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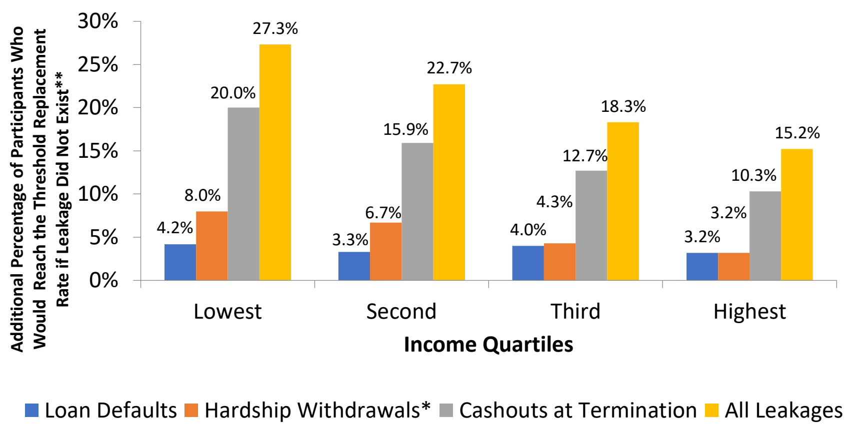
FAST Facts

How Eliminating Retirement Plan Leakage Can Get Workers On Track for Retirement Success

Policymakers have long been concerned about the toll that "leakage" from the retirement system can take on the ability for defined contribution plans to fund an adequate retirement. Often, the focus of that concern has been on plan loans. But there are numerous ways that money can leak out of the system, derailing workers' retirement income replacement prospects.

In its June 2018 *Issue Brief*, "EBRI Retirement Security Projection Model® (RSPM) – Analyzing Policy and Design Proposals" the Employee Benefit Research Institute (EBRI) models how this so-called leakage from automatic enrollment 401(k) plans can impact the ability of participants to achieve various replacement rate levels. Assuming being "on track" [i] equates to a projected ability to be able to replace 80 percent of real income in retirement, RSPM looks at how elimination of loan defaults, hardship withdrawals (with six-month contribution suspensions), and cashouts can move workers from the "off track" to the "on track" category.

Impact of Leakages for Participants in Automatic Enrollment Plans



*Assuming six month suspension of contributions.
**Assuming an 80% real replacement rate; workers currently ages 25-29 with more than 30 years of simulated DC eligibility; and no participant behavior change for participation, contribution, or asset allocation
Source: Jack VanDerhei, "The Impact of Leakages on 401(k) Accumulations at Retirement Age" Testimony for the ERISA Advisory Committee, June 17, 2014.

For example, eliminating loan defaults would move 4.2 percent of "off track" low income workers to the "on track" category of being projected to replace 80 percent of real income in retirement. Eliminating loan defaults would shift 3.2 percent of "off track" high-income workers to the "on track" category. The analysis also shows that eliminating loan defaults has the least impact of any single form of leakage in improving outcomes. For example, eliminating hardship withdrawals (with six-month contribution suspensions) would allow 8 percent of "off track" low-wage workers to reach retirement success according to the model—nearly twice as much. And eliminating cashouts at employment termination, it turns out, yields the greatest potential for successful outcomes:

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20 percent of "off track" low-income participants would achieve retirement success were cashouts to be eliminated, according to the model.

> In this analysis, the additional percentage of workers who would reach an 80 percent real replacement rate assuming leakage is removed from automatic-enrollment defined contribution plans is shown. In other words, if loan defaults, hardship withdrawals and cashouts were eliminated from the system, how many more workers could be "on track" by this measure? This impact is assessed by simulating projected Social Security benefits as well as future 401(k) balances and individual retirement account (IRA) rollovers from 401(k) plans.
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> The simulated population consists of workers currently ages 25–29 who will have more than 30 years of eligibility for participation in a 401(k) plan. The 80 percent real replacement rate is based on Social Security benefits plus annuitized 401(k) and IRA rollover balances

Indeed, for each income quartile, the impact on retirement success of eliminating cashouts is significantly greater than the other two components combined. In other words, the analysis suggests that from a policy perspective, a focus on reducing cashouts would be much more impactful than reducing loans or hardship withdrawals. It should be noted, however, that these results do not consider any potential reduction in contributions on behalf of workers who might, knowing that monies would not be available at employment termination, decide to reduce, or even cease contributing to these plans.

For more information, please see Jack VanDerhei. "EBRI Retirement Security Projection Model®(RSPM) – Analyzing Policy and Design Proposals." EBRI Issue Brief, no. 451 (Employee Benefit Research Institute, May 31, 2018).

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[i] The analysis assumes no participant behavior change for participation, contribution or asset allocation

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