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New Research From EBRI:

Study Shows Value of Preserving Lump-Sum Distributions

WASHINGTON—Save those 401(k) lump-sum distributions for a better retirement.

A new study by the nonpartisan Employee Benefit Research Institute (EBRI) shows the value of preserving lump-sum distributions from 401(k) and assets from other retirement plans when you switch jobs: "A significantly higher percentage of those who spent their lump-sum distributions entirely reported their standard of living (in retirement) as being somewhat or much worse than was reported by those who rolled over their entire distribution (24.5 percent compared with 16.2 percent)," the study says. It adds:

"In both cases, the percentage who reported being much worse was fairly small, but the consequences of spending lump-sum distributions highlight the fact that those who took a lump-sum distribution and spent it entirely were approximately 50 percent more likely to describe their standard of living as being somewhat or much worse than was reported by all of those age 55 or older who rolled over their assets."

The study, "Retirement Plan Participation and Retirees' Perception of Their Standard of Living," is published in the January 2006 *EBRI Issue Brief*, available on the Web at www.ebri.org.

Some 16 million individuals had taken lump-sum distributions from retirement plans as of 2003, the latest year for which the government data used in the study are available. The average distribution, in 2003 dollars, was $30,072; the median (mid-point) amount was $8,118.

As the study notes, the decision of whether to take a lump-sum distribution is not always up to the individual. Under federal regulations, private-sector retirement plan sponsors can require workers to take a lump-sum payment when they leave a job if the value of their retirement account is less than $5,000, in order to avoid the administrative costs of small, inactive accounts. Nearly 38 percent said they were required to take their most recent distribution, while about 62 percent said they took their most recent distribution voluntarily.

((more))

Individuals have two basic choices of what to do with any lump-sum distribution. They can:

- Spend it.
- Roll the money over to a tax-qualified plan at a new job (if allowed by that plan), to an individual retirement account (IRA), or to an individual annuity.

The overwhelming preference for rollovers was to an IRA, accounting for about 70 of the most recent lump-sum distributions that were rolled over. The next most popular choice, favored by about 13 percent, was to roll over a distribution to a plan at another job.

According to the study, about 47 percent of those who took a lump-sum distribution through 2003 used at least some of the money for a tax-qualified savings plan—such as another employment-based plan, an IRA, or an annuity. By contrast, about 22 percent used at least some of the money for consumption—such as buying a home, paying off debt, or starting a business.

The average loss of retirement assets by individuals cashing out (not rolling over) their most recent lump-sum distributions by the time they reach age 65 ranges from $24,138 (assuming a 3 percent annual rate of return), to $40,972 (assuming a 5 percent annual rate of return), to $179,483 (assuming a 10 percent annual rate of return), the study says.

“Despite these numbers being fairly small—except for the high-rate return value—these amounts could certainly make a difference in many individuals’ retirements,” says the study, written by Craig Copeland, senior EBRI research associate.

Other key points from the wide-ranging study:

- As of 2003, about two-thirds of wage and salary workers age 16 or older worked for an employer or union that sponsored any type of retirement plan for its employees or members. Almost 51 percent of wage and salary workers participated in a plan, with nearly 47 percent being entitled to a benefit or eligible to receive a lump-sum distribution from a plan if they left their job.
- When workers who are participating in a current or previous job’s plan are added to those who own an IRA or Keogh, the proportion of all workers who had some type of retirement plan in 2003 was just over 55 percent. Among workers ages 51–60, nearly 70 percent had some form of retirement plan, and individuals with 15 or more years of job tenure in a job had a 75 percent probability of having a plan.

Decisions about how to handle lump-sum distributions will be an increasingly important factor in retirees’ standard of living, the study concludes, adding, “The ultimate decisions workers make on what to do with rollover assets will have a significant impact on the likelihood that retirees will be able to cover the same level of expenses throughout retirement.”

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