401(k) PLANS

Policy Changes Could Reduce the Long-term Effects of Leakage on Workers' Retirement Savings

GAO Accountability•Integrity•Reliability
Highlights

Highlights of GAO-09-715, a report to the Chairman, Special Committee on Aging, U.S. Senate

Why GAO Did This Study

Under federal regulations, 401(k) participants may tap into their accrued retirement savings before retirement under certain circumstances, including hardship. This "leakage" from 401(k) accounts can result in a permanent loss of retirement savings. GAO was asked to analyze (1) the incidence, amount, and relative significance of the different forms of 401(k) leakage; (2) how plans inform participants about hardship withdrawal provisions, loan provisions, and options at job separation, including the short- and long-term costs of each; and (3) how various policies may affect the incidence of leakage. To address these matters, GAO analyzed federal and 401(k) industry data and interviewed federal officials, pension experts, and plan administrators responsible for managing the majority of 401(k) participants and assets.

What GAO Recommends

GAO is suggesting that Congress consider changing the requirement for the 6-month contribution suspension following a hardship withdrawal. In addition, GAO recommends that the Secretary of Labor promote greater participant education on the importance of preserving retirement savings, and that the Secretary of the Treasury clarify and enhance loan exhaustion provisions to ensure that participants do not initiate unnecessary leakage through hardship withdrawals. Both agencies agreed to take actions consistent with GAO's recommendations.

View GAO-09-715 or key components.
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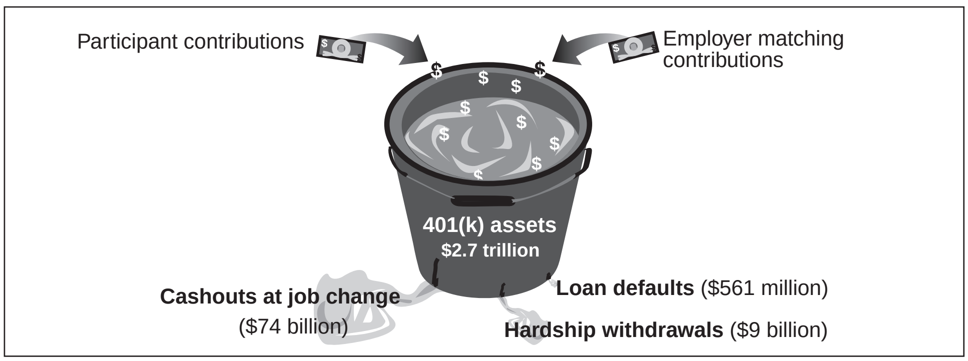
What GAO Found

The incidence and amount of the principal forms of leakage from 401(k) plans—that is, cashouts of account balances at job separation that are not rolled over into another retirement account, hardship withdrawals, and loans—have remained relatively steady, with cashouts having the greatest ultimate impact on participants' retirement preparedness. Approximately 15 percent of participants initiated some form of leakage from their retirement plans, according to an analysis of U.S. Census Bureau survey data collected in 1998, 2003, and 2006. In addition, the incidence and amount of hardship withdrawals and loans changed little through 2008, according to data GAO received from selected major 401(k) plan administrators. Cashouts of 401(k) accounts at job separation can result in the largest amounts of leakage and the greatest proportional loss in retirement savings.

Leakage as a Proportion of Overall 401(k) Plan Assets in 2006



Sources: GAO analysis of Department of Labor and Census Bureau data; Art Explosion (images).

Most plans that GAO contacted used plan documents, call centers, and Web sites to inform participants of the short-term costs associated with the various forms of leakage, such as the tax and associated penalties. However, few plans provided them with information on the long-term negative implications that leakage can have on their retirement savings, such as the loss of compounded interest and earnings on the withdrawn amount over the course of a participant's career.

Experts that GAO contacted said that certain provisions had all likely reduced the overall incidence and amount of leakage, including those that imposed a 10 percent tax penalty on most withdrawals taken before age 59½, required participants to exhaust their plan's loan provisions before taking a hardship withdrawal, and required plan sponsors to preserve the tax-deferred status of accounts with balances of more than $1,000 at job separation. However, experts noted that a provision requiring plans to suspend contributions to participant accounts for 6 months following a hardship withdrawal may exacerbate the long-term effect of leakage by barring otherwise able participants from contributing to their accounts. GAO also found that some plans are not following current hardship rules, which may result in unnecessary leakage.