



RETIREMENT INSIGHTS

Insights for Plan Sponsors

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Your HFS Team

Heffernan Retirement Services
180 Howard Street, Suite 200
San Francisco, CA 94105
800-437-0045
rebeccat@heffgroup.com
www.heffgroupfs.com
CA Insurance Lic# 0118899

Older Participants' Distribution Decisions Have Implications for DC Plan Design

With 10,000 baby boomers turning 65 every day, and millions poised to retire, plan sponsors, providers and lawmakers are paying close attention to the distribution decisions retirement-age employees make when accessing their defined contribution plan assets.

In light of an imminent mass exodus from the workforce, it can be instructive to examine participant withdrawal behaviors over time. That is exactly what Vanguard did in its September 2015 update to its December 2013 analysis of participant distribution decisions among retirement-age DC plan participants. The report, "Retirement Distribution Decisions Among DC Participants-An Update," considered distribution behaviors through year-end 2014 of 249,600 DC plan participants age 60 and older who terminated employment in calendar years 2004-2013.

Observing these behaviors has implications for plan design, especially target date funds¹ and retirement income programs. For example, should target date funds take a "to" or "through" retirement approach? When it comes to target date fund glide paths, the former suggests a more conservative strategy that assumes assets are used right away at retirement; the latter, an approach that accounts for the preservation of assets several years post-retirement. Please keep in mind that different investment managers use different investment strategies. Participants should review holdings as they approach the target date to make sure the investments remain consistent with their objectives.

Majority of assets rolled over or stay in plan

Vanguard's findings seem to support a "through" strategy. According to the study, more than two-thirds of retirement-age participants acted to preserve assets, and 9 in 10 plan dollars are preserved for retirement. Specifically, 2% remained in the plan with no installments, 7% remained in the plan with installment payouts, and 57% completed an IRA rollover. In asset terms, 4% remained in the plan with no installment payments, 12% remained in the plan with installment payments, and 72% rolled over to an IRA.

Moreover, the financial crisis of 2008 and 2009 did not trigger an uptick in cash-out rates among participants terminating during those years, further supporting a "through" retirement approach for target date funds design, according to Vanguard.

The report's authors also observed that most DC plan participants age 60 and older leave their employer's plan within five years of terminating their employment, with the majority rolling assets over to an individual retirement arrangement. This termination behavior seems to be motivated by plan rules governing partial distributions.

Most plans disallow partial withdrawal; should that change?

It's no wonder. A full 87% of Vanguard DC plans require participants who desire a partial ad hoc distribution to take a lump-sum distribution of their entire account balance. For example, a terminated participant with a \$100,000 plan balance who wishes to make a one-time withdrawal of \$100 must withdraw the entire amount-i.e., by rolling over the entire \$100,000 to an IRA and withdrawing \$100, or by executing an IRA rollover of \$99,900 and taking a \$100 cash distribution. Vanguard suggests that plan sponsors might boost in-plan distributions by eliminating rules prohibiting partial ad hoc distributions.

Research cited in the report shows retirees seldom withdraw IRA assets until age 70, when required

minimum distribution rules apply.

Additionally, these findings emphasize the importance of more flexible in-plan retirement income strategies. With an emphasis on lump-sum distributions, participants will need help transforming their savings into a consistent income stream. Based on Vanguard's analysis, these decisions will be made mostly in the IRA marketplace, not within employer-sponsored qualified plans. However, retirement-age participants' distribution behaviors may change over time as more providers adopt in-plan payout options.

Vanguard's complete analysis is available online at <http://tinyurl.com/VanguardDistributionUpdate2015>.

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Kmotion, Inc., 412 Beaver Creek Road, Suite 611, Oregon City, OR 97045; www.kmotion.com

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