

# Lump-Sum Distributions: Fulfilling the Portability Promise or Eroding Retirement Security?

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Issue Brief

- The critical decision an employee makes on receipt of a lump-sum distribution (LSD) is whether to roll over the distribution to another tax-qualified retirement savings vehicle or to cash out the distribution for current consumption. In order to be an effective mechanism for preserving retirement income, LSDs must remain as retirement assets. This *Issue Brief* examines trends in LSD availability, utilization, and magnitude.
- In 1983, 47.8 percent of retirement plan participants reported the availability of a LSD, compared with 71.5 percent in 1993. Lump-sum availability has increased in both defined contribution and defined benefit retirement plans.
- In 1983, 55 percent of all individuals reporting a previous pension benefit also reported a *cashout LSD*. This propensity dropped to 50 percent in 1993. So while the availability of LSDs has increased, the propensity to choose a cashout LSD has fallen. The decrease in the propensity for cashouts is concentrated primarily among individuals earning more than \$30,000.
- The percentage of cashouts larger than \$5,000 increased from 13 percent in 1983 to 19 percent in 1993. A possible explanation for this increase is that typical account balances are becoming larger. Another possibility is that cashouts are coming from the larger accounts in plan participants' later years relative to their early years.
- The overall median cashout actually declined from \$2,320 in 1988 to \$2,000 in 1993. Younger workers, i.e., those under age 40, experienced a slight increase in their typical cashout levels. Workers in the accumulation phase of their careers, i.e., aged 40–55, actually experienced a large *decline* in the size of the typical cashout LSD from 1988 to 1993.
- The only category that experienced a large increase in the size of the typical cashout LSD was workers aged 61–65. However, if the goal is to assess the impact of cashouts on retirement income adequacy, this fact is hardly distressing, given the age category. The real danger of pension erosion occurs during job turnover at a younger age. Furthermore, the main concern for pension erosion is centered on lower wage workers, and the typical cashout levels of workers who earn less than \$40,000 were either relatively flat or decreased from 1983 to 1993.

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## Introduction

Fifteen years ago, predominant employment-based retirement plan coverage came from the defined

benefit retirement plan. Defined benefit plans usually provide benefits based on the number of years of service and the highest wage attained. This type of benefit calculation favors individuals who remain with a single employer throughout their careers. Individuals who continually change employers could enter their retirement years with little or no retirement income accumulation because, to a large degree, defined benefit plans lack portability provisions. Defined benefit plans offer inflation protection by linking benefits to employee wage levels. However, this inflation protection is effective only until the worker terminates employment with his or her defined benefit sponsor. Once employment terminates, the retirement benefit is fixed in nominal dollars. Thus, inflation can significantly erode retirement benefits for defined benefit plan participants who leave their employer prior to retirement.

Portability provisions, such as lump-sum distribution (LSD) options, can mitigate the problem of inflation erosion.<sup>1</sup> A plan sponsor could increase portability by either adopting portability provisions in a defined benefit plan and/or offering a defined contribution retirement plan. Over the past 15 years, participation in and contributions to defined contribution plans have grown enormously.<sup>2</sup> Defined contribution plans differ from typical defined benefit plans in that they have individual account balances for each employee. When defined contribution participants change jobs, they are typically allowed the option of receiving their account

balances in the form of a LSD or are allowed to leave their vested account balance invested with their old employer.

Participants in an employment-based salary reduction plan (a type of defined contribution plan the most common of which is the 401(k) plan) have essentially invested for their own retirement through the plan. Like any other investment, a successful retirement investment involves principal preservation and inflation protection. As mentioned earlier, a defined benefit plan offers inflation protection by linking benefits to an employee's wage level. Defined contribution plans offer inflation protection because the contributions can earn a competitive return. After a job termination, principal preservation and inflation protection become significant issues. A defined benefit plan without LSD options mandates principal preservation but also typically entails inflation erosion. A retirement plan, of either variety, that offers a LSD option affords the possibility of inflation protection at the expense of possible principal erosion.

**The critical decision an employee makes on receipt of a LSD is whether to roll over the distribution to another tax-qualified retirement savings vehicle or to cash out the distribution for current consumption. In order to be an effective mechanism for preserving retirement income, LSDs must remain as retirement assets.** If individuals repeatedly cash out their LSDs from the pension environment, they again face the possibility of entering their retirement years with little or no retirement income benefit. The advantage of LSDs is that they allow benefit portability. Their disadvantage is that they allow recipients to use assets for current consumption, thereby reducing their retirement income security.

This study uses information on LSDs from pension supplements to the Current Population Survey (CPS) to examine trends in LSD availability, use, and magnitude. The CPS is a monthly survey with irregular supplements used to analyze employee benefit issues. Employee benefit supplement questions concerning LSD

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<sup>1</sup> See Emily S. Andrews, "Pension Portability and What It Can Do for Retirement Income: A Simulation Approach," EBRI Issue Brief no. 65 (Employee Benefit Research Institute, April 1987).

<sup>2</sup> See Employee Benefit Research Institute, EBRI Databook on Employee Benefits, Third edition (Washington, DC: Employee Benefit Research Institute, 1995).

availability, receipt, magnitude, and use were collected in 1983, 1988, and 1993. The data from these three years are used to assess these trends. Also analyzed are data from the September 1994 CPS, which contains a one-time supplement survey of persons aged 40 and over that includes some questions on LSDs.

Other studies do not involve such trend analysis of LSD availability and cashout propensities over time. Rather, they focus on cross-sectional evaluation of rollover behavior based on a single year of survey data. Yakoboski et al. (1994) and Poterba, Venti, and Wise (1995) both use the April 1993 CPS (the latter also uses the Health and Retirement Survey) in such a cross-sectional fashion, finding that most LSDs are not rolled over, but that most large distributions are rolled over. Furthermore, older and higher income workers are more likely to roll over their distributions. Yakoboski (1994) used Internal Revenue Service data over the period 1987–1990 to document a slight decrease in the number of distributions, a sharp increase in the dollar amounts distributed, and slight increases in the both the fraction of distributions that are at least partially rolled over and the fraction of distributed dollars that are rolled over. However, the data are strictly aggregate and permit no analysis of changes over time broken out by worker demographics. Korczyk (1996) uses tabulations of the 1988 CPS and 1993 CPS to identify groups that appear particularly vulnerable to incurring portability losses (including the young, the less educated, and low earners) and further notes that such groups typically face long-term disadvantages in their earnings growth path.

The first section of this *Issue Brief* examines the availability of LSDs. It verifies previous research documenting the growth of defined contribution plans and the implications of wider LSD availability.<sup>3</sup> As emphasized

previously, there is a difference between a LSD that is rolled over into another retirement vehicle (rollover LSD) and one that is cashed out of the pension environment (cashout LSD). The second section addresses trends in the *utilization rate of cashout LSDs*. An examination of utilization rates is vital because increases in LSD availability can be beneficial if the cashout LSD option is rarely utilized. Finally, the third section examines the trend in *magnitude of a typical cashout LSD* from 1983 to 1993. Cashout LSD magnitude is crucial because it indicates the amount of assets actually leaving the retirement plan system.

## LSD Availability

This section explores the trend in (LSD) availability from 1983 to 1993. It deals only with the possibility of such a distribution, thus

there is no need to distinguish between cashout LSDs and rollover LSDs. The CPS asks workers, “If you left your employer now, could you get a lump-sum payment from this [primary] plan when you leave?” Responses to this question form the basis for the following analysis.<sup>4</sup>

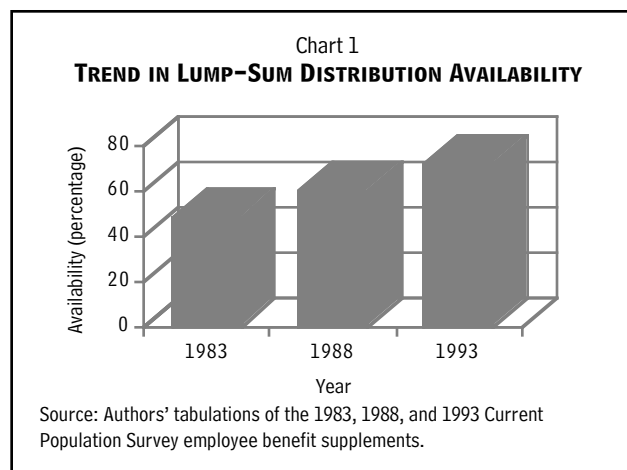
**In 1983, 47.8 percent of employment-based retirement plan participants reported the availability of a LSD from their primary retirement plan. This figure rose to 59.9 percent by 1988 and continued to climb to 71.5 percent by 1993 (chart 1). This trend suggests a large increase in LSD availability over the decade from 1983–1993.**

One possible explanation for this upward trend is the increase in primary coverage of defined contribution retirement plans.<sup>5</sup> If defined contribution plans are

<sup>3</sup> See, for example, Paul Yakoboski and Annmarie Reilly, “Salary Reduction Plans and Individual Saving for Retirement,” EBRI Issue Brief no. 155 (Employee Benefit Research Institute, November 1994); Paul Yakoboski and Annmarie Reilly, “Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey,” EBRI Issue Brief no. 153 (Employee Benefit Research Institute, September 1994); and Celia Silverman,

“Pension Evolution in a Changing Economy,” EBRI Special Report SR-18/ Issue Brief no. 141 (Employee Benefit Research Institute, September 1993).

<sup>4</sup> Unfortunately, the availability question is only asked when discussing an individual’s “primary” plan. Thus, availability is understated in this analysis because an individual could have a lump-sum distribution (LSD) available from a secondary plan.



more likely to offer LSDs, a shift toward greater utilization of defined contribution plans will automatically increase the availability of LSDs. Charts 2 and 3 indicate that indeed there has been a large shift in the composition of primary pension coverage. The 1983 data do not allow an accurate distinction in the type of plan coverage, but from 1988 to 1993 the fraction of participants indicating that a defined contribution plan was their primary plan rose from 19 percent to 34 percent. Part of the increase in the availability of LSDs can be attributed to an increasing fraction of workers covered by a primary defined contribution plan.<sup>6</sup>

While the accelerated growth of defined contribution plans has contributed to increasing LSD

availability, another general trend has also been a factor. LSD availability has been

increasing for both defined contribution and defined benefit retirement plans (chart 4). LSD availability in defined contribution plans increased from 75 percent to 87 percent<sup>7</sup> between 1988 and 1993. The availability of LSDs also increased in defined benefit plans from 58 percent in 1988 to 64 percent in 1993<sup>8</sup> (chart 4). Perhaps this increase among defined benefit plans is due to an increase in demand for portability by defined benefit plan participants. These numbers indicate that LSD availability would have increased somewhat even without a compositional shift from defined benefit to defined contribution plans.

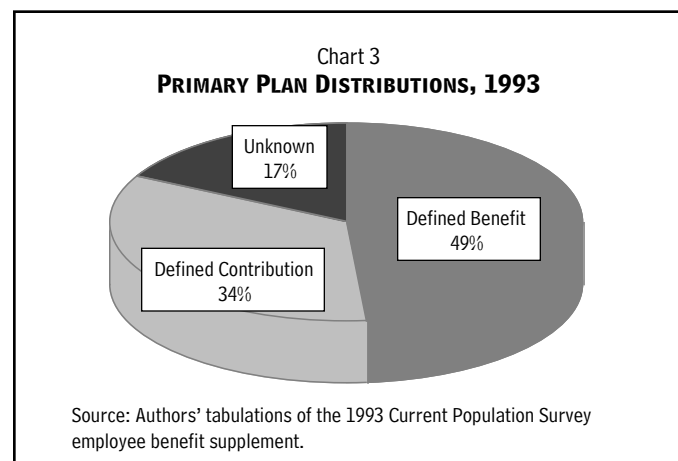
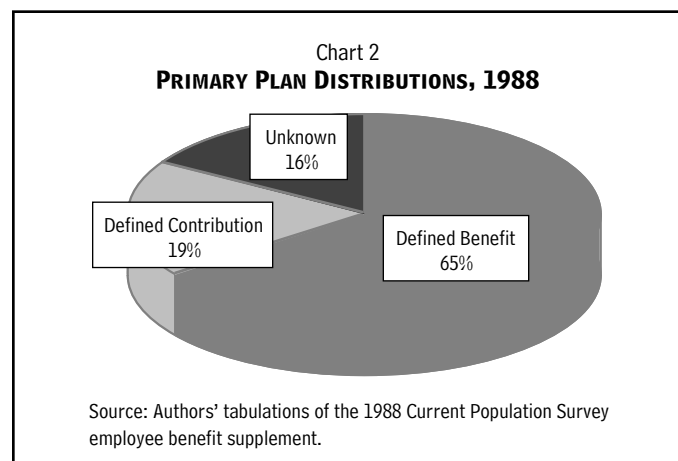
**There is a clear trend in LSD availability.**

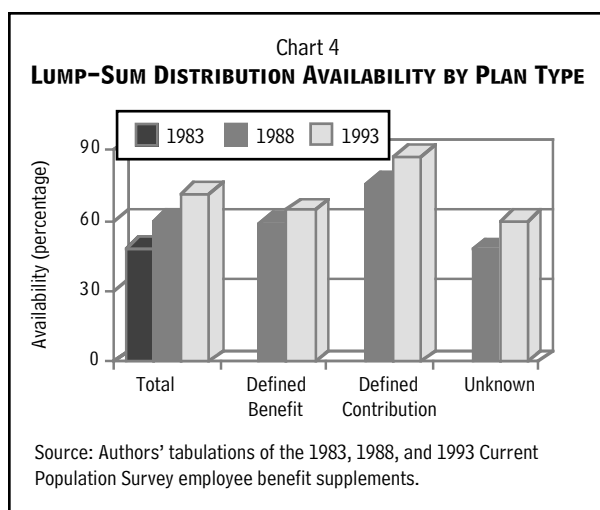
<sup>5</sup> The sample for these charts includes all employed workers reporting participation in at least one pension plan. If more than one plan is reported, the self-reported primary plan is used. Finally, money purchase pension plans are categorized as defined contribution pension plans.

<sup>6</sup> This compositional effect may be overstated because individuals with both defined benefit and defined contribution plans increasingly named their defined contribution plan as the primary plan. See Paul Yakoboski and Annmarie Reilly, "Salary Reduction Plans and Individual Saving for Retirement," EBRI Issue Brief no. 155 (Employee Benefit Research Institute, November 1994); and Paul Yakoboski, "Salary Reduction Arrangements as Primary Retirement Plans," EBRI Notes, no. 10 (Employee Benefit Research Institute, October 1995): 1-3 for details of the propensity of individuals to name their defined contribution plan as primary.

<sup>7</sup> Typically, LSD availability is thought to be universal in defined contribution plans. Two possible explanations for lower reported availability numbers include reporting error and new employees indicating they are not vested in their employers' defined contribution plan.

<sup>8</sup> A study by Hewitt (1992) indicated lower levels of availability in defined benefit plans. Many defined benefit plans allow or require small amounts to be paid out as a LSD but do not allow larger accounts to be distributed. The wording of the question in the Current Population Survey (CPS) allows for the possibility that the respondents are indicating the availability of LSDs when in reality only small LSDs are available.





**The increase in availability over the period 1983–1993 can be attributed to two factors. First, there has been a compositional shift (in primary plan type) from defined benefit to defined contribution plans, at least over the period 1988–1993. Second, there has been a general trend toward increasing LSD availability for both defined contribution and defined benefit plans.** The increase in LSD availability could be a boon to high turnover workers desiring to maintain their benefit accumulations; however, the possibility exists that LSDs will not be preserved until retirement. To explore the possibility of increased retirement income erosion due to LSDs, the next section examines the propensity of individuals to choose a cashout LSD.

## Cashout LSDs

**LSDs can be used for two distinct purposes. They can either be rolled over into an individual**

**retirement account (IRA) or another employer's retirement plan or they can be cashed out from the pool of retirement income assets.** In addition to income taxes, a 10 percent tax penalty is imposed on any LSD that is received prior to age 59 1/2 and that is not rolled over or annuitized.<sup>9</sup> Note, this analysis *ignores* LSDs that are rolled over into another tax-qualified retirement vehicle.<sup>10</sup> These assets remain inside the retirement income system, and thus this type of LSD is assumed not to be detrimental to retirement security. Nonrollover LSDs or cashout LSDs are the focus of the

following analysis. The cashout LSD can have a serious impact on retirement income security.

To assess the importance of cashout LSDs, this analysis examines the propensity of employees to use their cashout LSD option. It uses two distinct measures of this propensity. The first measure analyzes participants who report a previous pension benefit; the second examines individuals reporting a LSD within the past three years.

## Previous Pension Benefit

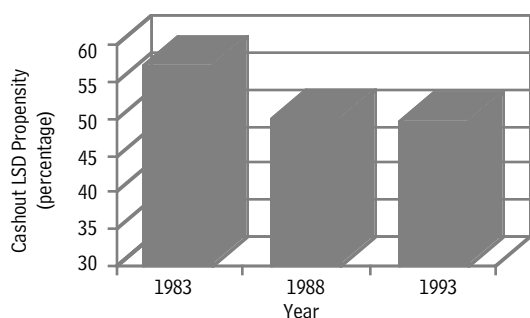
The first measure of the propensity to cash out LSDs calculates the number of individuals reporting a cashout LSD relative to the total number of individuals reporting any pension benefit from a previous employer. Individuals with a previous employment-based retirement plan were asked three questions. First, have you received a previous benefit from a previous pension plan? Second, do you expect to receive a future benefit from a previous plan? Third, have you ever received a LSD from a previous pension plan? Finally, individuals who report receiving a LSD were asked what they did with the LSD. This question allows LSDs to be categorized as cashout or rollover LSDs. The previous pension benefit measure is defined as the ratio of individuals reporting receipt of a cashout LSD to the total number of individuals reporting any pension benefit (previous, future, cashout LSD, or rollover LSD).

**In 1983, 55 percent of all individuals reporting a previous pension benefit also reported a cashout LSD (chart 5). This propensity drops to around 50 percent for 1988 and 1993 (chart 5).** Given the increased availability of LSDs previously documented, the decline in the previous pension benefit

<sup>9</sup> The 10 percent tax penalty affects distributions made after 1986 (see Internal Revenue Code sec. 72(t)). Beginning in 1993, employers must provide the option of a direct transfer of assets to other tax-qualified vehicles for departing employees; a 20 percent employer tax withholding is imposed on all LSDs not utilizing the direct transfer option. Both of these regulatory changes could impact cashout propensities.

<sup>10</sup> Any LSD that is totally or partially rolled over or annuitized is considered to be a nonLSD. Thus, only LSDs that result in a complete exit of funds from the pension environment are considered to be cashout LSDs for the purposes of this work. Considering partial rollovers to be nonLSDs has a minimal effect on the results because 80 percent to 90 percent of all rollovers are full rollovers.

Chart 5  
TREND IN CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY



Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

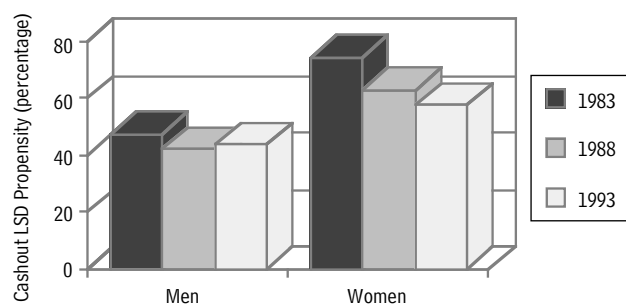
measure of cashout LSDs is somewhat surprising. In 1983, probably a larger fraction of the participants reporting a previous pension benefit derived that benefit from a defined benefit plan. Since fewer defined benefit plans allow LSDs relative to defined contribution plans, this would bias the previous pension benefit measure of cashout propensity downward for 1983 relative to other years. **Given this natural bias toward lower cashout propensities in 1983, the fact that this propensity actually declined over the decade is strong evidence that cashout LSD propensities are not accelerating. Thus, even though there are more cashout LSDs today, this seems to be due to an increase in availability of LSDs rather than to an increase in the propensity to choose a cashout LSD.** To explore which types of individuals are largely affected by cashout LSDs, the cashout propensity measure is broken out by gender, age, and wage categories.

**Gender—Women have consistently higher cashout propensities than men (chart 6). The decrease in cashout propensity over time is primarily a female phenomenon. Male cashout propensity decreased from 47 percent to 44 percent over the decade from 1983–1993. Female cashout propensity declined from a high of 74 percent in 1983 to a low of 58 percent by 1993. The percentage point gap between male and female cashout propensity fell from 27 points in 1983 to 14 points by 1993. One possible explanation of this phenomenon is that women are becoming primary wage earners. Several authors have hypothesized that**

<sup>11</sup> Marital status could play a key role in women's cashout propensity. Marital status at the time of the LSD is not observed in this survey, so this hypothesis is untestable with the current data.

<sup>12</sup> Age in survey year, not at time of LSD.

Chart 6  
CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY BY GENDER



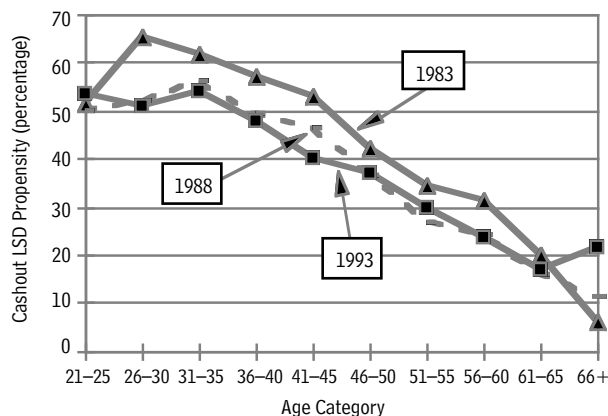
Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

cashout LSDs among women are more common because their retirement funds may be supplementary funds.<sup>11</sup> If this hypothesis is accurate, the reduction in women's propensity to choose a cashout LSD could be indicative of their retirement programs becoming primary sources of retirement funds.

**Age—Cashout propensity also varies for different age categories. The general trend is the same for all three time periods (chart 7).<sup>12</sup> As workers age toward retirement, the propensity to take cashouts decreases. There was a fairly constant reduction in cashout LSD propensity for all age groups between 1983 and 1993. Two age groups differ from this general trend. First, young workers (aged 21–25) show a fairly constant cashout propensity. Second, retirement age individuals are increasingly likely to choose the**

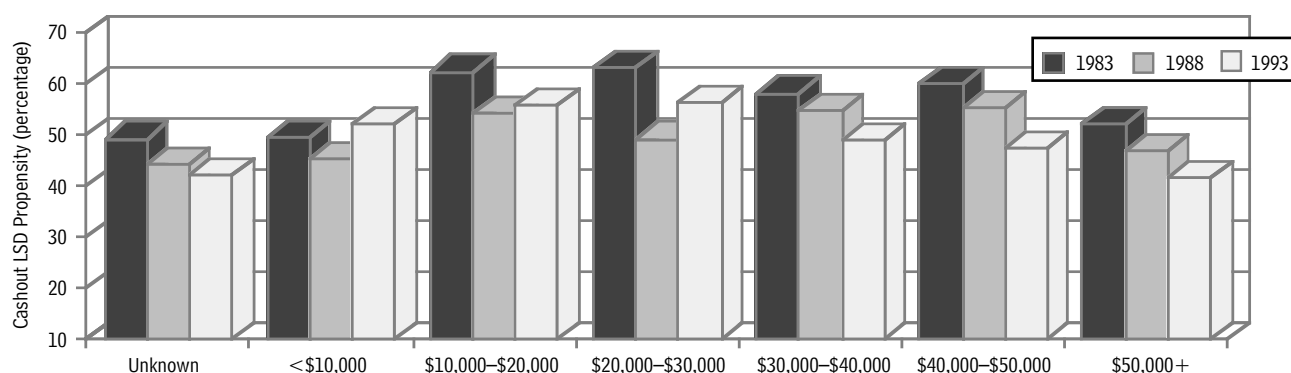
Chart 7  
CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY BY AGE



Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

Chart 8  
CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY BY SALARY



Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.  
Note: Lump-sum distribution definition does not include rollovers.

**cashout LSD option over time.**<sup>13</sup> The main concern regarding cashout LSDs is that the potential exists for retirement assets to be used prior to retirement. This is not a concern for retirement age workers. Thus, the only age category in which a significant increase in cashout propensity is observed is also an age category whose members have already arrived at their retirement years. Use of cashouts at retirement is probably symptomatic of the rise of defined contribution plans since these plans are more likely than defined benefit plans to allow a LSD at retirement.

The increased cashout propensity for retirement aged workers found in the April 1993 CPS was not found in the September 1994 CPS. According to the Employee Benefit Research Institute (EBRI) tabulations, the cashout propensity among workers aged 40–65 in 1994 was 47 percent. This propensity was highest for the youngest older workers (aged 40–45) at 54 percent and fell steadily to 33 percent for workers in the preretirement age group (aged 61–65) and further still to 29 percent for those over age 65. This latter finding differs from the April 1993 CPS results.

**Wages—Wages are also an important determinant of cashout LSD propensity (chart 8). For any given year, the relationship between salary and cashout propensity seems to rise until wages reach around**

**\$30,000 and then decline.**<sup>14</sup> Examining the change in this propensity over time indicates that the decrease in the propensity for cashouts is concentrated primarily among individuals making more than \$30,000. Lower income categories show a decline in propensity from 1983 to 1988 but then a rise from 1988 to 1993. Only the upper income categories show a consistent decrease in cashout LSD propensity.

Two related complications exist for the cashout LSD propensity measure presented in this section. First, the exact timing of the previous pension benefit is unknown.<sup>15</sup> The cashout propensity reported in this section can be thought of as a lifetime average propensity. This fact implies that the negative relationship between age and cashout propensity could be greatly *understated*. Chart 7 indicates that, as individuals age, their lifetime average cashout propensity tends to decrease. The decrease in the marginal cashout propensity for any age category must be larger than the decrease in the lifetime average propensity.<sup>16</sup> Since the survey reports the lifetime average cashout propensity, and these propensities decline with age, this implies the true propensity for the older age categories is lower than the lifetime averages reported.

Second, the CPS survey does not report multiple previous pensions. This causes another complication for the cashout propensity measure. Individuals with

<sup>13</sup> Unfortunately, individuals younger than age 25 or older than age 64 are only asked the previous pension question in the 1993 survey if they were employed. All age categories in 1988 and 1983 were asked the previous pension questions. Thus, the results for individuals over age 66 in 1993 could be anomalous. The results from the 1994 CPS would seem to indicate that.

<sup>14</sup> Salary in survey year, not at time of LSD. Salary at time of LSD is not available.

<sup>15</sup> The date of the previous pension benefit is known only if the benefit is in the form of a LSD. The date must be known for all previous pensions in order to accurately calculate the true propensities for each age category.

<sup>16</sup> To illustrate, consider the following example. Imagine 100 pension participants, all aged 35. At age 35, 10 participants receive a LSD, and 5 of these actually cash out their distribution. At age 45, another 10 participants receive a LSD, and only 3 cash out their distribution. If these workers are surveyed at age 35, then their cashout propensity is 50 percent (5 out of 10). If these same individuals are surveyed at age 45, their propensity has fallen to 40 percent (8 out of 20). Notice that the 40 percent represents a lifetime average propensity. The true or marginal propensities are 50 percent for individuals in their 30s, and 30 percent for individuals in their 40s. The decrease in the marginal propensity (20 percent) is larger than the decrease in the lifetime average propensity (10 percent).



*In 1988, roughly 4.5 percent of current retirement plan participants received a cashout LSD in the previous three years. By 1993, this ratio had dropped to 3.75 percent.*

multiple previous pensions will tend to have their cashout propensity overstated by this analysis. For example, an individual with two previous pensions and a single cashout LSD will be reported as having had a previous pension and a cashout LSD. The ideal measure would count this individual as having a 50 percent cashout LSD propensity; however, the available data only allow an individual to have either a 0 percent or 100 percent propensity. Individuals with multiple previous pensions tend to be attributed a 100 percent rate rather than their true lower rate. In terms of the results, the importance of this complication depends on the prevalence of multiple previous pensions. The bias could strengthen the age results. If older individuals have had more possibilities for previous pensions, their results would be biased upward. Even given this bias, the cashout propensity decreases with age. If women are more likely to have received previous pensions, this bias could account for their larger propensities relative to men in any given year. However, unless the incidence of multiple previous pensions has decreased over time, this bias would not affect the results indicating a reduction in women's cashout propensities over time.

## Cashout LSDs in the Previous Three Years

The cashout LSD measure in the previous section measures the likelihood that any given individual with a benefit from a previous retirement plan also took a cashout. A second measure of cashout propensity examines what fraction of employment-based retirement plan participants actually received a cashout. This measure avoids some of the problems associated with the previous pension benefit measure. Since the data for 1988 and 1993 indicate the year of the most recent LSD, they can be used to construct another cashout propensity measure. The second measure of cashout propensity is simply the number of cashouts reported for the three years prior to the survey year<sup>17</sup> relative to the total

number of retirement plan participants in the survey year. This gives an approximate measure of the

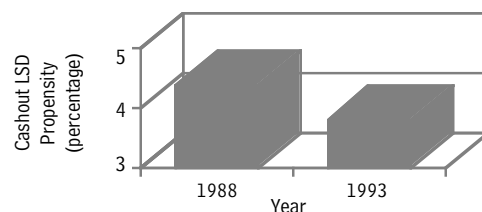
probability of any given participant receiving a cashout in the next three years. Notice, this measure differs from the previous measure in that all participants are included. Thus, while the first measure reported the likelihood of a cashout, given a previous pension benefit, this measure reports the likelihood of a cashout, given pension participation.

In 1988, roughly 4.5 percent of current retirement plan participants received a cashout LSD in the previous three years. By 1993, this ratio had dropped to 3.75 percent (chart 9). Earlier results indicated that more individuals had the LSD option available in 1993 than in 1988. The previous three years' measure of cashout propensity should therefore tend to increase as availability increases (all else being equal).<sup>18</sup> Surprisingly, even though availability increased over this period, the propensity to cash out, using the previous

<sup>17</sup> The previous three years are used to get a reasonably large number of LSDs while minimizing the problem of only the latest LSD being reported.

<sup>18</sup> Suppose the cashout propensity is 10 percent when the cashout option is available. If only one-half of participants have the cashout option, the reported propensity would be 5 percent because one-half of the individuals wanting to cash out did not have the option to do so. If cashout availability increased to 75 percent, the reported cashout propensity would be 7.5 percent. Thus, the reported cashout propensity increases with availability.

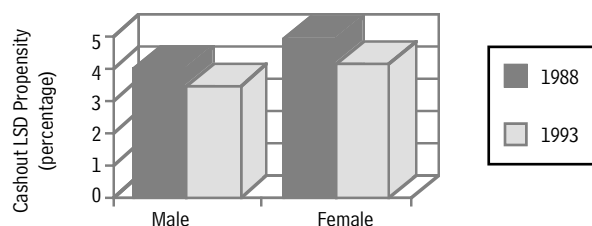
Chart 9  
TREND IN CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

Chart 10  
**CASHOUT LUMP-SUM DISTRIBUTION (LSD)  
PROPENSITY BY GENDER**



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

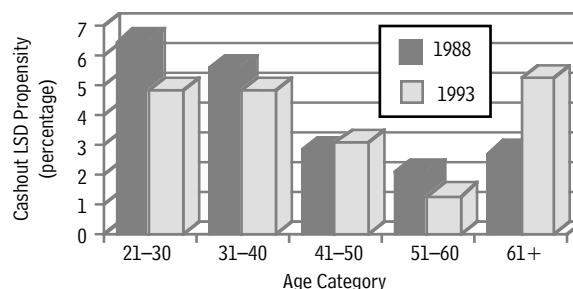
three years' measure, actually decreased. The fact that this measure of cashout propensity should naturally rise but instead actually fell is strongly indicative of the fact that cashout propensities did not increase over this time frame.

The results can be broken out by gender (chart 10). Recall that this propensity measures the number of cashouts in the previous three years relative to the number to total participants. Again, women exhibit larger cashout LSD propensities on average than men. For 1988, the propensity for women was 25 percent higher than it was for men (5.0 percent versus 4.0 percent). Female propensity exhibited a fairly large decline (5.0 percent to 4.0 percent) from 1988 to 1993. Male propensities also declined, but the decline was more modest (4.0 percent to 3.5 percent). These results corroborate the earlier results in that the decline over time is more pronounced for women.

Chart 11 examines cashout LSD propensity by age. Again, the results using the second measure are consistent with the earlier analysis both across age groups and over time. Chart 11 indicates that propensities decrease with age until retirement age.<sup>19</sup> At retirement age, the propensity tends to increase. Furthermore, the time trend is consistent in that cashout propensities tended to decrease from 1988 to 1993, except for retirement aged individuals. These individuals seemed to be increasingly likely to take a cashout benefit.<sup>20</sup>

The results of this analysis are surprising. Two very different measures of cashout propensity give analogous results. These results indicate that, except for

Chart 11  
**CASHOUT LUMP-SUM DISTRIBUTION (LSD) PROPENSITY  
BY AGE**



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.

Note: Lump-sum distribution definition does not include rollovers.

retirement aged individuals, the cashout propensity has actually declined over recent years. While not conclusive, the results indicate that cashouts, at least in terms of cashout propensity, seem to be less cause for concern currently than they were in prior years.

## Cashout Magnitude

**Even though the propensity of workers to select a LSD cashout has failed to increase**

**dramatically over time, cashouts could still pose a problem to workers' retirement income security if their typical size has increased dramatically. For example, suppose the propensity to cash out a previous pension is fixed over the years.** That is, all years have an identical cashout propensity associated with them; they differ only in which distributions are cashed out. Suppose in 1983 only the smallest distributions were cashed out, while in 1993 only the largest distributions were cashed out.<sup>21</sup> This would be cause for concern because the larger the cashout, the greater the impact on future retirement income security.

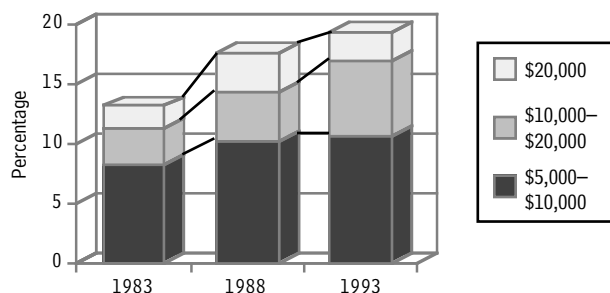
This section explores this possibility by first examining the trend in the fraction of cashout LSDs that are large and then examining the trend in the size of the typical or median cashout. Two questions from the CPS were used in performing this analysis. First, a question concerning the size of the LSD was asked in all three

<sup>19</sup> The age results could be partially explained if younger workers tended to have defined contribution plans with readily available cashouts, and older workers tended to belong to defined benefit plans without cashout possibilities. This would explain higher cashout propensities for younger workers relative to older workers. A problem with this explanation is the simultaneous trend toward more defined contribution plans and lower cashout propensities. The data do not allow a full analysis of this possibility since the type of previous pension is unknown.

<sup>20</sup> Unfortunately, this measure is not suited to examining salary effects. Salary, unlike age and gender, is greatly affected by a recent LSD. Thus, current salary is a bad proxy for salary prior to the recent LSD. The LSD propensity cannot be constructed by salary because of this poor proxy.

<sup>21</sup> Of course, holding all other considerations such as age, wage, and gender constant.

Chart 12  
TREND IN UTILIZATION OF LARGE LUMP-SUM  
DISTRIBUTION CASHOUTS



Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.

Note: Rollover lump-sum distributions are not included in these calculations.

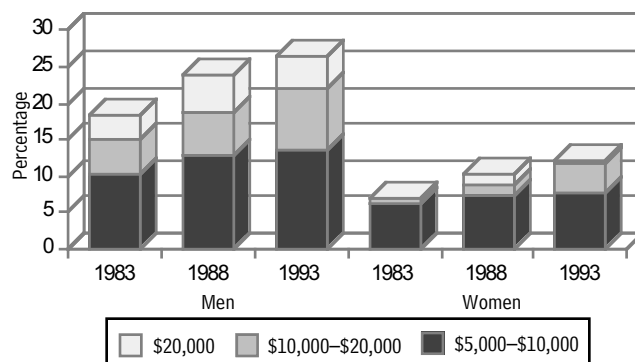
years. The size is only reported in categories for 1983, but the actual size is recorded for 1988 and 1993. Furthermore, the 1988 and 1993 supplements also asked the date of the LSD.

## Evidence from Size Categories

Data from the 1983 CPS supplement report the size of LSDs in terms of size categories.<sup>22</sup> This fact makes comparisons between 1983 and the later two surveys (1988 and 1993) difficult because the later years report the actual level of the cashout. To facilitate comparisons, LSDs reported in 1988 and 1993 are deflated into 1983 dollar levels, and then categories similar to the 1983 data are constructed.

The percentage of all cashout LSDs that fell into the largest categories, i.e., greater than \$5,000, can be found in chart 12. The results indicate that **large cashouts have indeed become more prevalent over the decade 1983–1993. Roughly 13 percent of cashouts in 1983 were larger than \$5,000; however, this number had risen to 19 percent by 1993.** One possibility to explain the increase in the size of cashouts is the maturation of the defined contribution system over time. As defined contribution plans mature, the cashout level should tend to increase. The cashout level increase is the result of increases in the number of years the typical person and/or his or her employer has contributed to a plan. Eventually, as the plans mature, the typical years of contribution and account balance should stabilize. This explanation implies that the increase in the

Chart 13  
UTILIZATION OF LARGE LUMP-SUM DISTRIBUTION  
CASHOUTS BY GENDER



Source: Authors' tabulations of the 1983, 1988, and 1993 Current Population Survey employee benefit supplements.

Note: Rollover lump-sum distributions are not included in these calculations.

size of cashouts is caused by increases in account balances in general, not by a shift toward cashouts of the larger accounts. However, since account balances are not reported in this survey, this hypothesis cannot be tested here.

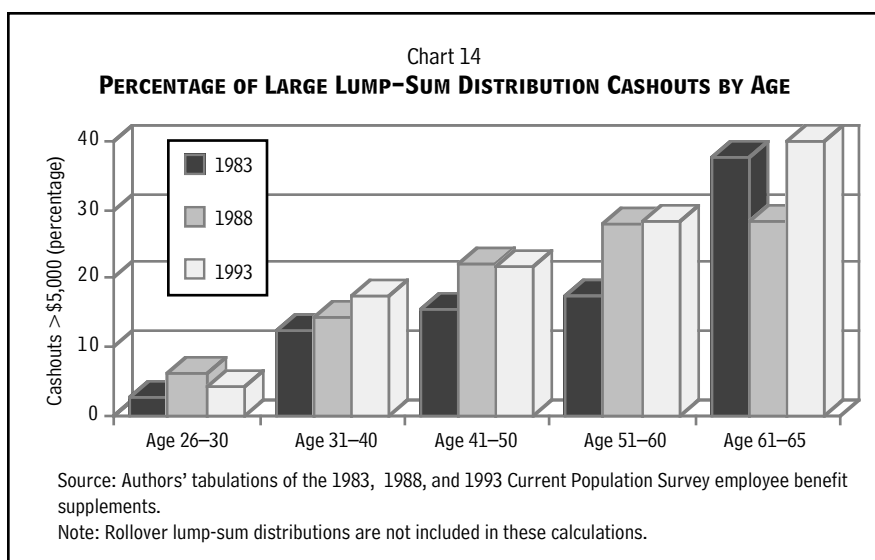
Examining this effect separately for men and women indicated that men were much more likely to receive a large cashout, but the trend for both men and women was increasing (chart 13). By 1993, better than one in four cashouts made by men was larger than \$5,000, up from 18 percent in 1983. For women, the increase was from 7 percent to 12 percent. This across-the-board increase in the percentage of large cashouts also supports the hypothesis of an overall increase in the size of account balances.

Chart 14 shows the large cashout percentage broken out by different age categories. The oldest age category (age 61–65) should be viewed with caution because the sample was extremely small.<sup>23</sup> The typical result is a large increase from 1983 to 1988 and a more modest increase or no change from 1988 to 1993. The major exception to this rule is younger workers aged 26–30. These workers experienced a large increase in the percentage of large cashouts between 1983 and 1988 but also a large decline in this percentage from 1988 to 1993. Defined contribution plans should mature quickly for this age group, in terms of years of contribution.<sup>24</sup> Thus, young workers should be least affected by the problem of maturing defined contribution plans. If maturing defined

<sup>22</sup> The smallest size category was <\$5,000, which captured about 87 percent of the total number of LSDs.

<sup>23</sup> Employment was a condition for being asked this question. Very few individuals were both currently employed and reported a cashout at an age in this category (61–65 years).

<sup>24</sup> For example, assume the typical plan is 10 years old in 1988 and 15 years old in 1993. A worker who has less than 10 years tenure is eligible to contribute the same number of years regardless of whether the plan is 10 or 15 years old. Young workers are likely to have lower tenure levels and thus are more comparable across the different survey years.



contribution plans explain the increase in the number of large cashouts, examining the younger workers may be especially important in mitigating this problem.

**The percentage of cashouts larger than \$5,000 steadily increased between 1983 and 1993, with the largest increase coming between 1983 and 1988. Large cashouts increased from 13 percent in 1983 to 19 percent in 1993.** While this represents roughly a 50 percent increase in the percentage of large cashouts, the absolute magnitude of the increase is still relatively small (6 percentage points). A possible explanation for this increase is that account balances are becoming larger in general because participants typically have had more years to contribute to their defined contribution plans. Another possibility is that cashouts are coming from the larger accounts in later years relative to the early years. If the second hypothesis is accurate, this could be a warning sign of potential retirement income erosion. To further examine the issue of the magnitude of the cashout, the next section analyzes the typical or median cashout.

## Trends in Median Size of Cashouts

While the number of large cashouts is an interesting measure, a more accurate measure of the typical size of a cashout is the median<sup>25</sup> value of cashouts. Unfortunately, the median cannot be constructed from the size categories reported in 1983. Thus, the median analysis is only performed on the 1988 and 1993 data. The goal of this analysis is to determine if the typical size of cashouts increased or decreased from 1988 to 1993. However, the data for 1988 and 1993 report the most recent LSD whenever it may have occurred. For example, a cashout LSD included in the 1993 data might actually have occurred in any year prior to 1993. To assess the trend in the size of cashouts, only recent

cashouts are considered. Thus, the cashout LSDs reported in the 1988 data are

restricted to those occurring between 1983 and 1988. Likewise, cashout LSDs in the 1993 data are restricted to those occurring between 1988 and 1993. Comparisons between these two restricted data sets create a more accurate picture of the trends in the size of the typical cashout LSD.

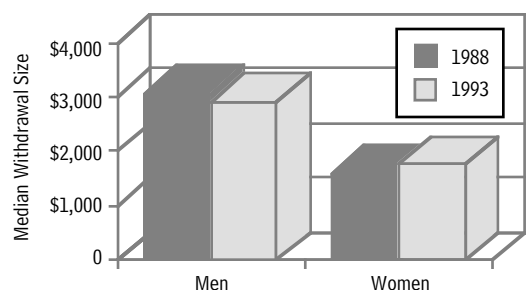
**The overall median cashout actually declined from 1988 to 1993. The median cashout in 1988 was \$2,320, while the median cashout in 1993 was only \$2,000.**<sup>26</sup> Charts 15–17 break down the results for the median size of cashouts by gender, age, and salary. While the median size of a cashout is much larger for men relative to women, it was fairly constant from 1988 to 1993 for both men and women. The median for men declined slightly, and the median for women increased slightly.

The trends in medians are more apparent when broken down by age and salary. First, an interesting pattern emerges when examining different age categories. The median cashout LSD typically increases with age, with large increases occurring after age 50. The trend in median cashout is very different, depending on the individual's age. Younger workers, i.e., those under age 40, experienced a slight increase in their typical cashout levels. Workers in the accumulation phase of their careers, i.e., aged 40–55, actually experienced a large *decline* in the size of the typical cashout LSD from 1988 to 1993. Finally, older workers between the age 56 and age 65 had a dramatic increase in the size of their cashouts.

<sup>25</sup> The median is the value above and below which lie an equal number of population elements.

<sup>26</sup> Dollar amounts are in constant 1993 dollars. Note these median figures are unweighted. Analysis of the 1994 CPS indicates that the difference between using weighted and unweighted medians is negligible regarding levels and variations with worker demographics.

Chart 15  
**MEDIAN LUMP-SUM DISTRIBUTION CASHOUT BY GENDER**



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.  
 Note: Rollover lump-sum distributions are not included in these calculations.

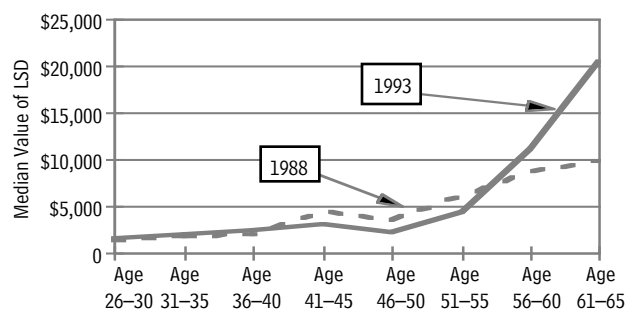
The September 1994 CPS revealed similar variations in median cashout amounts with worker age for the sample of older workers. **According to EBRI tabulations, the median cashout over the 5 previous years for all workers aged 40–65 in 1994 was \$4,079. For workers aged 40–45, the median cashout was \$3,496, and this increased to \$7,346 for those aged 56–60 and then more than doubled to \$15,117 for workers aged 61–65.**

The trends in median cashout LSD by salary are similar to the age trends. Lower wage workers experienced a slight increase in the typical cashout LSD. Mid-range salary workers experienced a large decline in the typical cashout level, and higher wage workers experienced a large increase in the typical cashout level. Even though the typical cashout increases for some wage categories, the absolute level of cashouts is not very high. The typical cashout for high wage workers grew from 1988 to 1993, but even after this growth the value in 1993 was only \$3,250.

The pattern in cashouts is fairly clear. By and large, the typical cashout did not increase dramatically from 1988 to 1993. In fact, the only category that experienced a large increase in the size of the typical cashout LSD was workers aged 61–65. The median cashout for this category of worker was roughly \$20,000. However, if the goal is to assess the impact of cashouts on retirement income adequacy, this fact is hardly distressing, given the age category. The real danger of pension erosion occurs during job turnover at a younger age. Furthermore, the main concern in terms of pension erosion is centered on lower wage workers, but typical cashout levels for workers earning less than \$40,000 were either relatively flat or decreasing.

#### **The overall results concerning median**

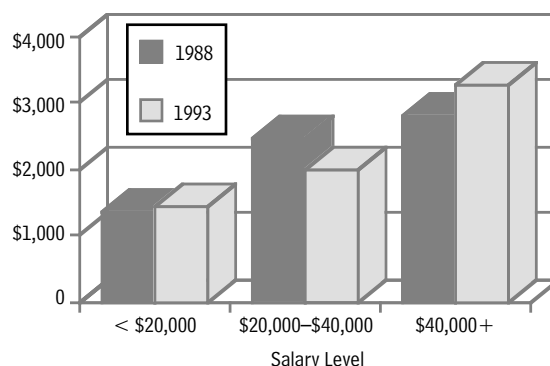
Chart 16  
**MEDIAN LUMP-SUM DISTRIBUTION (LSD) CASHOUTS BY AGE**



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.  
 Note: Rollover lump-sum distributions are not included in these calculations.

**cashout LSDs is encouraging. First, the overall median actually decreased from 1988 to 1993. Second, workers accumulating assets for retirement had their median level of cashout either remain relatively constant, as was the case for young workers, or fall dramatically, as was the case for middle-aged workers.** The results, broken out by salary, indicate that the group of workers that would be hurt the most by cashouts (i.e., low to medium wage workers) were also the groups with either little change (low wage) or a large decrease (medium wage) in the typical cashout level. All of these results tend to indicate that the increase in LSD availability has not coincided with increases in the median level of cashout, especially among groups presumably most affected by them.

Chart 17  
**MEDIAN LUMP-SUM DISTRIBUTION CASHOUT BY SALARY**



Source: Authors' tabulations of the 1988 and 1993 Current Population Survey employee benefit supplements.  
 Note: Rollover lump-sum distributions are not included in these calculations.

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## *Implications*

LSDs provide the opportunity for preservation of benefits accrued in employment-based retirement plans after

employment with a given plan sponsor has ended. This opportunity comes with the potential for benefit erosion if such distributions are not rolled over into tax-qualified saving vehicles. Such opportunities have increased for plan participants over time, even those participating in defined benefit plans. It is noteworthy for plan sponsors and public policymakers that, while lump-sum availability has increased, the propensity for plan participants to cash out their LSD instead of rolling it over when they change jobs has actually fallen slightly. Furthermore, the size of the typical cashout, when it occurs, has actually fallen over time by a slight amount (even though a larger share of cashouts are large).

**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. Some would say that cashout propensities of greater than 50 percent among women, young workers, and low income workers mean that potentially significant amounts of retirement income are being lost by those who may be least able to afford it. This then signifies a need for more and better education within retirement plans about the long-run cost—in terms of lost retirement income—of cashing out a LSD on job change. Such education may serve to accelerate or at least continue the positive trends documented here.**

## *Conclusion*

The accelerated growth of defined contribution plans relative to defined benefit retirement plans has increased the

availability of LSDs. Furthermore, even defined benefit plans, which traditionally have not offered LSDs, are increasing their portability provisions. The goal of this analysis was to examine the importance of cashout LSDs in an environment of ever-increasing LSD availability. Two distinct measures of cashout LSD propensity were examined with very similar results. Both measures indicated that cashout propensity tended to *decrease* over the period from 1983 to 1993. Furthermore, this decrease in propensity was more pronounced for women but was pervasive at all preretirement age levels. Finally, the typical magnitude of a cashout LSD was examined. The results indicate that cashouts are not dramatically increasing in size. Even though the availability of LSDs has increased over time, this increase has not been associated with an increase in the propensity to use cashout LSDs or an increase in the typical size of a given cashout LSD. Taken together, these results indicate that the recent trend toward more portable retirement plans is not being used to cash out pension assets prior to retirement.

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