hooker & holcombe

Stop retirement savings setbacks

How can employers help stop retirement savings setbacks? Here is why tapping into retirement savings too early can have long-term effects and undo years of savings for participants.

The global pandemic has had a staggering effect on the economic lives of millions, driving them to actions that could have long-lasting effects on their retirement savings.

Facing unprecedented strain caused by the COVID-19 crisis, individuals who lack adequate emergency savings are turning to retirement plans to address their financial shortfalls.

Additionally, hardship withdrawals have been made easier by the passage of the 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act. The Act expanded distribution options, offered favorable tax treatment for coronavirus-related distributions from eligible retirement plans and relaxed payback options for those who met specific criteria.[1]

A reported 6% of retirement plan holders took advantage of at least one CARES Act provision offered by the plan. Of these withdrawals, 21% took the maximum amount allowed under the Act ($100,000 or 100% of the vested balance).[2]

Plan leakage consequences

Overall, retirement plan leakage – which includes in-service withdrawals, cash-outs at job change and loans – can create savings repercussions and even a delay in retirement, even if the amounts are paid back.

In a single year, Employee Benefit Research Institute (EBRI) reported that $92.4 billion was lost due to leakages from cash-outs.[3] This is a serious problem as it can reduce aggregate 401(k)/IRA wealth at retirement. Essentially, money withdrawn early loses its potential for growth and interest accumulation, hindering its ability to produce adequate income replacement in retirement.

For those who still consider tapping into their retirement plan savings, they may be doing so as a result of a lack of emergency savings, something that is increasingly prevalent, according to a recent Bankrate study.[4]

— In 2020, about three times as many Americans report having less emergency savings now than before, compared to those reporting more savings.

— Approximately 21% of Americans say they have no emergency savings, the lowest rate in the 10-year history of the Bankrate poll.

These staggering facts point to the importance of having a robust financial wellness program in the workplace and by placing special emphasis on maintaining an emergency savings account, which employers can offer via payroll deduction.

Curbing savings damage

Separating emergency or "rainy day" savings and retirement savings accounts can have a practical impact, too. It can reduce the urge to give into short-term wants and separate long-run retirement savings needs.[5]

Participants should be aware of these financial factors when making retirement plan withdrawals:[6]

— Repayments to a retirement plan are made with after-tax dollars that will, in turn, be taxed again when they eventually withdraw them from an account.

— The fees paid to arrange a retirement plan loan may be higher than a conventional loan, depending on how they are calculated.

— The interest is not tax deductible even if you use the money to buy or renovate a home.

Benefits of financial education

Employers should work with retirement plan advisors to find ways to educate participants in today's remote work environments; for example, an employer could host a virtual employee education meeting.

In these volatile economic times, it's especially relevant to cover important topics that may help participants maintain a healthy retirement savings strategy including:

— Maintaining retirement plan contributions and not being influenced by market activity.

— Reviewing historical market trends on downturns and recoveries.

— Resisting plan withdrawals by looking at alternative sources such as home-equity loans or refinancing to take advantage of low-interest mortgage rates, personal lines-of-credit or even borrowing from a family member.

Despite the uncertainty brought on by the pandemic, employers can utilize key resources and get help from their plan advisors toward ensuring employees make sound retirement savings decisions today, and in the future.

1 Internal Revenue Service "Coronavirus-related relief for retirement plans and IRAs questions and answers" irs.gov. March 2020.

2 T. Rowe Price. "How the coronavirus is affecting retirement saving" Sept. 2020.

3 Employee Benefit Research Institute. "The Impact of Auto Portability on Preserving Retirement Savings Currently Lost to 401(k) Cashout Leakage" Aug 2019.

4 Bankrate. "Survey: Nearly 3 times as many Americans say they have less emergency savings versus more since pandemic" Aug. 2020.

5 Harvard Business School. "Building Emergency Savings Through Employer-Sponsored Rainy-Day Savings Accounts" Nov. 2019

6 FINRA. "401(k) Loans, Hardship Withdrawals and Other Important Considerations" 2020.