

# Plan leakage: A study on the psychology behind leakage of retirement plan assets

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In the excitement of landing a new job, many workers do not take the time to consider what they should do with the defined contribution (DC) retirement plan savings they accumulated at their last job. Ideally, those savings should stay in the retirement savings system and move with the employee to their new employer's plan or remain in the prior employer's plan. Unfortunately, many workers liquidate or "cash out" their DC accounts, unwittingly compromising their ability to create an adequate income in retirement. Other workers in the midst of a job transition decide to move their retirement assets to the new employer's plan, and, without assistance from their new employer, find the process confusing and difficult. According to a study by the Federal Reserve Board, \$0.40 of every dollar contributed to the DC accounts of savers under age 55 eventually "leaks" out of the retirement system before retirement.<sup>1</sup> This phenomenon, often referred to as plan leakage, has a disproportionate incidence in those workers least prepared for retirement: of those who cashed out their DC retirement accounts upon a change in employment, 41% had less than \$25,000 in household retirement savings.

A recent survey of 5,000 retirement plan participants sheds light on leakage patterns, as well as on the thought process of job changers who are confronted with the challenge of "rolling in" retirement savings from a former employer.<sup>2</sup>

## CASH OUT TRENDS ACROSS GENERATIONAL GROUPS AND INCOME LEVELS

A noticeable percentage of survey respondents cashed out savings at least once, with younger generations more likely to do so. Specifically, almost one fourth of Baby Boomers "cashed out" retirement savings at least once when changing jobs, while one third of Millennials and GenXers did so. About 75% of the cash outs involved accounts with assets of less than \$20,000, suggesting that small amounts of savings might be considered not worth the effort required to roll over these assets to the new employer's DC plan.

A worrisome trend is that Millennials are increasingly using cash outs for non-emergency spending. Forty-two percent of Millennials reported spending retirement plan cash outs on non-emergency items such as weddings and cars, while less than 25% of GenXer respondents used the cash out for such non-emergency purposes.

Cash outs occur at all income levels. Even among the highest income level (those earning over \$150,000 annually), 33% reported they have cashed out at least one account during their career. However, cash outs occur more frequently among those with lower wealth levels. More than 40% of workers with a modest level of wealth (defined as those with less than \$25,000 in household retirement savings) cashed out at least once in their working lifetime compared to only 23% of workers with more than \$150,000 in retirement savings.

## ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of American workers. Toward this end, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA members include investment managers, consultants, law firms, record keepers, insurance companies, plan sponsors and others committed to the best interests of plan participants.

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## ATTITUDINAL FINDINGS

Millennials differ from older generations in their feelings towards cash outs. Of those Millennials that cashed out, only 36% reported regret for this decision, while almost half of the older generations reported so. One could surmise this may be because Millennials are too far away from retirement to see how this decision could impact their financial future.

Approximately half of survey respondents reported leaving their retirement assets in their former employer's plan, a finding consistent across generational groups. Only about 20% of all generations expressed a well-thought-out reason for leaving their money in the previous employer plan, such as preferring the prior plan's investment menu or customer service. On the other hand, barriers such as not knowing how to roll over assets, not having time to do so, or not prioritizing the issue were each mentioned by about 20% of all generations as reasons for not moving retirement assets to their new employer's plan. This suggests that there is an opportunity for employers to educate new and existing employees about the ability to consolidate prior retirement plan assets into their new plan in an effort to enhance their retirement preparedness.

When asked about their intentions for their current retirement plan, 20% of Millennials reported a plan to cash them out before retirement, while only 7% of the Baby Boomer respondents reported such a plan.

## CONCLUSIONS

The results from this survey confirm that plan leakage remains an issue that ultimately is undermining the critical public policy goal of preserving assets for retirement savings. In investigating the phenomenon by generational groups, participants' perceptions of the rollover process, and the reasons for the resulting decision-making, Millennials are reported to be at higher risk for leakage than the older generations. In addition, the majority of Millennials do not regret their decision to cash out. Lastly, according to the survey responses, obstacles such as the length and complexity of the roll-over process are barriers to the rollover decision. Further, responses suggest that eliminating the barriers present in the roll-over process would be a viable solution to plugging the leak from retirement plans.

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## ENDNOTES

<sup>1</sup>Argento, Robert, Victoria L. Bryant, and John Sabelhaus. 2015. "Early Withdrawals from Retirement Accounts During the Great Recession." *Contemporary Economic Policy* 33 (1): 1-16.

<sup>2</sup>Cormier, Warren, Boston Research Technologies on behalf of Retirement Clearinghouse, *Actionable Insights for Your Mobile Workforce*, 2015.