participation (SIPP). This topical module will next be fielded in 1998.

¹⁰ Paul Yakoboski, et al., "Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey," EBRI Special Report SR-25/Issue Brief no. 153 (Employee Benefit Research Institute, September 1994).

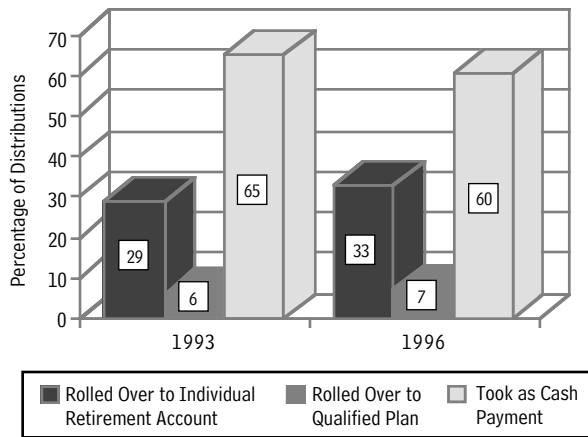
¹¹ Consumption uses include purchase of a car, medical or dental expenses, general everyday expenses, and other uses.

¹² The Retirement Confidence Survey is conducted annually by the Employee Benefit Research Institute, Mathew Greenwald and Associates, and the American Savings Education Council. One-thousand Americans (75 percent workers; 25 percent retirees) are surveyed regarding their savings, preparations, and attitudes with regard to retirement.

¹³ Paul Yakoboski, and Allen Schifffenbauer, "The Reality of Retirement Today: Lessons in Planning for Tomorrow," EBRI Issue Brief no. 181 (Employee Benefit Research Institute, January 1987).

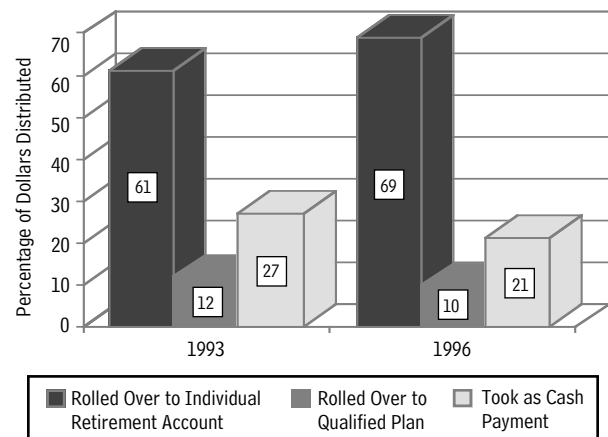
¹⁴ Workers who were eligible to receive a distribution but chose instead to leave their funds behind in their former employers' plan would not report having received a lump-sum distribution.

Chart 1
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DISTRIBUTIONS, 1993 VERSUS 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart 2
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993 VERSUS 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

leakage from the employment-based retirement system over the past three years because they chose to spend some or all of a lump-sum distribution that they received. In addition, 46 percent of those receiving a distribution reported rolling over at least some of the money into an IRA or a new employer's plan, and 27 percent reported putting at least some of the money into a saving vehicle other than an IRA or a new employer's plan. Lower-income workers (with annual incomes less than \$35,000) and younger workers (under age 35) were notably less likely to have rolled over their distribution.

Worker Rollovers

The 1996 Hewitt database used for this particular analysis consists of 87,318 distributions, totaling \$2.3 billion (for an

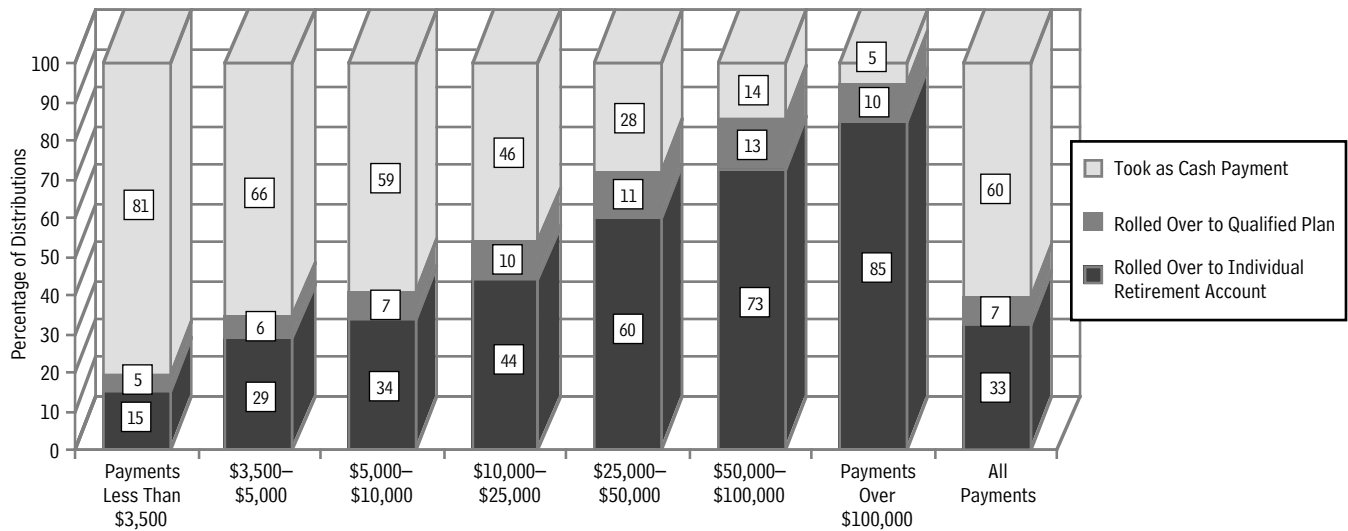
average distribution size of \$26,181). Out of this total, 71,736 distributions went to workers on job termination (i.e., to job changers), and these distributions totaled \$1.3 billion (for an average distribution of \$18,313). Of the remaining distributions, 13,868 distributions, totaling \$0.9 billion (for an average distribution of \$65,067, were made to retirees and disabled workers; and 1,714 distributions, totaling \$70 million (for an average distribution of \$40,825), were made to deceased plan participants' beneficiaries. The average number of participants per plan in this database was 5,635.

The 1993 Hewitt data consist of 138,088 distributions, totaling \$2.4 billion (for an average distribution size of \$17,436). Out of this total, 117,781 distributions

were made to workers on job termination (i.e., to job changers), totaling \$1.6 billion (for an average distribution of \$13,936). Of the remaining distributions, 17,965 distributions, totaling \$0.7 billion (for an average distribution of \$39,291), were made to retirees and disabled workers; and 2,342 distributions, totaling \$60 million (for an average distribution of \$25,791), were made to deceased plan participants' beneficiaries. The average number of participants per plan in this database was 4,549.

In the Hewitt data, 40 percent of all distributions to job changers, i.e., on job termination, in 1996 were rolled over (chart 1). (Thirty-three percent were rolled over to an IRA, and 7 percent were rolled into another tax-qualified plan.) This rollover rate increased from 1993, when 35 percent of all distributions resulted in a rollover. Rollover percentages are much higher when examined from the perspective of the dollars distributed, because larger distributions are more likely to be preserved on a tax-deferred basis. In the Hewitt data, 79 percent of all dollars distributed to job changers in 1996 were rolled over (chart 2). (Sixty-nine percent of the distributed dollars was rolled into IRAs, and 10 percent was rolled into another tax-qualified plan). By comparison, in 1993, 73 percent of all dollars distributed were preserved via rollover. Thus the data provided by Hewitt for this particular subset of the plans they service indicate that rollover percentages have improved during the period 1993–1996. They also indicate that most of the dollars distributed on job change are rolled over into tax-qualified retirement saving vehicles. These findings are consistent with the previous research discussed above.

Chart 3
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DISTRIBUTIONS, 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

One should note that these rollover rates may represent a lower bound, i.e., the minimum rates of rollover. It is possible that individuals receiving a cash payment of their distribution amount subsequently roll their distribution over into an IRA or other tax-qualified plan. This could happen in instances where an individual, not appreciating the tax consequences, receives a cash distribution only to find 20 percent of the vested account balance withheld. He or she might then roll over part or all of the distribution amount to avoid/minimize taxation. Given the data available, we do not know about subsequent rollover behavior and, specifically, what fraction of amounts cashed out stay out of tax-qualified retirement saving vehicles.

The Hewitt data confirm previous research findings that rollover propensities increase with the size of the distribution, i.e., the larger the distribution, the more likely it will be preserved in a tax-qualified vehicle. In the 1996 Hewitt data, 20 percent of distributions less than \$3,500 were rolled over, compared with 95 percent of distributions over \$100,000 (chart 3). Analogous findings emerge when the analysis focuses on the dollars distributed. Among distributions of less than \$3,500, 27 percent of the dollars were rolled over, while among distributions over \$100,000, 96 percent of the dollars were preserved via rollover (chart 4).

The likelihood of roll over is also positively correlated with the recipient's age. In the 1996 Hewitt data, 26 percent of all distributions made to workers in their 20s were rolled over into IRAs or other tax-qualified saving vehicles (chart 5). This rollover rate increased

steadily to 52 percent for recipients in their 50s, and then remained at 51 percent for those ages 60 and older. Just over one-half (51 percent) of the dollars distributed to recipients in their 20s were rolled over (chart 6). This figure increased to 86 percent for workers in their 50s and to 89 percent for those ages 60 and older.

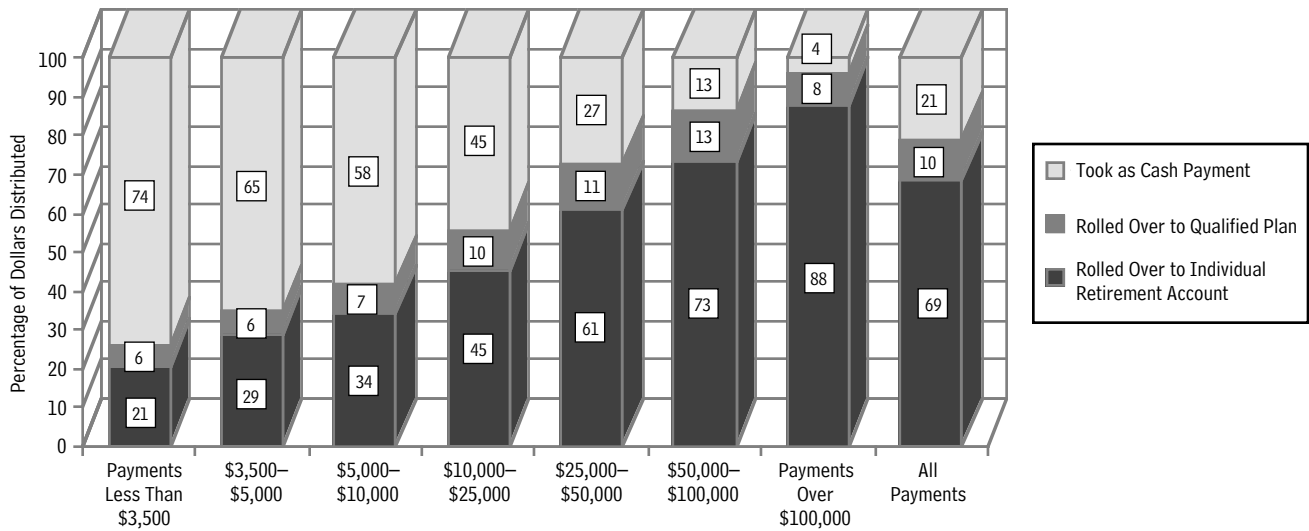
In general, rollover rates (both in terms of the number of distributions and the dollars distributed) increased for all size distributions during the 1993–1996 period. Also, rollover rates increased (both in terms of the number of distributions and the dollars distributed) among all age groups during this period. (Charts A1–A4 in the appendix contain data for 1993.)

Implications

From a retirement income security perspective, these data provide good news. First, the propensity to roll over preretirement distributions has been increasing over recent years. Second, over three-quarters of the dollars distributed (79 percent) are preserved via roll over to IRAs or other tax-qualified vehicles.

At the same time, the data point to shortfalls from a retirement income security perspective. While most dollars distributed are rolled over, and the likelihood of rollover increases with the recipient's age and the size of the distribution, most distributions do not result in a rollover. According to the 1996 Hewitt data, only 40 percent of distributions resulted in a rollover, while 60 percent resulted in a cashout. Again, the larger the distribution, the more likely it is to be rolled over.

Chart 4
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996



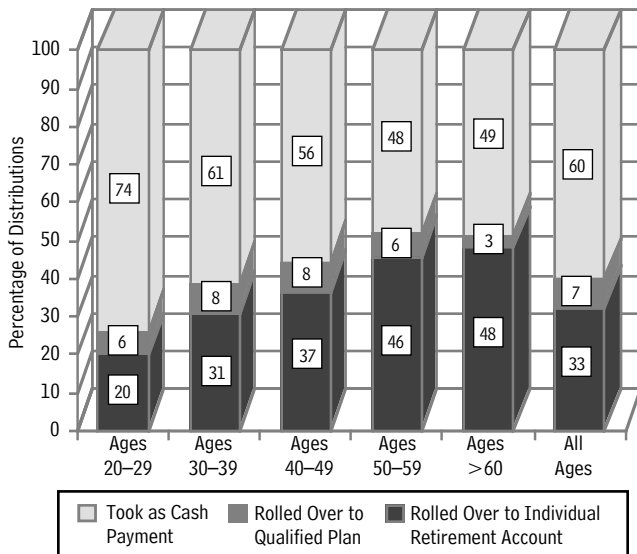
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Over 80 percent of distributions under \$3,500 were cashed out, while only 5 percent of distributions over \$100,000 were cashed out. However, it is interesting to note that even among workers in their 50s—an age group that should be focused on retirement and that is most likely to roll over distributions—almost one-half (48 percent) of the preretirement distributions were cashed out.¹⁵ Among workers in their 20s, nearly three-

quarters of distributions were cashed out. On one hand, it can be argued that, since most

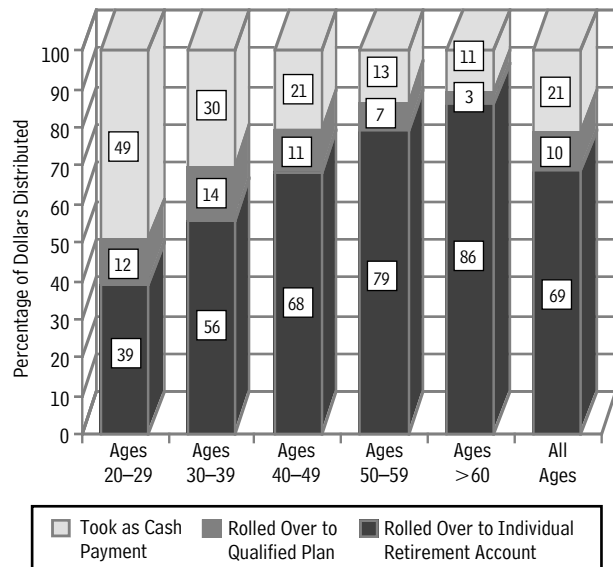
¹⁵ The rollover versus cashout decision of older workers may well be influenced by the other sources of retirement income that they have. For example, nearly 8 out of 10 large employers in 1996 offered both a defined benefit and a defined contribution plan. Thus, some participants with the security of having a stream of income from a defined benefit plan may be more willing to take a lump-sum distribution in cash.

Chart 5
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DISTRIBUTIONS, 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart 6
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996



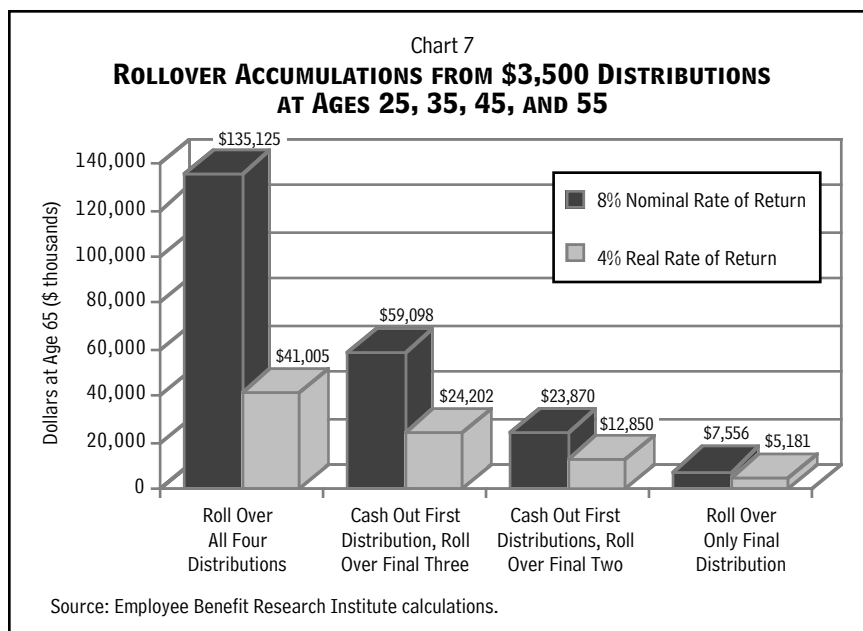
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

distributions that are cashed out are relatively small and are most likely to be received by young workers, there is no great need for concern from a

policy perspective. These individuals still have decades until retirement during which to accumulate retirement assets. On the other hand, it can be argued from a financial planning perspective that even relatively small sums of money can compound into nontrivial contributions to a retirement nest egg over a period of decades. Furthermore, the importance of preserving such balances is enhanced by the fact that the typical work-force entrant today will hold more than eight jobs on average over the course of a working life.¹⁶ This suggests the possibility of receiving a number of these “small” distributions over the course of a career.

To help quantify the dollars involved, consider a number of “small” distributions received over the course of a working life. Assume that an individual receives a \$3,500 distribution at ages 25, 35, 45, and 55. Chart 7 demonstrates the potential of these “small” distributions. Assuming an 8 percent annual nominal rate of return, this individual would have \$135,125 at age 65 if all four distributions were rolled over and preserved. If the distribution at age 25 was cashed out while the final three were rolled over, the individual would have \$59,089 at age 65. Note that cash out of the “small distribution” at age 25 sacrifices \$76,035 at age 65 due to the power of compounding interest over time. In real terms (assuming an annual inflation rate of 4 percent), preservation of all four distributions would result in \$41,005 at age 65.

To put these figures in perspective, assume a single male, age 65, purchases a life annuity today.¹⁷ With \$41,005, he could purchase a nominal monthly annuity for life of \$363; \$24,202 would produce a monthly annuity of \$214; \$12,850 would produce a



monthly annuity of \$114; and \$5,181 would produce a monthly annuity of \$46. By comparison, the current average monthly Old-Age and Survivors

Insurance (OASI) Social Security benefit for a retired male worker is \$840.¹⁸

Retirement Lump-Sums

The Hewitt data also allow analysis of distributions to retirees or disabled individuals. In 1996, 52 percent of distri-

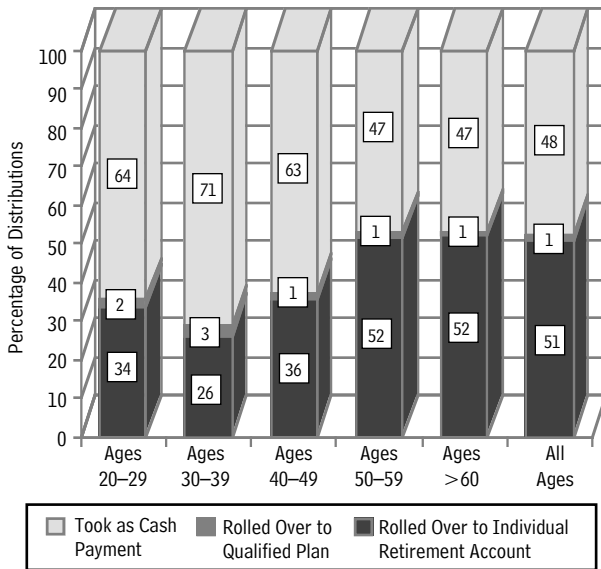
butions to retired or disabled individuals were rolled over (chart 8), and 87 percent of the dollars distributed to retirees and disabled workers were rolled over (chart 9). These rollover rates were higher than those for job changers, where the corresponding figures were 40 percent and 79 percent, respectively. Those who retired or became disabled at age 50 or older were more likely to roll over the money than those who retired or became disabled at earlier ages. In addition, the likelihood of rollover among retired or disabled individuals was positively correlated with the size of the distribution, both in terms of the number of distributions and the dollars distributed (charts 10 and 11). (Data for distributions to retired or disabled individuals in 1993 are presented in Appendix charts A5–A8.)

¹⁶ According to a 1993 U.S. Bureau of Labor Statistics report, between the ages of 18 and 30, a typical individual has held 7.5 jobs and has 8.6 years of work experience. Nineteen percent have held 3 or fewer jobs, 29 percent have held 4–6 jobs, 26 percent have held 7–9 jobs, and 27 percent have held 10 or more jobs. The average time spent at the longest job held between age 18 and age 30 is 5 years.

¹⁷ Assume \$9.41 buys annuity of \$1/year payable monthly (McGill, 1996).

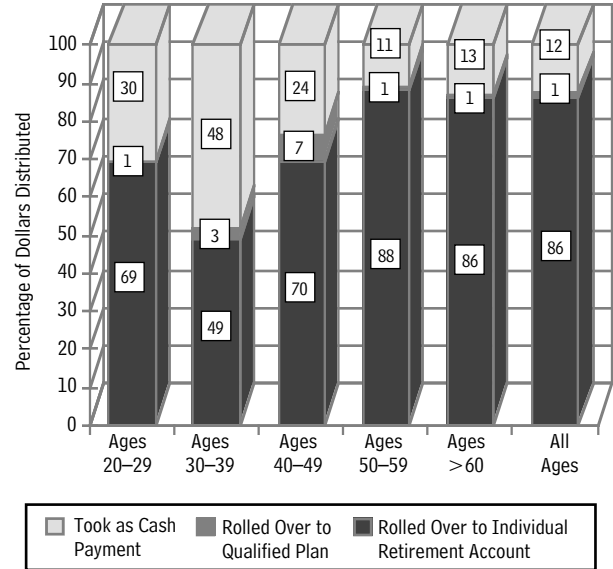
¹⁸ Note that Social Security benefits are indexed for inflation, while these annuity calculations are for nominal annuities that are not indexed.

Chart 8
**BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED,
 BY PERCENTAGE OF DISTRIBUTIONS, 1996**



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart 9
**BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED,
 BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996**



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Unfortunately the data allow no further analysis concerning the ultimate uses of these funds in retirement, especially with regard to annuitization.¹⁹ Unanswered questions remain. To what extent did those who did not roll over their distributions annuitize them? Among those who did roll over their distributions, when and how will they ultimately tap into their accounts to fund retirement? In addition, retirees' rollover versus cashout decision may well be influenced by their other sources of retirement income. For example, in 1996, nearly 8 out of 10 large employers offered both a defined benefit and a defined contribution plan. Thus, some retirees with the security of having a stream of income from a defined benefit plan may be more willing to take a lump-sum distribution in cash at the time of retirement.

Data from the 1996 RCS provide some insights. One-fifth (21 percent) of current retirees reported having money in an employment-based retirement savings plan, such as a 401(k) plan, at the time they retired. Sixteen percent had money in another type of defined contribution plan such as a profit-sharing plan. Allowing for those with both types of accounts, 30 percent of current retirees retired with money in some form of employment-based defined contribution plan. In the survey, they were

given five options and asked whether they had used any of their account money in any of these five ways. The most common action (reported by 32 percent) was having put some or all of the money in an IRA from which no withdrawals had yet been made. Note that retirement is a self-reported status, and that 13 percent of the retirees were under age 60. Penalty-free withdrawals from IRAs, 401(k) plans, and other defined contribution plans may not commence before age 59^{1/2}. This likely accounts for some of this behavior, but not all.

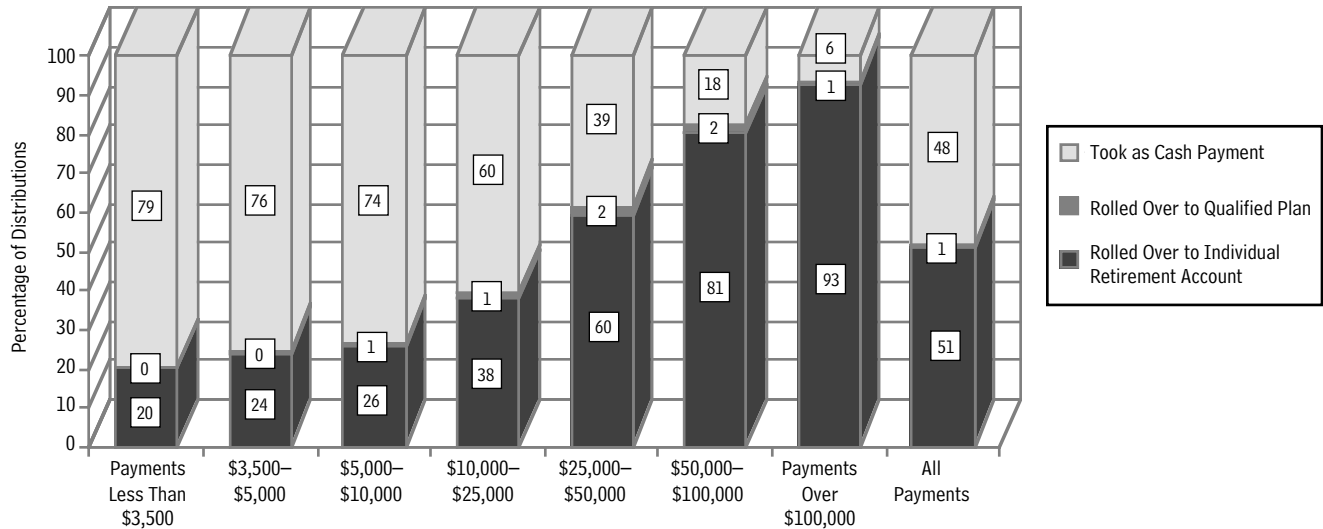
Eighteen percent reported having put some or all of the money in an IRA and making withdrawals as needed, and 15 percent reported having put some or all of the money in an IRA and receiving regular periodic payments from the account. Twelve percent reported annuitizing some or all of the money and receiving regular payments guaranteed for life, and 12 percent reported annuitizing some or all of the money and receiving regular payments.²⁰

Older retirees were more likely to be receiving regular periodic payments as a result of this money (either through annuitization or via an IRA), while younger retirees were more likely to have put the money in an IRA and not yet to have touched it.

¹⁹ An annuity is a contract or other arrangement that provides income at regular intervals for a specified period of time, such as for a number of years or for life. In this case, annuitization means converting the lump-sum amount into a stream of such annuity payments.

²⁰ Note, these numbers total 89 percent. Some retirees took action with their account balances other than the five specifically asked. This is likely accounted for mostly by retirees who have left the money within the employment-based plan to date.

Chart 10
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DISTRIBUTIONS, 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

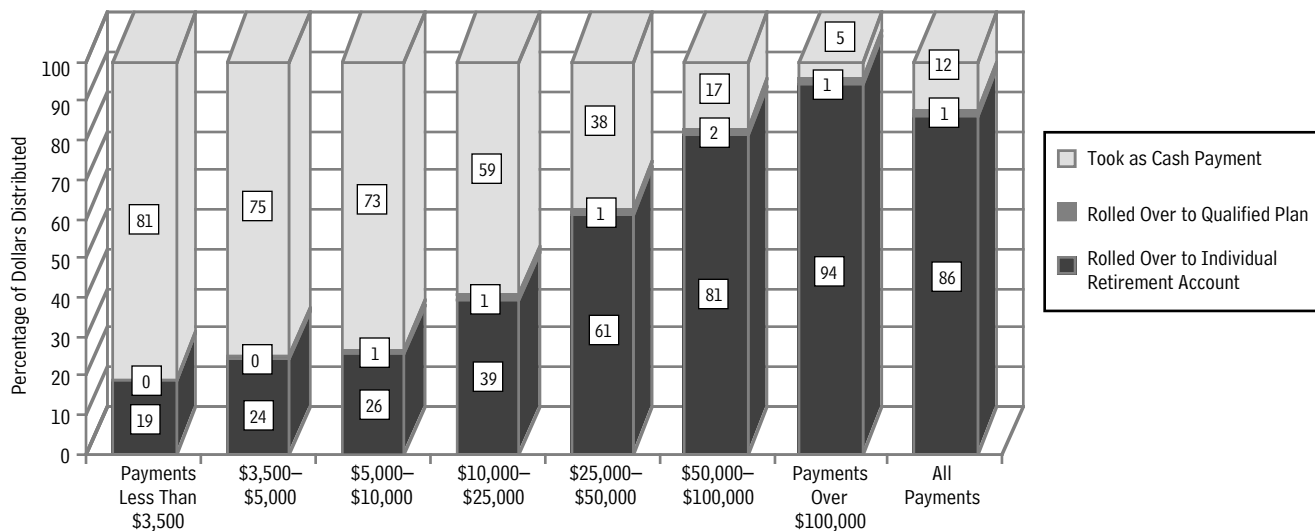
Distributions on Death

In 1996, 27 percent of distributions to beneficiaries resulting from the death of a plan participant were rolled over to

an IRA. Of the dollars distributed to the beneficiaries of deceased plan participants, 56 percent were rolled over to an IRA in 1996. (Data for the preservation of death

distributions are presented in appendix tables A9–A16.) The tendency to roll over is much lower in cases of death distributions than it is with distributions on job change and on retirement or disability. These lower rollover rates are likely to occur for two reasons. First, if the beneficiary is the surviving spouse, the payment may be rolled over into an IRA but not into another qualified retirement plan. Therefore, the spouse's options are limited. Second, if the beneficiary is someone other than a spouse, the distribution is not eligible for rollover.

Chart 11
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Conclusion

The data in this *Issue Brief* indicate that the propensity to roll over preretirement distributions has been increasing

over recent years. In 1996, over three-quarters of the dollars distributed on job change (79 percent) were preserved via roll over to an IRA or another tax-qualified vehicle. This increase can likely be attributed to several developments. In addition to creating a financial incentive to roll over distributions by imposing the 20 percent withholding requirement, changes in the law in 1993 made rollovers extremely simple from the individual's perspective. Rollovers can now be executed by a direct transfer of funds from the former employer's plan to an IRA at any financial institution or to a new employer's plan (if that plan accepts rollovers); the participant never even sees the money. These developments have been accompanied by financial companies' aggressive campaigns to educate the public and capture a larger share of the rollover market. In addition, workers are learning about rollovers and benefit preservation in educational material they receive through their retirement plans at work. Finally, since rollover propensities increase with worker age, we can expect further increases in aggregate rollover rates as the baby boom generation continues to move beyond age 50.

However, at the same time, the data suggest areas of shortfall from the perspective of retirement income and capital accumulation. While most dollars distributed are rolled over, and while the likelihood of rollover increases with age of recipient and size of the distribution, most distributions are not rolled over. In the 1996 Hewitt data, only 40 percent of distributions were rolled over, while 60 percent were cashed out. It can be argued from a financial planning perspective that even relatively small sums of money can compound into nontrivial contributions to a retirement nest egg over a period of decades. Furthermore, the importance of

preservation of seemingly small balances is enhanced by the fact that the typical work force entrant today will hold more than eight jobs on average over the course of a working life. This suggests the possibility of receiving a number of these "small" distributions over the course of a career. Again, it should be noted that we do not know how many individuals who cash out a lump-sum distribution subsequently choose to roll it over, and, therefore, the figures represented here are effectively upper bounds on cashout propensities.

Finally, policymakers continue to debate and consider IRA expansion. While some disagreement exists on the extent to which IRAs result in a net addition to retirement savings, IRAs are indisputably a major vehicle for retirement benefit portability, and are likely to become increasingly utilized for benefit preservation if recent trends continue.

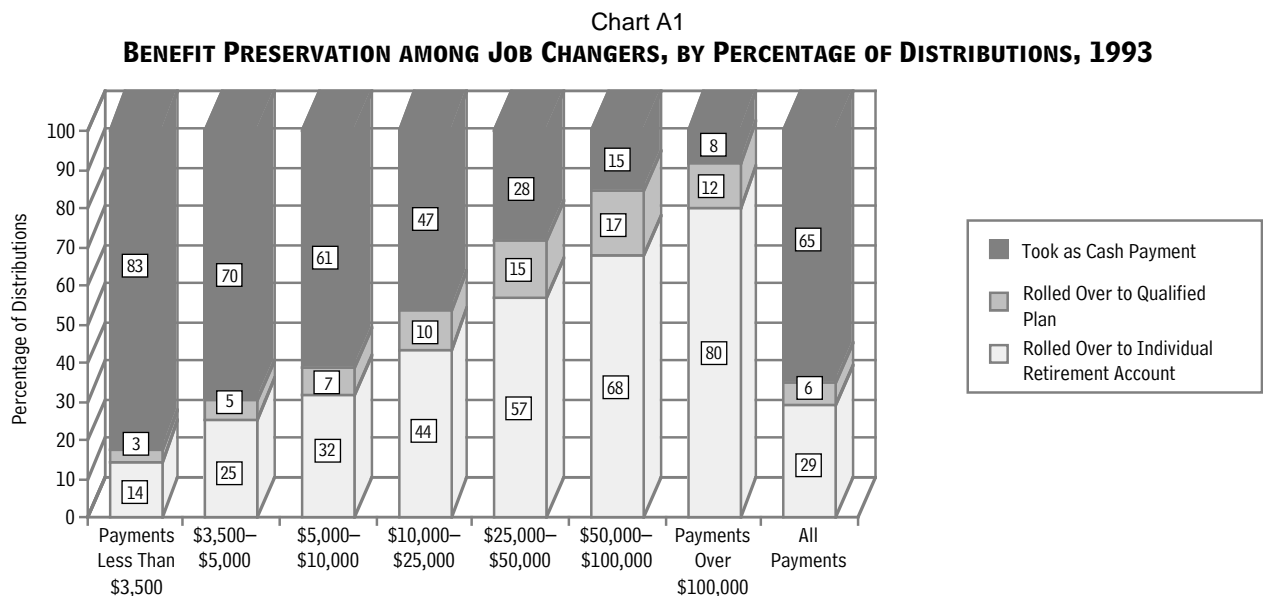
References

- McGill, D. M., K.N. Brown; J.J. Haley, and S.J. Schieber. *Fundamentals of Private Pensions*. Seventh edition (Philadelphia, PA: University of Pennsylvania Press, 1996).
- Scott, Jason S., and John B. Shoven. "Lump-Sum Distributions: Fulfilling the Portability Promise or Eroding Retirement Security?" *EBRI Issue Brief* no. 178 (Employee Benefit Research Institute, October 1996).
- U.S. Department of Labor. Bureau of Labor Statistics. *Work and Family: Turning Thirty-Job Mobility and Labor Market Attachment*. Report 862. Washington, DC: U.S. Government Printing Office, 1993.
- Woods, John R. "Pension Benefits Among the Aged: Conflicting Measures, Unequal Distributions." *Social Security Bulletin*. Vol. 59, no. 3 (Fall 1996): 3-30.
- Yakoboski, Paul, and Allen Schiffenbauer. "The Reality of Retirement Today: Lessons in Planning for Tomorrow." *EBRI Issue Brief* no. 181 (Employee Benefit Research Institute, January 1987).

Yakoboski, Paul. "Retirement Program Lump-Sum Distributions: Hundreds of Billions in Hidden Pension Income." *EBRI Issue Brief* no. 146 (Employee Benefit Research Institute, February 1994).

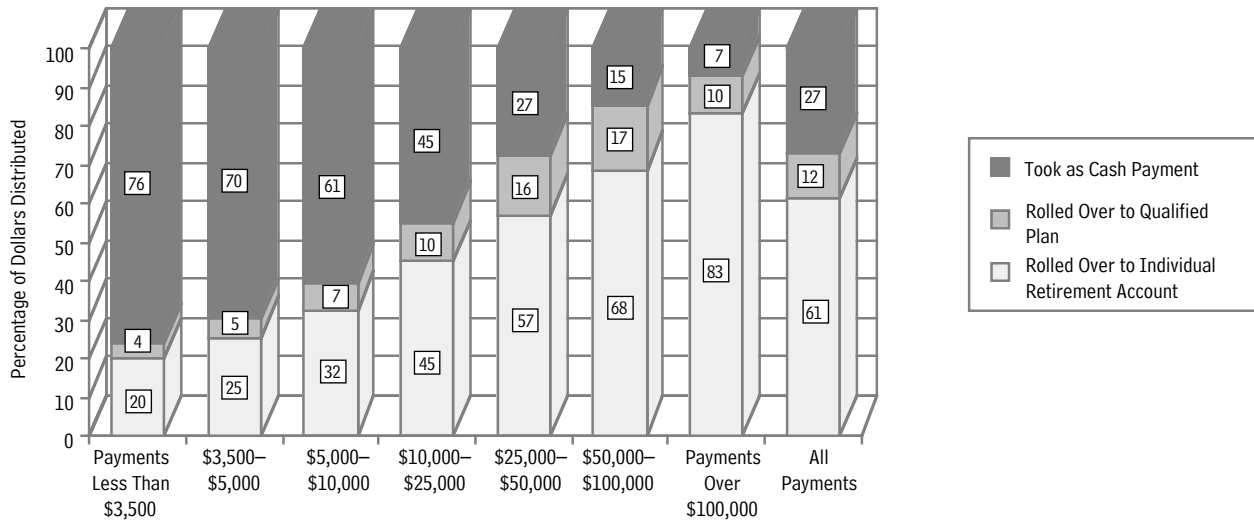
Yakoboski, Paul, et al. "Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey." *EBRI Special Report SR-25/Issue Brief* no. 153 (Employee Benefit Research Institute, September 1994).

Appendix



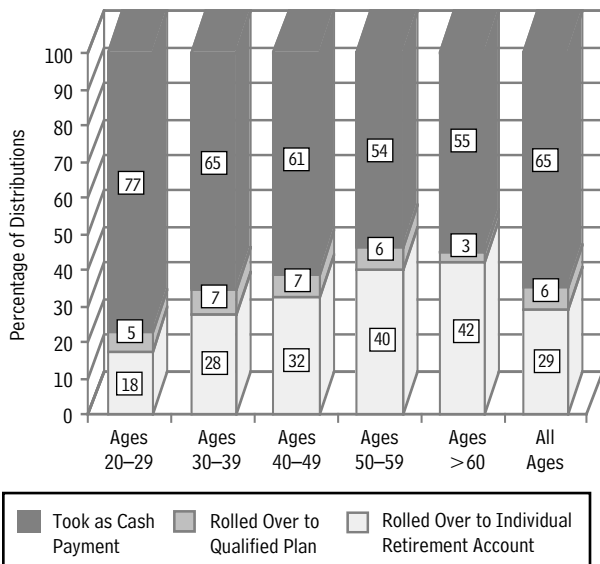
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A2
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993



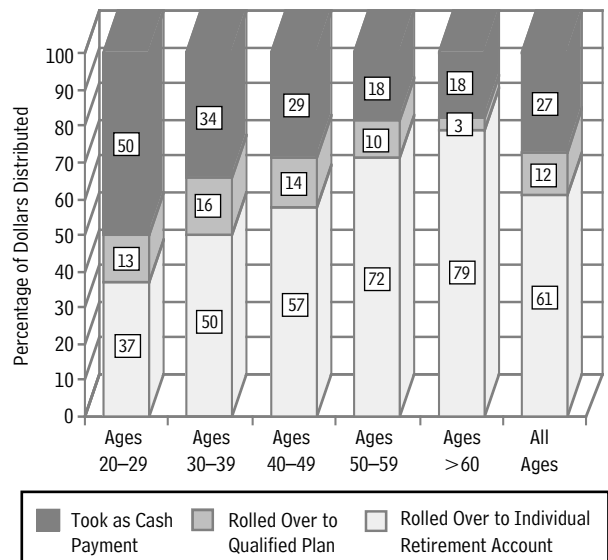
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A3
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DISTRIBUTIONS, 1993



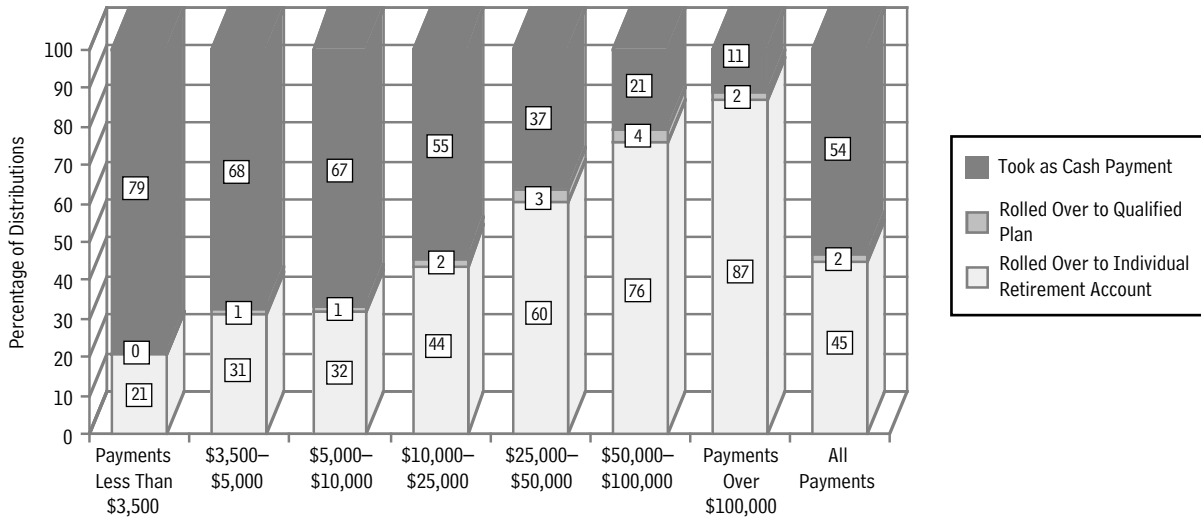
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A4
BENEFIT PRESERVATION AMONG JOB CHANGERS, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993



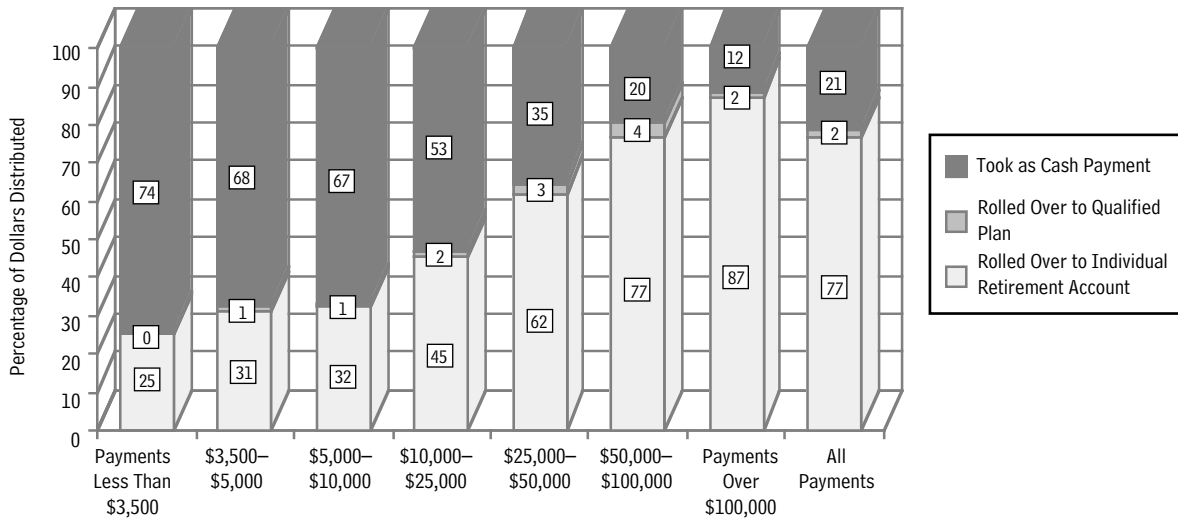
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A5
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DISTRIBUTIONS, 1993



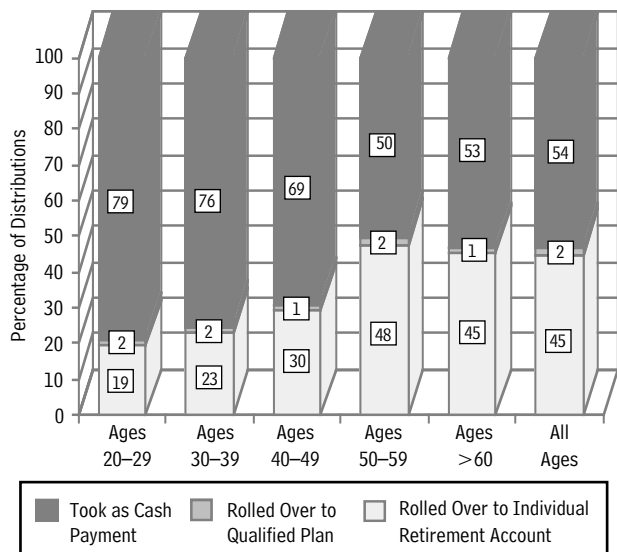
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A6
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993



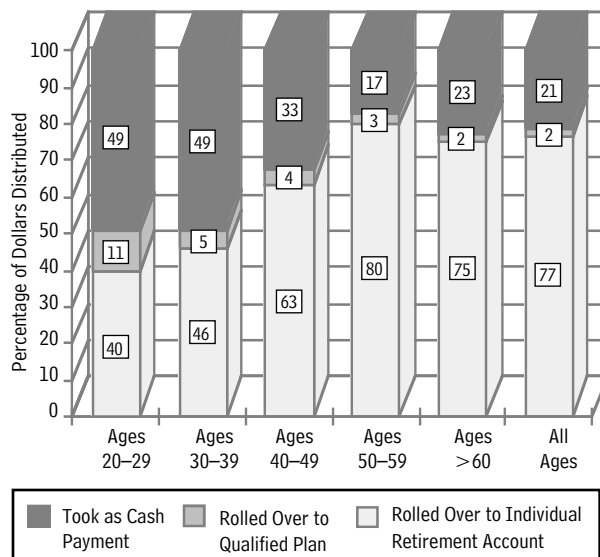
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A7
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DISTRIBUTIONS, 1993



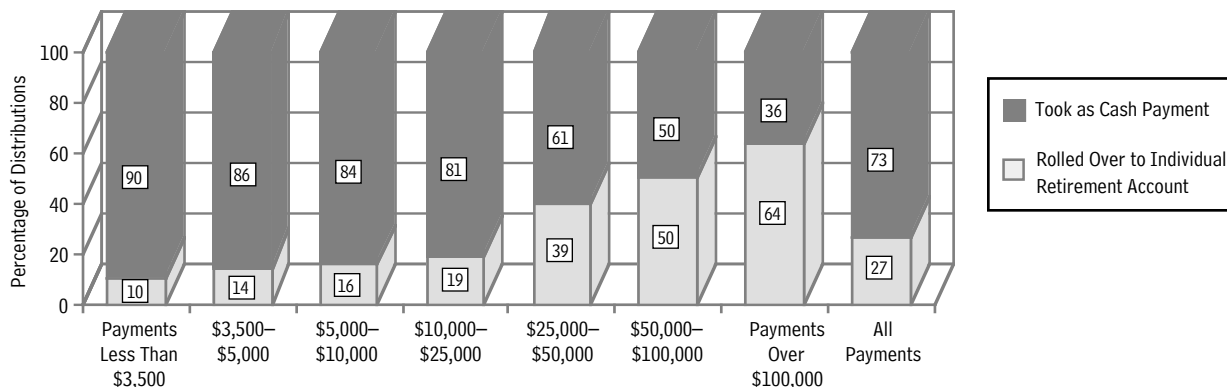
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A8
BENEFIT PRESERVATION AMONG THE RETIRED/DISABLED, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993



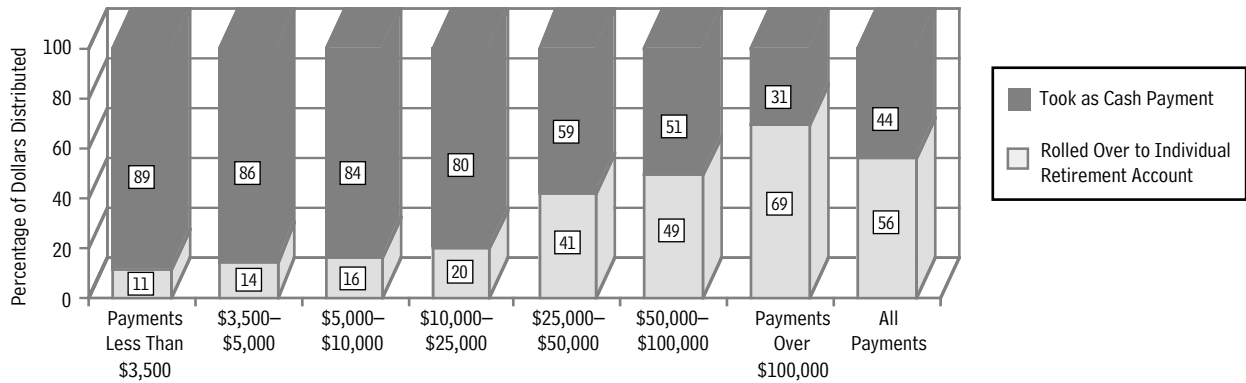
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A9
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DISTRIBUTIONS, 1996



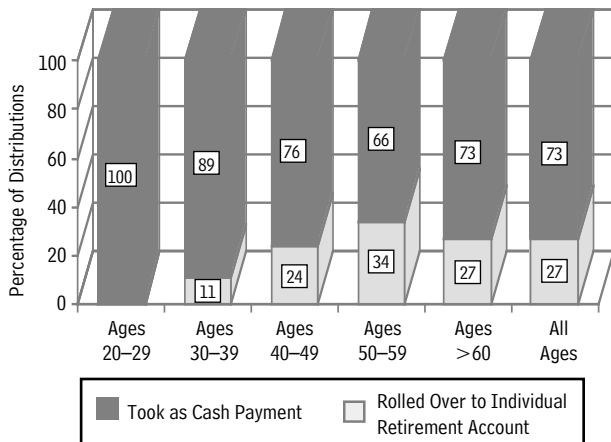
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A10
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996



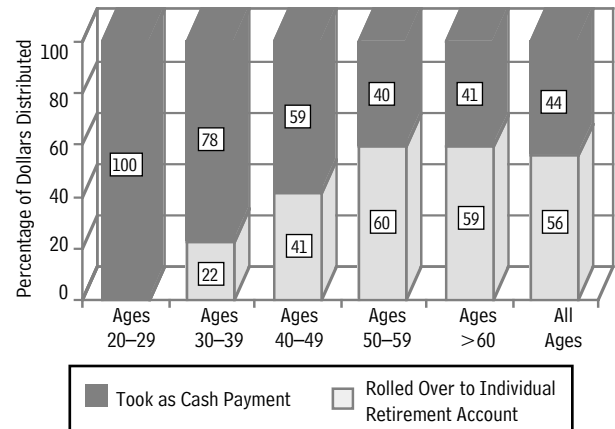
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A11
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DISTRIBUTIONS, 1996



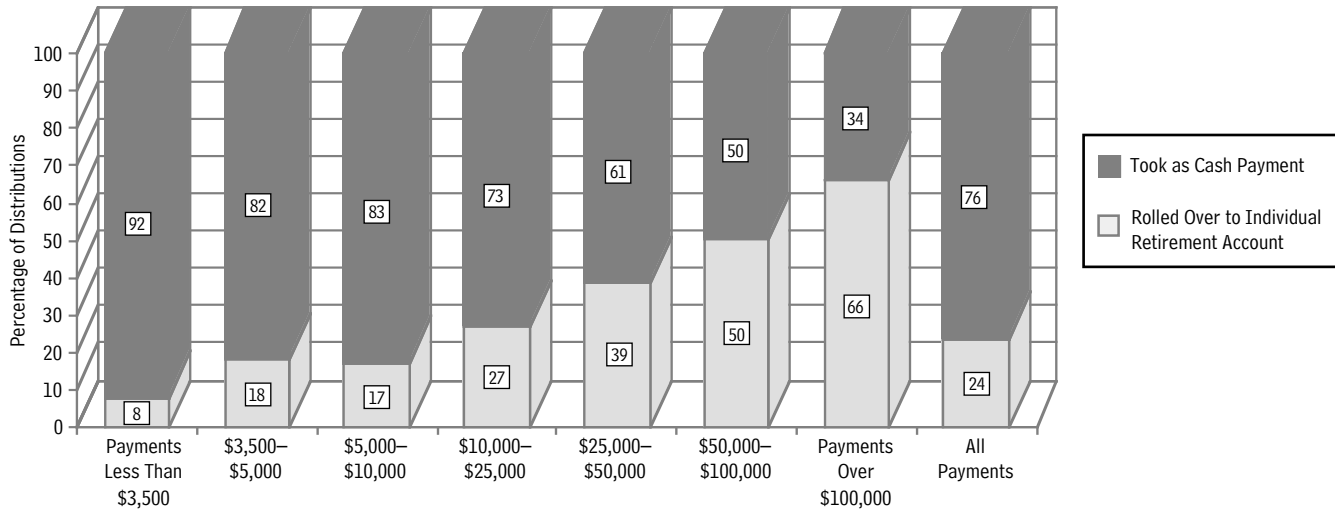
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A12
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1996



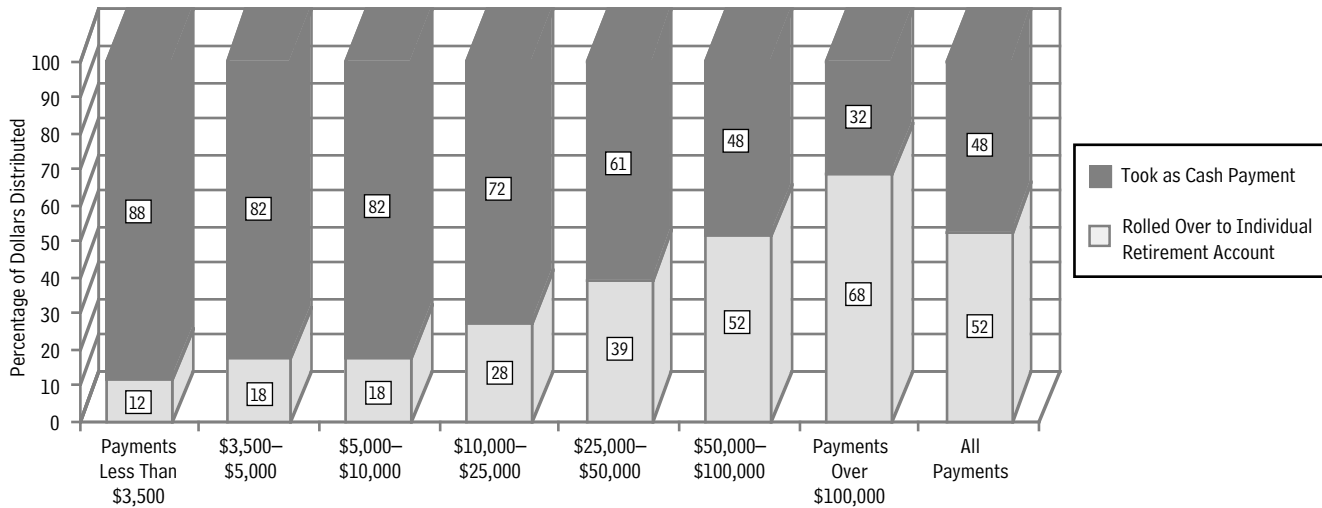
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A13
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DISTRIBUTIONS, 1993



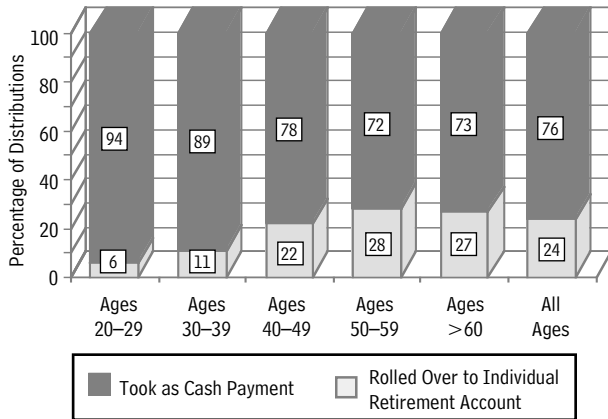
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A14
BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES, BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993



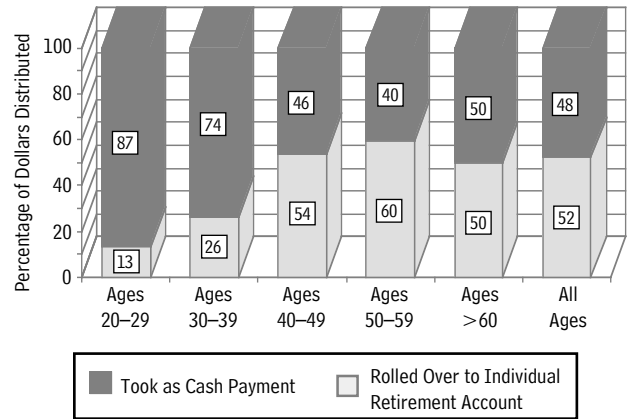
Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A15
**BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES,
 BY PERCENTAGE OF DISTRIBUTIONS, 1993**



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

Chart A16
**BENEFIT PRESERVATION AMONG DEATH BENEFICIARIES,
 BY PERCENTAGE OF DOLLARS DISTRIBUTED, 1993**



Source: Employee Benefit Research Institute and Hewitt Associates tabulations of Hewitt Associates data.

EBRI

EMPLOYEE

BENEFIT

RESEARCH

INSTITUTE®

Issue Brief

© 1997.
Employee
Benefit
Research
Institute-
Education
and
Research
Fund.
All rights
reserved.

Established in 1978, the Employee Benefit Research Institute (EBRI) is the only private, nonprofit, nonpartisan, organization committed to original public policy research and education on economic security and employee benefits. Through its activities, EBRI is able to advance the public's, the media's, and policy makers' knowledge and understanding of employee benefits and their importance to the nation's economy. EBRI's membership represents a cross section of pension funds; businesses; trade associations; labor unions; health care providers and insurers; government organizations; and service firms.

The Employee Benefit Research Institute Education and Research Fund (EBRI-ERF) performs the charitable, educational, and scientific functions of the Institute. EBRI-ERF is a tax-exempt organization supported by contributions and grants.

The American Savings Education Council (ASEC) is a part of EBRI-ERF. ASEC is a coalition of over 200 private- and public-sector institutions. ASEC's goal is to make saving and retirement planning a vital concern of Americans and in the economic interests of employers. Partnership is open to any organization that shares this goal. Inquiries regarding ASEC should be directed to Don Blandin, (202) 775-9130; email to: blandin@asec.org; or on the World Wide Web at www.asec.org.

EBRI Issue Briefs are monthly topical periodicals providing expert evaluations of employee benefit issues and trends, including critical analyses of employee benefit policies and proposals. Each issue, ranging in length from 16–28 pages, thoroughly explores one topic. Subscriptions to *EBRI Notes* are included as part of EBRI membership or as part of an annual \$224 subscription to *EBRI Notes* and *EBRI Issue Briefs*. Individual copies of *Notes* and *Issue Briefs* are available for \$25 each, prepaid, by calling EBRI.

Other EBRI publications include: *EBRI Notes* is a monthly periodical providing up-to-date information on a variety of employee benefit topics. *EBRI's Washington Bulletin*, provides sponsors with short, timely updates on major developments in Washington in employee benefits. *EBRI's Fundamentals of Employee Benefit Programs* offers a straightforward, basic explanation of employee benefit programs in the private and public sectors. *The EBRI Databook on Employee Benefits* is a statistical reference volume providing tables and charts on private and public employee benefit programs and work force related issues.

Other activities undertaken by EBRI include educational briefings for EBRI members, congressional and federal agency staff, and the media; public opinion surveys on employee benefits issues; special reports; and policy studies.

Editorial Board

Publisher: Dallas L. Salisbury

Editor: Maureen Richmond

Layout and Distribution: Cindy O'Connor

Subscriptions/Orders: Direct subscription inquiries to EBRI Publications, (202) 659-0670; fax publication orders to (202) 775-6312. A complete list of EBRI publications are available on the World Wide Web at <http://www.ebri.org>.

Change of Address: EBRI, 2121 K Street, N.W., Suite 600, Washington, DC 20037, (202) 775-6311; fax number, (202) 775-6312; e-mail to PublicationsSubscriptions@ebri.org.

Membership: Inquiries regarding EBRI membership and/or contributions to EBRI-ERF should be directed to EBRI President Dallas Salisbury or Director of Membership Deborah Milne, 2121 K Street, N.W., Suite 600, Washington, DC 20037, (202) 659-0670; e-mail to: Salisbury@ebri.org or Milne@ebri.org.

Any views expressed in this publication and those of the authors should not be ascribed to the officers, trustees, members, or other sponsors of the Employee Benefit Research Institute, the EBRI Education and Research Fund, or their staffs. Nothing herein is to be construed as an attempt to aid or hinder the adoption of any pending legislation, regulation, or interpretative rule, or as legal, accounting, actuarial, or other such professional advice.

EBRI Issue Brief is registered in the U.S. Patent and Trademark Office
ISSN: 0887-137X 0887-137X/90 \$.50 +.50
