



## CASHING OUT CAN DERAIL RETIREMENT EMPLOYEES IN TRANSITION NEED HELP

Plan guardrails such as Automatic Enrollment (AE), the Annual Increase Program (AIP), and Target Date Funds (TDFs) have led to dramatic improvements in participation rates, savings levels, and age-based asset allocation. The Pension Protection Act (PPA) of 2006 which supports these guardrails was a key factor in improving these metrics. One subject that the PPA did not address was “leakage.” Based on analysis of Fidelity’s 12.5 million defined contribution (DC) participants many—when changing jobs—are cashing out their retirement savings long before they should. This is especially true of younger participants and those in their prime savings years. As a result, many may be sacrificing their chance for a secure retirement.

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**Hypothetically, a participant at age 30 who cashes out a \$16,000 balance today could lose up to \$471\* per month in retirement income cash flow (assuming he or she retires at 67 and lives through 93).**

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Fidelity analyzed the behavior of participants leaving their jobs<sup>1</sup> to determine what they did with their DC plan assets. Participants fell into one of three categories:

- 1. Stayed in plan** – participants who kept their entire balance in the plan
- 2. Rolled over** – participants who took some or all of their plan assets and rolled them into an IRA or another DC plan
- 3. Cashed out** – those who withdrew some or all of their plan assets<sup>2</sup>

**One out of three job changers cashed out some or all of their workplace savings potentially causing a long-term impact to their retirement security.**

\*This hypothetical example assumes a real return of 4.7% and systematic withdrawal payments from retirement age 67 through death age 93. All values are expressed in today’s dollars (i.e., inflation is not included). Balance at retirement age 67 would have been \$87,500. The ending values do not reflect taxes or fees; if they did, amounts would be lower. Earnings and pretax contributions are subject to taxes when withdrawn. This example is for illustrative purposes only and does not represent the performance of any security. Individuals may earn more or less than this example. Investing on a regular basis does not ensure a profit or guarantee against a loss in a declining market.

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THE OLDER A PARTICIPANT IS WHEN WITHDRAWING ASSETS, THE HARDER IT MAY BE TO GENERATE SUSTAINABLE INCOME IN RETIREMENT.

## YOUNGEST WORKERS SUFFER THE BIGGEST IMPACT

Fidelity data show that younger, lower compensated, lower balance participants are cashing out at the highest rates, a trend that has remained consistent over the last 5 years. Figure 1 shows that the percentage of participants between the ages of 20 and 29 who cashed out some or all of their plan assets is 44%. Cash-out rates for those in their thirties and forties are at 38% and 33%, respectively. This is concerning given that these individuals are in their prime saving and earning years. The average cash-out balance for these participants is \$14,300. The older a participant is when withdrawing assets, the harder it may be to generate a sustainable income in retirement that could last 25 years or more.

FIGURE 1: DISTRIBUTION TYPES BY AGE

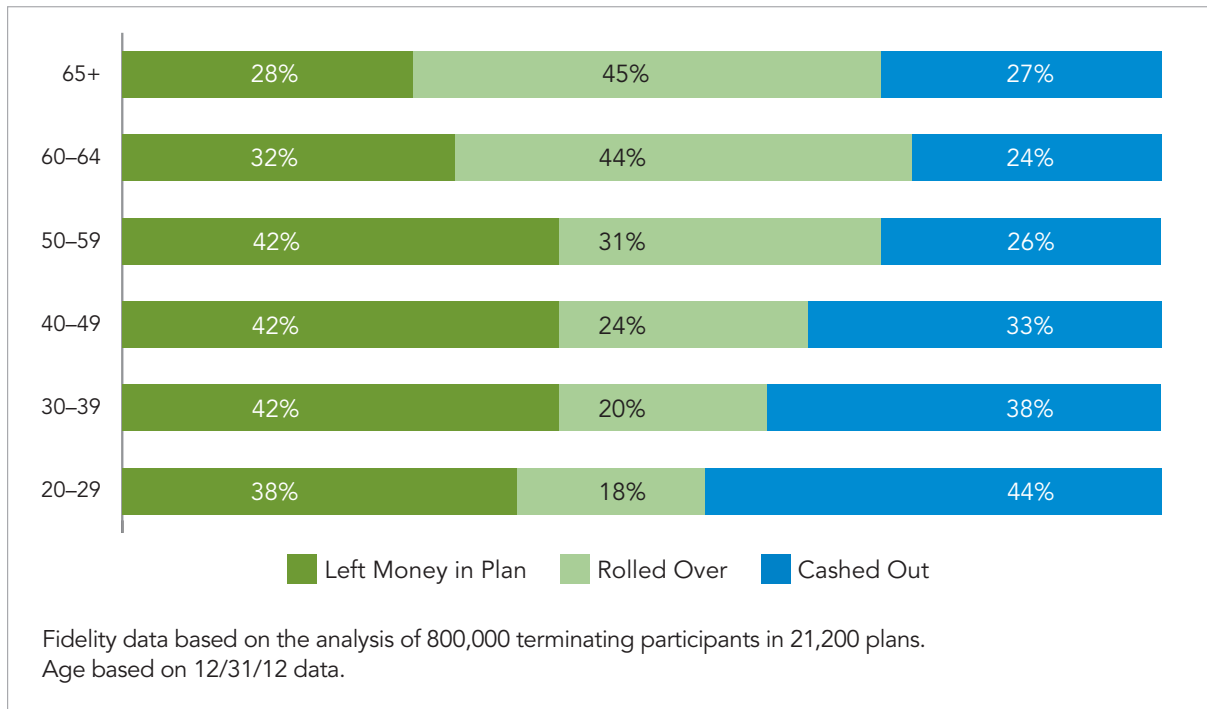
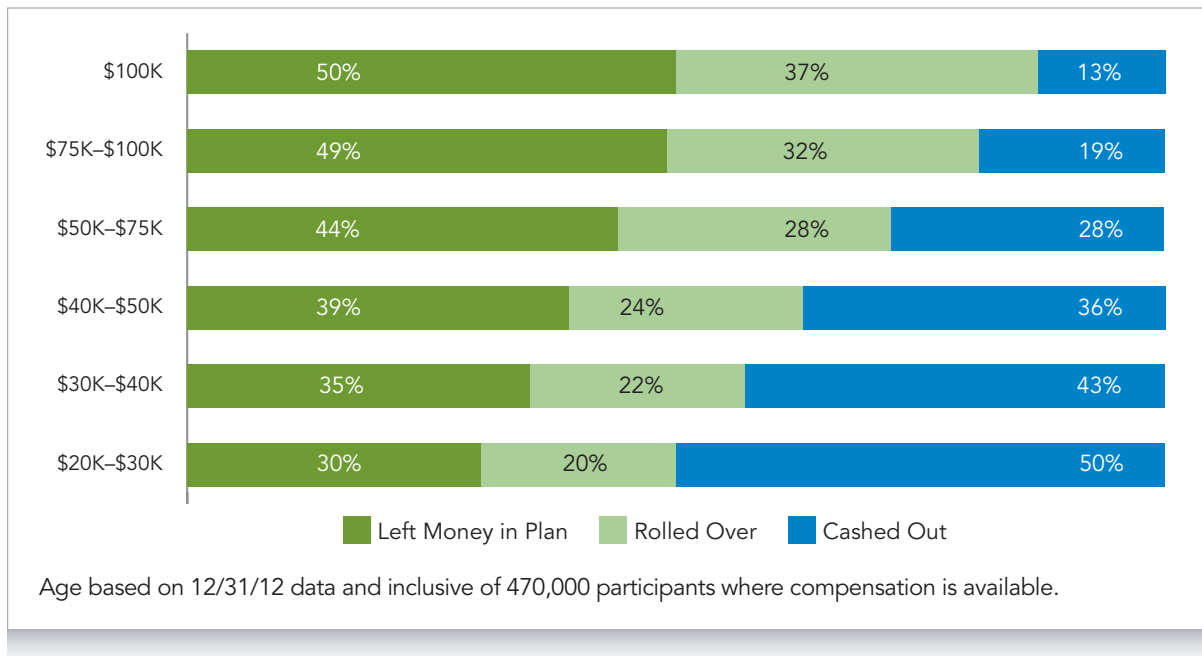


Figure 2 illustrates how lower compensated participants (\$20K–\$30K and \$30K–\$40K) have average cash-out rates of 50% and 43%, respectively, whereas cash-out rates are much lower (at 13%) for those at the higher end of the scale (over \$100K).

**FIGURE 2: DISTRIBUTION TYPES BY INCOME LEVEL**



## CHANGING JOBS: A DEFINING MOMENT

Fidelity knows that the decision to cash out isn't easy. Everyone's personal financial situation is different and there are times when a person must have access to cash. However, we urge all investors — especially young savers with years of potential investment gains — to keep their 401(k) savings working for them in a tax-advantaged retirement account when changing jobs. To this end, Fidelity offers a program for separated employees, educating them on their distribution options as well as the impact any distribution may have on retirement savings goals.

Participants who cash out when leaving a job will be starting over with their next employer. If employees change jobs several times over the course of their career (as is the trend for younger workers) and cash out their 401(k) each time, they will repeatedly drain their savings, making it extremely hard for them to reach their retirement savings goals.

Any level of cashing out is a major concern because of the potential lost opportunity for asset growth via market action, dividends, and interest. Consider this hypothetical example. A participant at age 30 who cashes out a \$16,000 balance today could lose up \$471\* per month in retirement income cash flow (assuming he or she retires at 67 and lives through 93).

\*This hypothetical example assumes a real return of 4.7% and systematic withdrawal payments from retirement age 67 through death age 93. All values are expressed in today's dollars (i.e., inflation is not included). Balance at retirement age 67 would have been \$87,500. The ending values do not reflect taxes or fees; if they did, amounts would be lower. Earnings and pretax contributions are subject to taxes when withdrawn. This example is for illustrative purposes only and does not represent the performance of any security. Individuals may earn more or less than this example. Investing on a regular basis does not ensure a profit or guarantee against a loss in a declining market.

## MANY PARTICIPANTS FAIL TO REALIZE THE DAMAGE THAT TAXES MAY INFLICT WHEN THEY CASH OUT THEIR RETIREMENT ACCOUNTS.

The average 401(k) account balance in Fidelity corporate DC plans at year-end 2013 was \$89,300, and for younger Generation Y workers the average balance was \$19,400.<sup>3</sup> However, for Generation Y participants who have been actively employed with a balance for the past 10 years, the average balance was \$88,700.

There are a number of ways for participants to keep their assets earmarked for retirement when faced with an opportunity to take a distribution. Participants can leave their balance in their previous employers plan if plan rules allow, or they may be able to roll the assets to their new 401(k) or an IRA if their new employer does not offer a 401(k). To allow for continued savings in a tax-advantaged account, participants may open an IRA while in transition between employers. Individuals who stay in plan or rollover have seen solid growth in their retirement savings, thanks in large part to the gains of the stock market. The average balance in a rollover IRA was \$113,700 as of December 31, 2013<sup>4</sup> and the average balance for those who remained in their retirement plan was \$82,300.<sup>3</sup>

We need to call attention to the potential for growth over an individual's lifetime. And, it's crucial that we provide participants with the guidance that will help them to see the long-term impact that even a seemingly small distribution may have on their retirement savings goals.

### A TAXING SITUATION

Many participants fail to realize the damage that taxes may inflict when they cash out their retirement accounts, and both federal and state taxes and in some cases, a penalty, apply. It is even possible that income from a distribution could impact a participant's tax bracket, potentially leading to higher tax obligations when filing returns.

Figure 3 shows a hypothetical participant. Leslie is 36 years old. She decides to cash out her 401(k) plan account which has a \$16,000 balance. Assuming a 20% effective tax withholding rate, federal and state taxes of \$3,200 are withheld from Leslie's proceeds. In addition, she is assessed a \$1,600 penalty for early withdrawal because she is under 59½. That makes a total of \$4,800 deducted from her account. The \$16,000 she was expecting instead became \$11,200.

## FIGURE 3: AMOUNT LOST TO TAXES

### A windfall? It's not what you think

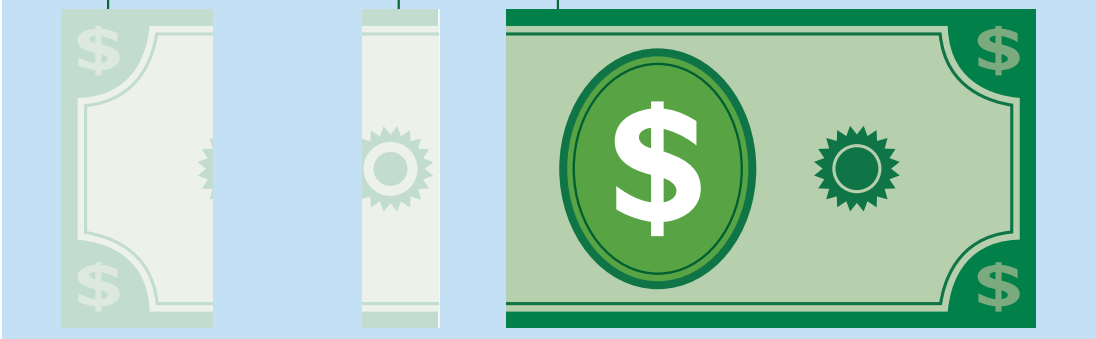
At 36 years old, Leslie decides to cash out her old 401(k) plan account, which has a \$16,000 balance.

**TAXES:** Federal and state taxes of \$3,200 are withheld.

**PENALTY:** Because Leslie is younger than 59½, she is assessed a \$1,600 penalty for early withdrawal.

**WHAT'S LEFT?** A lot less than the \$16,000 Leslie was expecting. After taxes and penalty, she is left with \$11,200.

**WHAT'S LOST?** The chance to take advantage of compounding interest over the course of her career.



Hypothetical example, for illustrative purposes only.

## KEY STEPS EMPLOYERS CAN TAKE

What can be done to address this trend? Most importantly, by being aware of the issue and by offering targeted guidance and education for workers transitioning in their careers, employers can play a pivotal role in helping their employees keep their savings working for them.

Fidelity recommends action steps that center on two key areas: 1) Communicate the Risks of Cash Out and 2) Prevent Savings Setbacks.

### 1. Communicate the Risks of Cashing Out

In addition to the traditional focus on savings and asset allocation, which is critical to building retirement income, Plan Sponsors should go a step further and encourage employees to keep their assets in the plan when transitioning. Proactive and thorough guidance on this topic should be made available to your employees, especially when they are entering or leaving your organization.

**While emphasizing plan enrollment, savings and asset allocation are critical to building retirement income. It's important to encourage employees to keep their savings in a retirement vehicle, especially when they are transitioning between jobs.**



**FOR ADDITIONAL INFORMATION PLEASE  
CONTACT YOUR FIDELITY REPRESENTATIVE.**

Communicate to new and departing participants the fact that cashing out a workplace retirement plan can significantly erode their savings and greatly reduce the probability of income replacement in retirement. Make sure your participants understand the costs of both possible tax penalties and the loss of potential growth and earnings when they take their money out of the plan.

At new hire orientation, ensure employees are aware of the options that may exist for their retirement accounts from previous employers. At termination, encourage your participants to carefully review their distribution options so they understand the full ramifications of cashing out their account. If they are under financial constraints, urge them to consider sources other than their retirement plan, and if at all possible, consider rolling their balance to an IRA versus a distribution.

## **2. Prevent Savings Setbacks**

Equally important to discouraging cash-outs at job change is ensuring savings levels are maintained and asset allocation is reviewed. It is an ideal time for employees to review their retirement savings goals when starting a new job.

Consider the fact that your plan's auto-enrollment default deferral may be less than a new hire was saving prior to coming to your company. Remind your new hires about the importance of saving enough to maintain their lifestyle in retirement, while encouraging them to fill any gap they may have experienced in saving while out of the workplace.

Fidelity recommends that investors review their asset allocation at least annually; however, when changing jobs it is just as important to ensure participant investment allocations are risk appropriate for the current situation. As a Plan Sponsor, encourage the use of guidance and tools that can help participants make informed decisions.

## **LEARN MORE**

With our Plan for Life program, Fidelity offers easy-to-understand guidance through on-line tools and telephone representatives who are available to support your employees' needs during job transition. For additional information on this topic or to discuss plan design options that help lead your participants to retirement readiness, please contact your Fidelity representative.

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<sup>1</sup>One-year periods covering 2000–2012 were analyzed. The analyses were limited to qualified corporate DC plans. In the analysis of the one-year period ending 12/31/2013, 800,000 terminating participants in 21,200 plans were analyzed. Participants analyzed for the 12-month period had terminated employment with their Plan Sponsor for a minimum of three months, and a maximum of 12 months, from the beginning of the period.

<sup>2</sup>For the 9.7% of participants who both cashed out and rolled over portions of their DC plan assets, they were categorized based on whichever category was of a larger withdrawal amount for the one-year period for them.

<sup>3</sup>Based on Fidelity analysis of 21,200 corporate DC plans (including advisor-sold DC) and 12.5 million participants as of 12/31/2013.

<sup>4</sup>Fidelity business data as of 12/31/13.

Withdrawals of taxable amounts are subject to ordinary income tax, and if made before age 59½, may be subject to a 10% Federal Income tax penalty.

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Investing involves risk, including the risk of loss.