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Report to the Chairman, Special Committee on Aging, U.S. Senate

August 2009

401(k) PLANS

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

GAO-09-715

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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

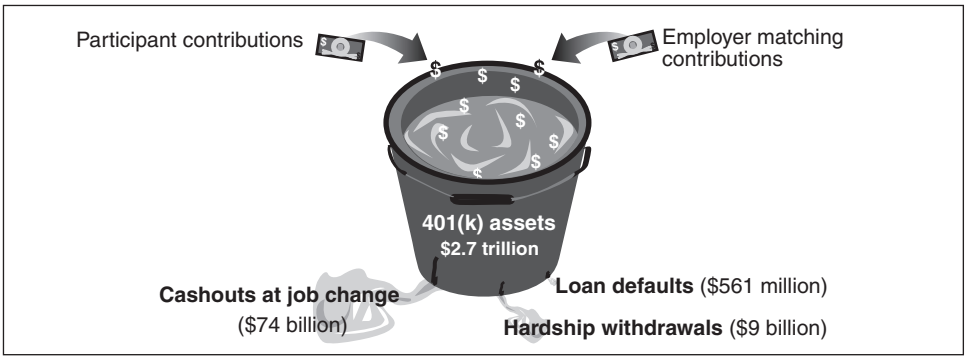
GAO is suggesting that Congress consider changing the requirement for the 6-month contribution suspension following a hardship withdrawal. In addition, GAO recommends that the Secretary of Labor promote greater participant education on the importance of preserving retirement savings, and that the Secretary 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.
For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

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.

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Abbreviations

DB	defined benefit
DC	defined contribution
ERISA	Employee Retirement Income Security Act of 1974
EBSA	Employee Benefits Security Administration
IRA	individual retirement account
IRS	Internal Revenue Service
OASDI	Old-Age, Survivors, and Disability Insurance
SIPP	Survey of Income and Program Participation
SMM	summary of major modifications
SPD	summary plan description

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

August 28, 2009

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

Dear Mr. Chairman:

The current economic recession has caused millions of U.S. workers to lose their homes, their jobs, and significant portions of their retirement savings. The sudden reduction in the value of retirement savings in response to stock market declines has reportedly led many 401(k) plan participants to feel less confident in reaching their retirement goals and to worry that they may never be able to retire. Moreover, the rise in unemployment has had a detrimental impact on retirement savings. For example, unemployed participants can no longer make tax-deferred contributions to employer-sponsored plans and will likely have more difficulty saving anything at all. In addition, unemployment may lead participants to tap into their accrued retirement savings to navigate difficult times. This "leakage," which can result in the permanent loss of retirement savings, has raised concerns that plan participants may be jeopardizing their long-term retirement security through the short-term consumption of their retirement savings. Such reductions in retirement savings may be even more pronounced if the leakage occurs at a time when a participant's account balance has already experienced market value losses.

Since they were first introduced several decades ago, 401(k) plans have become the principal retirement savings vehicle for millions of U.S. workers. Unlike employees with more traditional defined benefit pensions, employees with defined contribution plans—such as 401(k) plans—choose to participate in their employers' plans and generally decide the amount they want to contribute and how to invest it.[1] Thus, they bear the

[1]Employers may sponsor defined benefit (DB) or defined contribution (DC) plans for their employees. DB plans promise to provide a benefit that is generally based on an employee's salary and years of service. See 29 U.S.C. § 1002(35). DB plans use a formula to determine the ultimate pension benefit participants are entitled to receive. Under a DC plan, such as a 401(k) plan, employees have individual accounts to which the employee, employer, or both make contributions, and benefits are based on contributions, along with investment returns (gains and losses) on the accounts. See 29 U.S.C. § 1002(34).

responsibility for funding and managing their investments in a way that seeks to achieve sufficient benefits in retirement. The removal of retirement savings prior to retirement can affect a participant's ultimate preparedness for retirement, especially when the amounts removed are spent and not replaced. For example, 401(k) participants who choose to take a lump-sum distribution, or "cash out," from their account balance when separating from their employer, rather than rolling the money over to another qualified plan, may find it difficult to accrue sufficient savings to provide adequate income in retirement.

In this report, we use a standard definition of leakage—that is, participants tapping into their accrued retirement savings prior to retirement. We do not take into account other events that could adversely affect participant balances, such as participants not taking advantage of the full employer matching contribution, participants contributing less than the annual federal limit, or the costs associated with paying plan administrative fees.[2] In addition, we use the term "cashout" to refer to a lump-sum distribution made to an employee at job separation that is not subsequently rolled over into a qualified retirement account or an individual retirement account (IRA).[3]

You asked us to examine several aspects of leakage from 401(k) plans. Specifically, we answer the following questions in this report:

[2]See GAO, *Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, GAO-07-21 (Washington, D.C.: Nov. 16, 2006). In the 2006 report, we found that participants paid for the majority of investment fees and an increasing amount of plan recordkeeping fees, and that under the Employee Retirement Income Security Act of 1974, plans were not required to disclose information on 401(k) fees being borne by individual participants. While the current report focuses on participants' elective removal of their accrued retirement savings, we recognize that 401(k) fees have a considerable long-term effect on the accumulation of retirement income. See GAO, *Private Pensions: Participants Need Information on Risks They Face in Managing Pension Assets at and During Retirement*, GAO-03-810 (Washington, D.C.: July 29, 2003).

[3]Both cashouts and hardship withdrawals result in the permanent removal of money from 401(k) accounts. However, participant loans are borrowed from the plan and must be paid back to the plan. The borrowed amount does not leave the plan, unless the participant fails to repay according to the terms of the loan. A loan default would result in a distribution that would permanently reduce the account balance in a 401(k). In addition, a participant taking a loan may achieve slightly lower savings at retirement if the amount of loan interest paid back to the account during the loan repayment period is less than the market rate of return. Participants who have an outstanding loan balance at job separation generally must repay the loan balance in full or the loan will default, triggering an early distribution.

1. What are the incidence, amount, and relative significance of the different forms of 401(k) leakage?
2. How do 401(k) plans inform participants about hardship withdrawal provisions, loan provisions, and options at job separation, including the short-term and long-term costs associated with each?
3. What is known about how various policies may affect the incidence of 401(k) leakage?

To determine the principal forms of 401(k) leakage, we interviewed industry and academic experts, reviewed laws and regulations, and analyzed existing studies on leakage. We then identified cashouts, hardship withdrawals, and participant loans as the three principal forms of leakage for the purposes of this report. To determine the incidence and amount of leakage over time, we analyzed a cross-section of the 3 most recent years of nationally representative survey data collected in 1998, 2003, and 2006 in the U.S. Census Bureau's Survey of Income and Program Participation (SIPP). We also analyzed published annual statistics from the Department of Labor and the Internal Revenue Service (IRS), respectively, to obtain aggregate loan default amounts and early withdrawal penalties paid. To determine the recent prevalence of leakage, we analyzed summary data from 2005 through 2008 that we obtained from 401(k) plan administrators that represent about 22 million 401(k) participants and over $1 trillion in 401(k) plan assets. To illustrate the relative significance of leakage over time, we developed scenarios to simulate the effect that various forms and amounts of leakage may have on retirement savings. In developing these scenarios, we considered a range of factors, including historical and projected rates of return, earnings, wages, contribution rates, years until retirement, loan administration fees, and penalties associated with leakage.

To determine how plans inform participants about leakage, we interviewed 26 plan administrators that represented an estimated 80 percent of 401(k) participants and 65 percent of 401(k) plan assets. As part of these efforts, we analyzed documents related to leakage from 401(k) accounts and conducted 10 site visits during which we interviewed representatives, reviewed relevant documentation, and toured a participant call center. We also reviewed selected 401(k) plan sponsor and administrator Web sites, and current pension law and regulations. Appendix II provides a list of the 401(k) plan administrators that we contacted.

To identify what is known about how various policy options may affect the incidence of leakage, we identified provisions in current law, regulations, and legislative proposals to identify policy options that are likely to affect leakage. We then interviewed selected industry and academic experts to determine how these provisions may affect leakage. We analyzed their responses and identified the provisions that these experts said were likely to affect leakage. We then developed model scenarios based on the factors that experts identified, to illustrate the effect that certain provisions may have on the accumulation of a participant's retirement savings.

We conducted this performance audit from August 2008 to August 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We determined that the data that we analyzed were sufficiently reliable for the purposes of this report. Appendix I of this report contains a detailed description of the methodology used in this review and its limitations.

Background

Private-sector pension plans are classified either as defined benefit or as defined contribution plans. Defined benefit plans generally offer a fixed level of monthly retirement income based upon a participant's salary, years of service, and age at retirement, regardless of how the plan's investments perform. In contrast, defined contribution plans, such as 401(k) plans, benefit levels depend on the contributions made to the plan and the performance of the investments in individual accounts, which may fluctuate in value. Named after section 401(k) of the *Internal Revenue Code*, traditional 401(k) plans allow workers to save for retirement by diverting a portion of their pretax income into an investment account that

can grow tax-free and be withdrawn without penalty after age 59½.[4] Employers and employees may make pretax contributions, up to certain limits, to individual participant accounts. In 2009, participants may contribute up to $16,500 per year. The 401(k) account balance is a function of both the contributions made to the accounts over a career as well as the investment performance of the account. As such, the declines in the markets can have a stark effect on retirement savings, as happened in 2007 and 2008 when the financial markets declined.

About one-half of all U.S. workers participate in some form of employer-sponsored retirement plan. Participation in 401(k) plans rose steadily from fewer than 8 million participants in the mid-1980s to over 70 million participants in 2006—the most recent year for which data were available. The assets in 401(k) plans also increased significantly over the same time period, from less than $100 billion to over $3 trillion.[5]

Current law limits participant access to their retirement savings in their employer-sponsored retirement plans so that the favorable tax treatment for retirement savings is limited to savings that are, in fact, used to provide retirement income. Only under certain circumstances do federal regulations allow 401(k) plan sponsors to provide participants with access to their tax-deferred retirement savings before retirement. IRS, within the Department of the Treasury, and Labor's Employee Benefits Security Administration (EBSA) are primarily responsible for enforcing laws that govern defined contribution plans. IRS interprets and enforces provisions of the *Internal Revenue Code* that apply to tax-qualified pension plans. EBSA enforces the Employee Retirement Income Security Act (ERISA) reporting and disclosure provisions and fiduciary responsibility standards,

[4]The *Internal Revenue Code*, as amended, exempts certain early distributions from the penalty if the distributions are made to a beneficiary or estate on or after death; made on account of total and permanent disability; made as part of a series of substantially equal periodic payments over the life expectancy of the owner or life expectancies of the owner and the beneficiary; equal to or less than deductible medical expenses (7.5 percent of adjusted gross income); made due to an IRS levy of the plan; made to individuals called to active duty after September 11, 2001, and before December 31, 2007; made to a participant after separated from service with an employer in or after the year that he or she reaches age 55; made to an alternate payee under a qualified domestic relations order; dividends from employee stock ownership plans; or made to an individual whose main home was located in a designated hurricane disaster area and who sustained an economic loss by reason of the hurricane. Additionally, some plan sponsors offer Roth 401(k) plans that allow plan participants to make elective after-tax contributions through payroll deduction.

[5]For 2006 estimates, see Investment Company Institute, "The U.S. Retirement Market, 2007," *Research Fundamentals*, vol. 17, no. 3 (2008).

which, among other things, concern the type and extent of information provided to plan participants.

Plan sponsors have considerable latitude within the regulatory guidelines to choose whether to provide this access in the form of a participant loan, a hardship withdrawal, or a lump-sum distribution when the participant separates from an employer. Plans may allow participants to take loans, but may place limitations on the amounts, purpose, or number of loans available. Plans may also allow participants who can demonstrate that they are facing a hardship to take hardship withdrawals. In addition, when separating from their employer, participants may elect to receive a lump-sum distribution of their account balance, or "cash out," rather than to preserve the tax-deferred status of their accounts by rolling over their account into another qualified plan or IRA. Table 1 provides a summary of the provisions related to leakage from 401(k) plans.

Table 1: Provisions Related to 401(k) Leakage

Provision	Requirements	Cashouts	Hardship withdrawals	Loans
Employee Retirement Income Security Act of 1974	Requires plan administrators to furnish participants with a summary plan description to ensure that all participants and beneficiaries in participant-directed individual account plans have the information relating to their benefits and rights under their plans.	X	X	X
Revenue Act of 1978	Provides for a cash or deferred arrangement under section 401(k) of the *Internal Revenue Code*.	X	X	X
Internal Revenue Code of 1986	Levies a 10 percent penalty for early withdrawals from qualified retirement accounts except for instances involving death, disability, severance from service, plan termination, or the attainment of age 59½.	X	X	X
	Sets the maximum amount that the plan can permit as a loan as (1) the greater of $10,000 or 50 percent of a participant's vested account balance or (2) $50,000, whichever is less.			X
	Provides that a participant's elective contributions to a 401(k) plan may not be distributed prior to the occurrence of certain events, such as the employee's separation from service or a hardship.	X	X	
	Provides that plan administrators may not cash out an account balance that exceeds $5,000 without the consent of the participant.	X		
	Prohibits a hardship withdrawal from being rolled over into an IRA or other qualified plan.		X	
	Provides exceptions for paying the 10 percent penalty on early withdrawals from qualified retirement plans.	X		

Provision	Requirements	Cashouts	Hardship withdrawals	Loans
	Requires plan administrators to provide a notice to a participant of his or her right, if any, to defer receipt of an immediately distributable benefit.	X		
Taxpayer Relief Act of 1997	Allows for distributions from certain plans to be used without penalty to purchase first homes.		X	
Economic Growth and Tax Relief Reconciliation Act of 2001	Reduces elective contribution prohibition period following a hardship withdrawal, from 12 months to 6 months.		X	
	Requires automatic rollover of certain mandatory distributions unless a participant opts out and reduces the cap to $1,000 for involuntary cashouts at job separation.	X		
Pension Protection Act of 2006	Permits hardship withdrawal distributions for expenses relating to medical, tuition, and funeral expenses for a "primary beneficiary."		X	
	Requires plan sponsors to provide a notice to participants of the consequences of the failure to defer their account balance at job separation.	X		

Source: GAO analysis of relevant laws.

Plan sponsors may, but are not required to, offer loan and hardship withdrawal provisions to participants. In providing these options, plans offer participants a certain flexibility and short-term financial relief that may improve a participant's overall long-term financial standing if the distributions are used, for example, to pay off high-interest credit card debt, purchase a primary residence, or support a college education. Furthermore, as we reported in October 1997, the availability of loan provisions is associated with encouraging workers to join their employer-sponsored 401(k) plans when they otherwise might not, resulting in higher overall participation and contribution rates.[6] Unlike other forms of leakage, participant loans, which are paid back to the plan with interest, become leakage only if they are not repaid.

Early access to retirement savings may also burden participants with short-term costs and long-term consequences. In the short term, participants who take a distribution before reaching age 59½ generally pay a 10 percent early withdrawal penalty and income taxes on the distribution amount, and may face other restrictions and fees, such as loan origination fees. In the longer term, this leakage may reduce the amounts that

[6]GAO, *401(k) Pension Plans: Loan Provisions Enhance Participation But May Affect Income Security for Some*, GAO/HEHS-98-5 (Washington, D.C.: Oct. 1, 1997).

participants can save prior to retirement by permanently removing assets from their accounts and forgoing the accumulation of savings realized through compounding.

Rules Affecting Early Distributions from Retirement Plans

The tax-deferred contributions in participants' 401(k) plans can only be distributed upon the occurrence of certain events. As shown in table 2, each of the principal forms of 401(k) leakage that we identified is subject to a number of specific rules. For example, to discourage the use of pension funds for purposes other than retirement, the law imposes an additional 10 percent tax on certain early distributions made from qualified retirement plans, such as a 401(k) plan, before a participant reaches age 59½. As regular income distributions, these early distributions are subject to federal and state income tax withholding and taxed at the marginal income tax rate.[7] Some early distributions may not be taxable if they are rolled over into an IRA or another qualified retirement account. Certain other distributions have been exempted from the additional tax.[8]

[7]Different portions of taxable income are taxed at different rates. IRS refers to the tax rate applied to the last dollar of income as the "marginal tax rate" for that return.

[8]IRS makes guidance available to participants on the rules governing distributions from qualified retirement accounts, including allowable exceptions, on its Web site: http://www.irs.gov.

Table 2: Comparison of the Rules Governing the Three Principal Forms of 401(k) Leakage

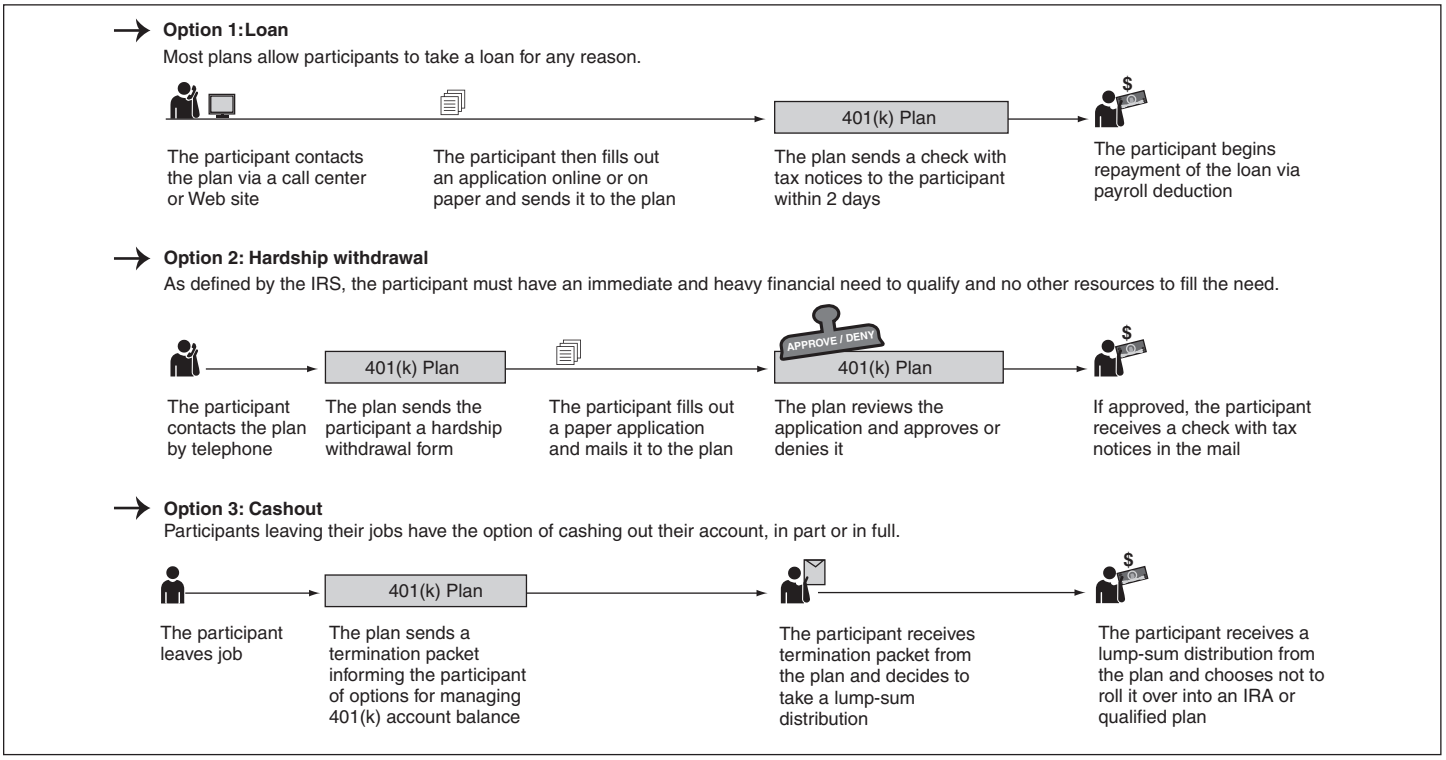
Leakage type	Amount restrictions	Allowable purpose	Documentation requirements	Associated costs	Other restrictions
Cashouts	Up to 100 percent of account balance.	Participants may use the distribution for any purpose.	Participant with account balances over $5,000 must affirm their decision to take a lump-sum distribution at job separation.	Participants are required to pay federal and state income taxes on the distribution amount. Participants under age 59½ may be subject to 10 percent early withdrawal penalty. Participants are subject to 20 percent employer withholding.	Available to participants only when separating from their employer. Generally, a plan administrator must obtain participants' consent before making a distribution from an account balance that exceeds $5,000. Employers may cash out separating participants' account balances under $5,000 from their plan without the participants' consent. They may compel cashouts of balances under $1,000, but are required to roll over account balances of between $1,000 and $5,000 into an IRA.
Hardship withdrawals	Limited to the amount of the employee's elective contributions, and generally do not include any income earned on the deferred amounts.	Hardship withdrawal distributions must be made on account of an immediate and heavy financial need. The financial need may be immediate and heavy, even if the event was reasonably foreseeable or voluntarily incurred. A distribution is deemed to be on account of an immediate and heavy financial need of the employee if the distribution is for the following: • expenses for medical care previously incurred by the employee, the employee's spouse, or any dependents of the employee or necessary for these persons to obtain medical care;	Participants must provide documentation of their hardship.	Federal and state income taxes. Participants under age 59½ may be subject to 10 percent early withdrawal penalty. Participants are subject to 20 percent employer withholding.	A plan may only allow hardship withdrawals if participants have obtained all other currently available distributions and loans under the plan and all other plans maintained by the employer. Participants face a 6-month suspension of contributions to their accounts following hardship withdrawal. Participants may not roll over any part of their hardship withdrawal into an IRA or other qualified plan.

Leakage type	Amount restrictions	Allowable purpose	Documentation requirements	Associated costs	Other restrictions
		• costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments); • payment of tuition, related educational fees, and room and board expenses, for the next 12 months of postsecondary education for the employee or the employee's spouse, children, or dependents; • payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence; • funeral expenses; or • certain expenses relating to the repair of damage to the employee's principal residence.			
Loans	Up to 50 percent of a participant's vested account balance or $50,000, whichever is less.	General purpose. Purchase of a primary residence.	None for general purpose loans. Evidence of imminent home purchase generally required for principal residence loans.	Must pay amount back to account, with interest. Loans that are not repaid are treated as loan defaults and the outstanding loan balance is removed from the plan and sent to the participant as a taxable distribution of income.	Loan repayments are not considered plan contributions. Participants must repay loans in substantially equal payments that include principal and interest. The repayment period is within 5 years for general purpose loans, and is longer for primary residence loans.

Source: GAO analysis of laws and regulations.

Participants tapping into their 401(k) account follow different rules and procedures to gain access to their money, depending on whether they take a loan, hardship withdrawal, or cashout. Figure 1 describes the process that a participant must generally follow to withdraw money using one of these options.

Figure 1: Options Available to Participants to Withdraw Money from a 401(k) Account before Retirement



Sources: GAO (analysis); Art Explosion (images).

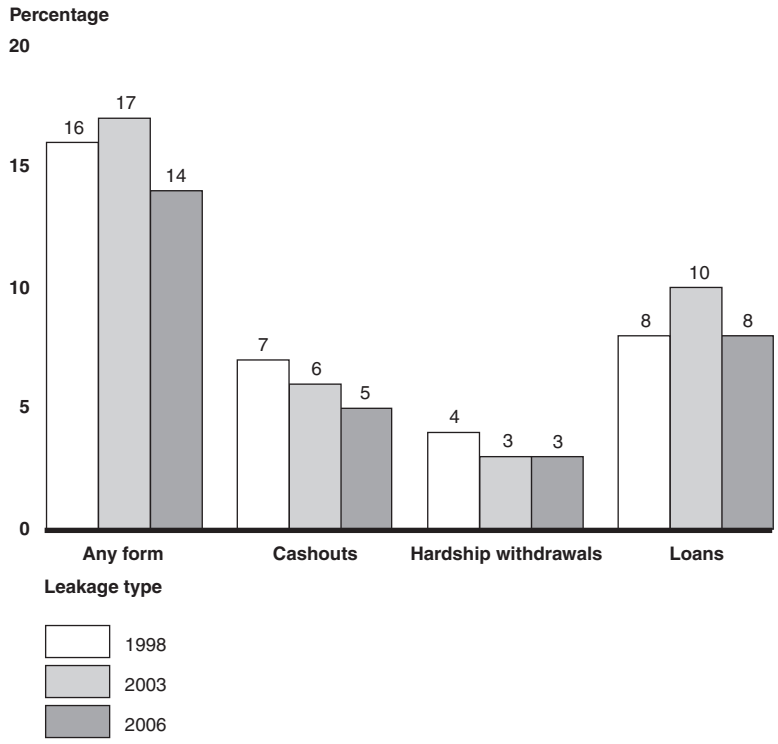
Leakage Has Remained Relatively Steady, with Cashouts Having the Greatest Impact on Retirement Savings

Leakage Has Remained Relatively Steady, Even in the Poor Economy

Our estimates—based on SIPP data collected in 1998, 2003, and 2006—found no statistically significant differences in the overall incidence of leakage from 401(k) accounts in the data from the three SIPP panels that we analyzed, with approximately 15 percent of participants between ages 15 and 60 initiating at least one form of leakage.[9] As shown in figure 2, we estimated that the percentage of participants experiencing each leakage type remained steady across the 3 years, with more participants borrowing money from their plans in the form of a loan than taking a cashout or hardship withdrawal.

[9]We analyzed data from the Pension and Retirement Topical Module collected during wave 7 for the 1996, 2001, and 2004 SIPP panels.

Figure 2: Estimated Percentage of 401(k) Participants Ages 15 to 60 Reporting Leakage, by Leakage Type



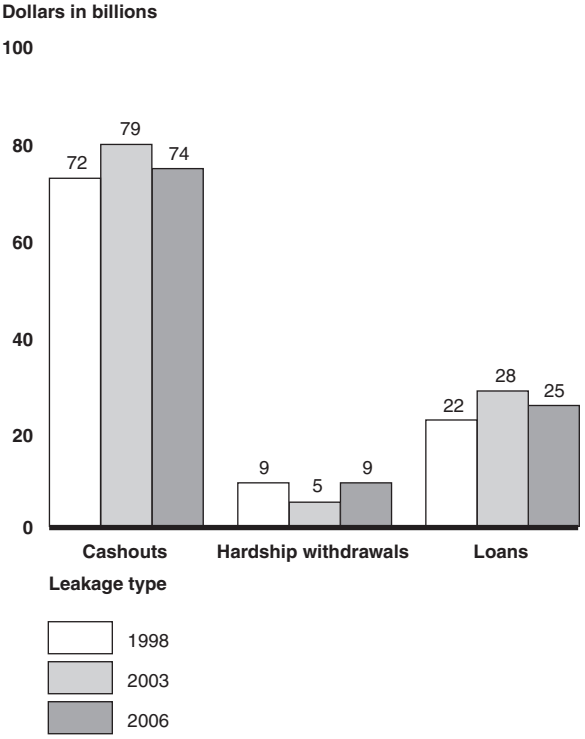
Source: GAO analysis of SIPP data.

Note: The SIPP wave 7 Pension and Retirement Topical Module was collected 2 years after the start of the 1996, 2001, and 2004 SIPP panels, respectively. The amounts for the individual forms of leakage do not equal the total for the *Any form* category due to rounding of estimates to the nearest percentage. The 95 percent confidence intervals for the estimates shown are as follows. Any form: 1998 (15.4, 17.1), 2003 (15.7, 17.7), 2006 (13.5, 14.9). Cashouts: 1998 (6.1, 7.2), 2003 (5.5, 6.8), 2006 (4.7, 5.6). Hardship withdrawals: 1998 (3.5, 4.3), 2003 (2.6, 3.6), 2006 (2.8, 3.6). Loans: 1998 (7.5, 8.7), 2003 (9.1, 10.7), 2006 (7.5, 8.6).

Our analysis of SIPP data found significant differences in the amounts of leakage, by type, that participants reported taking from their 401(k) plans, with the total cashout amounts being significantly higher than the total amounts of either hardship withdrawals or loans. As shown in figure 3, we estimated that the amount of leakage reported in 2006 was approximately $108 billion, with cashouts comprising the bulk of that amount.[10]

[10]The Pension and Retirement Topical Module for the 2004 SIPP was collected in the seventh wave of participant interviews during 2006.

Figure 3: Estimated Total Amounts of Leakage Reported by 401(k) Participants, Ages 15 to 60, by Leakage Type

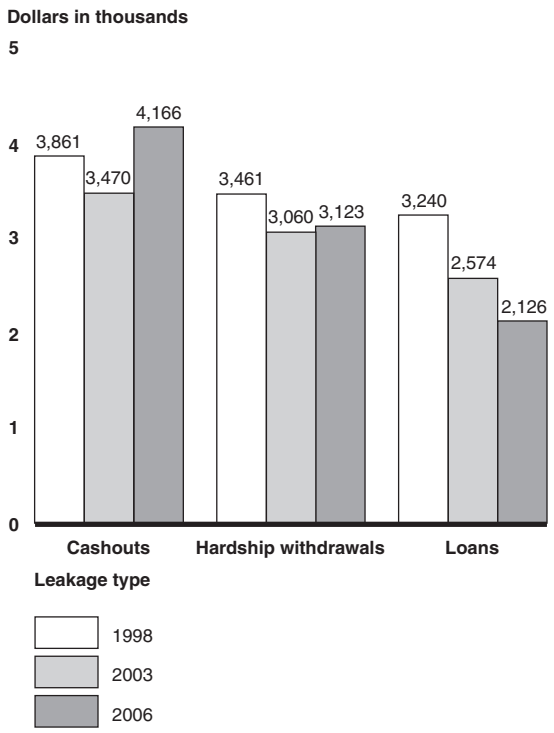


Source: GAO analysis of SIPP data.

Note: The SIPP wave 7 Pension and Retirement Topical Module was collected 2 years after the start of the 1996, 2001, and 2004 SIPP panels, respectively. Dollar amounts have been adjusted for inflation and are reported in constant calendar year 2008 dollars. The 95 percent confidence intervals are expressed in billions of dollars. The 95 percent confidence intervals for the estimates shown are as follows. Cashouts: 1998 (65.2, 79.8), 2003 (68.0, 89.6), 2006 (66.5, 81.8). Hardship withdrawals: 1998 (6.9, 10.2), 2003 (3.8, 6.5), 2006 (7.4, 10.7). Loans: 1998 (19.7, 24.8), 2003 (24.6, 30.5), 2006 (22.2, 27.4).

The median amounts of leakage also remained steady in the 3 years of SIPP data that we analyzed. According to our estimates, the median cashout amount was significantly higher than the median loan amount. (See fig. 4.)

Figure 4: Estimated Median Amounts of Leakage Reported by 401(k) Participants, Ages 15 to 60, by Leakage Type



Source: GAO analysis of SIPP data.

Note: The SIPP wave 7 Pension and Retirement Topical Module was collected 2 years after the start of the 1996, 2001, and 2004 SIPP panels, respectively. Dollar amounts have been adjusted for inflation and are reported in constant calendar year 2008 dollars. The 95 percent confidence intervals are expressed in thousands of dollars. The 95 percent confidence intervals for estimates are as follows. Cashouts: 1998 (3.8, 4.0), 2003 (3.9, 4.7), 2006 (4.3, 5.7). Hardship Withdrawals: 1998 (2.6, 4.1), 2003 (2.3, 4.2), 2006 (2.6, 4.2). Loans: 1998 (2.8, 4.0), 2003 (2.4, 3.6), 2006 (2.0, 2.8).

The overall incidence and amounts of leakage from loans and hardship withdrawals also remained steady through 2008, according to data that we obtained from selected major 401(k) administrators.[11] While these data were not nationally representative, they covered a wide spectrum of 401(k) plans, participants, and assets. As shown in table 3, the overall incidence and average amounts of leakage changed little, if at all, from 2005 through 2008. Two administrators also told us that they had seen

[11]The three administrators that provided us with recent data represent about 22 million 401(k) participants and over $1 trillion in 401(k) plan assets.

little change in the number of hardship withdrawals and loans in the first quarter of 2009.

Table 3: Recent Trends in 401(k) Leakage as Reported by Selected Major 401(k) Plan Administrators, 2005 through 2008

		2005		2006		2007		2008	
Leakage form	Administrator	Average amount	%	Average amount	%	Average amount	%	Average amount	%
Loans	#1	$8,030	20.0	$8,300	20.0	$8,590	20.0	$8,710	19.0
	#2	8,039	18.0	8,260	17.0	8,571	16.0	8,624	16.0
	#3	6,091	18.0	7,246	18.0	8,228	18.0	8,657	18.0
Hardship withdrawals	#1	6,070	1.4	6,250	1.5	6,160	1.6	5,960	1.8
	#2	6,113	—	6,458	1.5	5,305	1.6	5,821	1.7
	#3	7,240	2.1	7,555	2.3	8,038	2.3	8,444	2.4

Source: GAO analysis of data obtained from selected major 401(k) administrators.

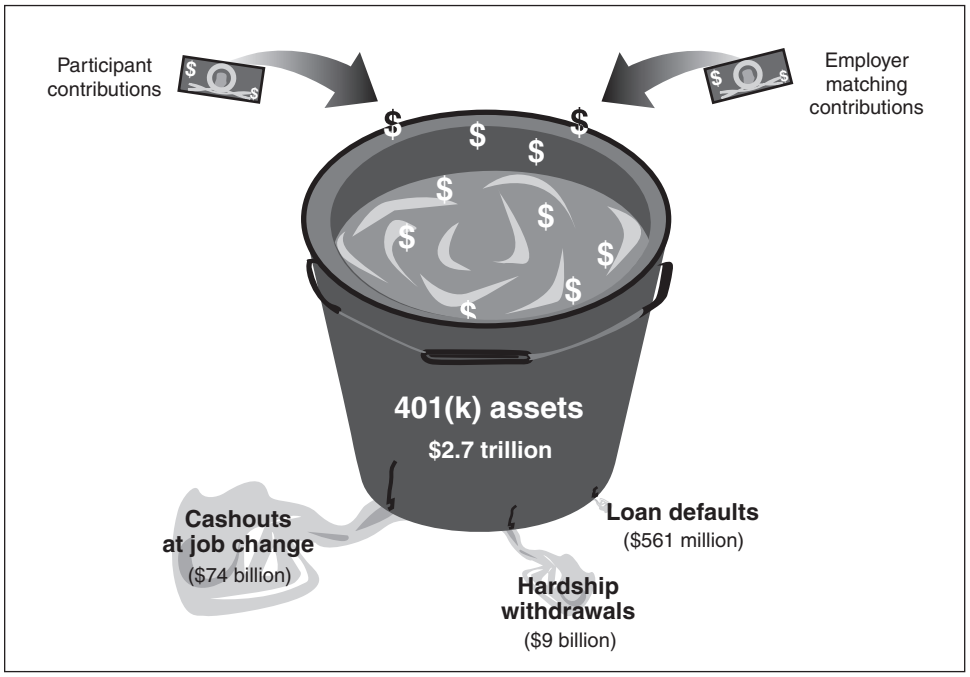
Note: These data from selected 401(k) administrators are not nationally representative and may not reflect the estimates provided of nationally representative SIPP data. Not all of the administrators we contacted provided comparable data on the incidence and amount of cashouts taken by 401(k) participants before turning age 60.

Taking a cashout, hardship withdrawal, or loan can come with costs that can amplify the detrimental effect that leakage can have on a participant's retirement savings. For example, early distributions from a 401(k) account, whether in the form of a cashout, hardship withdrawal, or defaulted loan, may be subject to a 10 percent tax penalty that must be paid in addition to the amount of the distribution. In addition, some plans require participants who take a loan to pay an additional loan origination fee or periodic loan maintenance fees over the course of the loan repayment period. Participants taking hardship withdrawals are subject to the 10 percent penalty and must eventually pay federal and state income taxes on the hardship withdrawal amount. In addition, the requirement that participants suspend all contributions to their plans for 6 months following the hardship withdrawal not only prevents participants from continuing to make contributions but also precludes them from obtaining any employer matching contribution. The additional costs associated with cashouts, hardship withdrawal, and defaulted loans can compound permanent losses of retirement income by reducing a participant's balance and precluding these amounts from compounding in the account over time.

While the estimated amount of 401(k) leakage is in the billions of dollars, it represents a relatively small proportion of the aggregate value of assets

in 401(k) plans. As shown in figure 5, in 2006, leakage resulted in marginal losses in retirement savings in aggregate. Yet, at the level of the individual participant, leakage can create considerable displacement of retirement savings.

Figure 5: Illustration of 401(k) Leakage as a Proportion of Overall 401(k) Plan Assets in 2006



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

Cashouts Can Have the Greatest Impact on Retirement Savings

Cashouts at job separation can have the greatest impact of the principal forms of leakage on an individual participant's savings, according to the results of our analysis. We simulated a range of leakage scenarios that took into account the age, earnings, and job tenure of participants as well as a range of leakage amounts. We found that cashouts of any amount at job separation—whether taken in part or in full—can have a greater effect on a participant's account balance at age 65 than comparable amounts taken in the form of a hardship withdrawal or loan. As shown in table 4, cashouts resulted in a greater proportional loss of retirement savings among low-wage earners, especially those who took a partial cashout earlier in their working careers.

Table 4: Illustration of the Effect of a $5,000 Loan, Hardship Withdrawal, or Cashout on a Participant's 401(k) Account, by Age and Wage Level

			No leakage		Loan ($5,000)		Hardship withdrawal ($5,000)		Partial cashout ($5,000)	
Age	Wage level	Average annual earnings	Account balance at age 65	%	Account balance at age 65	%	Account balance at age 65	%	Account balance at age 65	%
35										
	Low	$16,444	$264,624	100.0	$264,075	99.8	$233,607	88.3	$230,035	86.9
	Medium	36,546	588,049	100.0	587,500	99.9	552,597	94.0	544,658	92.6
	High	58,497	940,839	100.0	940,290	99.9	900,506	95.7	887,836	94.4
45										
	Low	$26,383	$264,624	100.0	$264,331	99.9	$243,873	92.2	$240,341	90.8
	Medium	58,606	588,049	100.0	587,756	100.0	562,860	95.7	555,013	94.4
	High	93,802	940,839	100.0	940,546	100.0	910,802	96.8	898,243	95.5
55										
	Low	$36,105	$264,624	100.0	$264,447	99.9	$252,090	95.3	$249,347	94.2
	Medium	80,252	588,049	100.0	587,873	100.0	572,064	97.3	565,968	96.2
	High	128,418	940,839	100.0	940,663	100.0	921,090	97.9	911,334	96.9

Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's most recent *Old-Age, Survivors, and Disability Insurance (OASDI) Trustees' Report* and for low, medium, and high annual earnings. Employee contributions are 6 percent and receive a 3 percent employer matching contribution. We assume that loans are taken out at the beginning of the year that the individual reaches the age indicated, loans incur a $100 fee deducted from the account balance, and loans are repaid in 5 years at a fixed interest rate equal to the rate of return at the time that the loan is made. Participants who reduce their rate of contributions while making loan payments will experience a greater reduction in their account balance at age 65. We assume that hardship withdrawals are taken out at the beginning of the year that the individual reaches the age indicated and follow the rules. We assume that partial cashouts are taken out at the beginning of the year that the individual reaches the age indicated, partial cashouts incur the 10 percent early withdrawal penalty, and the individual does not resume elective or employer matching contributions to a 401(k) account for 12 months following the distribution, to allow for any delay in the resumption of employment or a waiting period before beginning to participate in a new employer's 401(k) plan, or both. Individuals who take a partial cashout and resume contributions to a 401(k) plan prior to the end of a 12-month period would under certain circumstances experience less leakage from their account balance at age 65. For example, a participant taking a cashout at job change who experienced no interruption in contributions would have a higher account balance at age 65 than if he or she had taken a hardship withdrawal for the same amount.

Participants who voluntarily cashed out their entire 401(k) account balance at job separation experienced the largest reductions in the amount of retirement savings that accumulate over their working careers. As shown in table 5, unlike partial cashouts, which leave some assets in the plan to grow over time, total cashouts can significantly reduce a

participant's retirement savings, even when the participant experiences no interruption of 401(k) contributions. Cashouts can be especially damaging if taken later in a career when a participant has less time to recover the losses. For example, table 5 also shows that if a participant were to cash out their plan at age 35, their account balance at age 65 would be $404,431, or $183,618 less than had they left the money in their account.

Table 5: Illustration of the Effect of Cashing Out the Entire 401(k) Account Balance at Job Separation, for Medium-Income Earners

Age at which cashout occurs	401(k) account balance at age 65		Total cashout from 401(k) plan[a]	Decrease in account balance	
	With no leakage	After total cashout		Amount	Percent
25	$588,049	$551,256	$4,214	$36,794	6
30	588,049	482,675	16,538	105,375	18
35	588,049	404,431	36,874	183,618	31
40	588,049	323,036	65,240	265,013	45
45	588,049	241,382	111,392	346,667	59
50	588,049	164,174	180,632	423,876	72
55	588,049	95,329	279,022	492,720	84

Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's *2009 OASDI Trustees' Report* and use their medium level for annual earnings. Employee contributions are 6 percent and receive a 3 percent employer matching contribution. These full cashouts incur a 10 percent tax penalty for early withdrawal, which is included in the amount cashed out from the 401(k) plan, and are taken out at the beginning of the year that the individual reaches the age indicated. We assume that the individual resumes employment immediately following the job separation and continues his or her own and matching contributions at the same level without interruption. Any interruption in 401(k) contributions—such as unemployment or a waiting period before an individual can participate—would further reduce the 401(k) account balance at age 65.

[a]This amount represents the amount that an participant earning a medium income could have accumulated by the age in which the cashout occurred, assuming a steady 6 percent elective participant contribution and a 3 percent employer matching contribution.

Hardship Withdrawals Can Result in Large Reductions in Retirement Savings

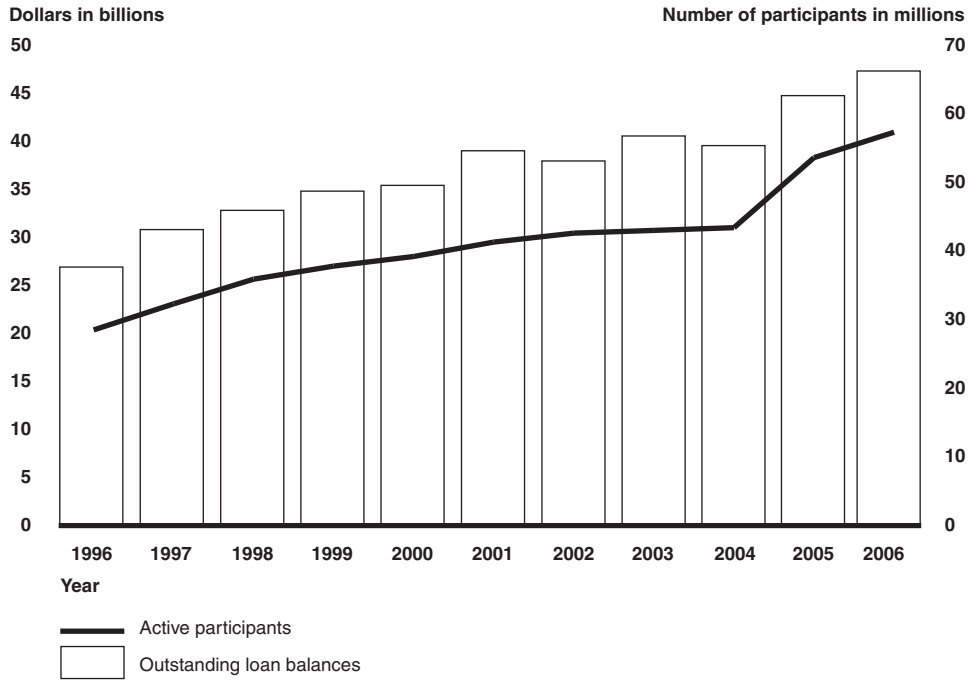
Participants who initiated hardship withdrawals also experienced large reductions in their retirement savings over their careers. While slightly less than the amounts lost due to cashouts, hardship withdrawals can result in permanent loss of retirement income and may affect participants at a time when they face greater difficulty in recouping the losses. In our analysis of various leakage scenarios, we found that among all age and income levels, hardship withdrawals had the greatest impact on low-income and younger participants. For example, our simulation showed that a low-earning 35-year-old participant taking a $5,000 hardship withdrawal would forgo 12

percent in retirement savings resulting from the hardship, whereas a high-earning participant of the same age would forgo less than 5 percent due to higher contribution amounts. Larger hardship withdrawal amounts taken earlier in a participant's career had the greatest proportional impact on participants who earned lower incomes.

Loans Have the Least Damaging Effect on Retirement Savings

Of the three principal forms of leakage that experts identified, loans paid back to the plan in regular installments are the least damaging, because participants are able to recover most of their losses, regardless of their age or earnings level. While the overall amount of participant loans has increased since 1996, as shown in figure 6, this rise roughly paced the overall growth in the number of 401(k) participants.

Figure 6: Outstanding Participant Loan Balances and Number of Active 401(k) Participants, 1996 through 2006



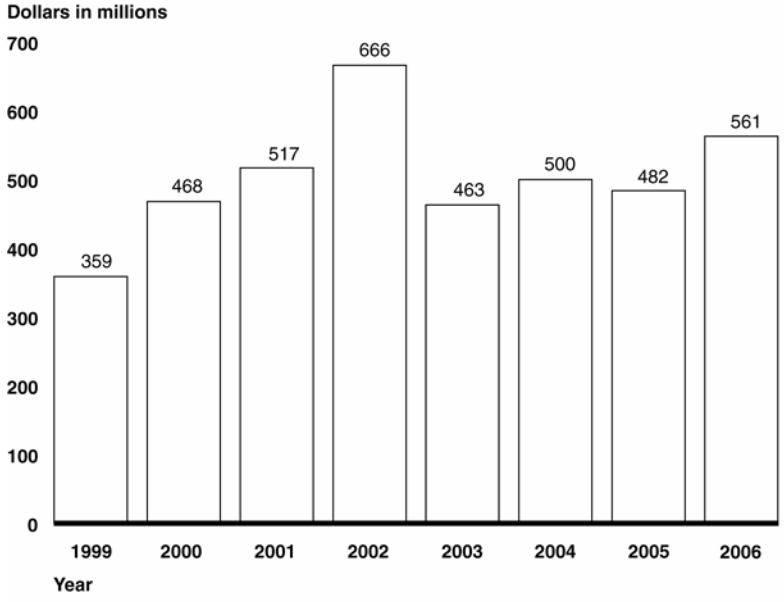
Source: GAO analysis of Department of Labor's Form 5500 Annual Reports.

Note: Dollar amounts are reported in constant 2008 dollars.

Experts told us that participant loans constitute limited leakage only when they are not paid back to the plan, even though there may be costs, such as paying loan fees, which could reduce participant balances. Like cashouts,

the outstanding balance of a defaulted loan is distributed to the participant as income and is subject to the 10 percent penalty and various taxes. According to the most recent data available from Labor, the amount of loan defaults from 401(k) plans ranged from a low of $359 million to a high of $666 million in the period of 1999 through 2006. (See fig. 7.)

Figure 7: Loan Default Amounts Reported by 401(k) Plans, 1999 through 2006



Source: GAO analysis of Department of Labor's Form 5500 Annual Reports.

Note: Dollar amounts are reported in constant 2008 dollars.

Plans have some security against default on a participant loan because loan repayments are automatically deducted from a participant's paycheck as long as the participant is employed. However, under current rules, participants who separate from their employer and have an outstanding loan balance generally must repay the loan balance in full shortly after their separation.[12] For participants who face involuntary job separation, such as a layoff, the requirement to repay the loan in full may create a burden. Like cashouts, the larger the loan balance when the participant

[12]In some cases, participants who separate from one employer with an outstanding loan balance can transfer that balance over to their new employer and continue making repayments. Other plans allow former participants to make loan payments by check, although administrators told us that the administrative costs of doing so were high.

defaults, the greater the impact the loan default can have on a participant's retirement savings. Table 6 illustrates the effect of a loan default on a participant's retirement savings at age 65.

Table 6: Illustration of the Effect of Defaulting on a $5,000 Loan after 1 Year of Repayment, for a Medium-Income 401(k) Participant

	401(k) account balance at age 65		Decrease in account balance	
Age when loan default occurs	If loan is repaid	If loan defaults after 1 year	Amount	Percent
35	$587,500	$566,121	$21,379	4
45	587,756	574,445	13,311	2
55	587,873	580,330	7,543	1

Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's *2009 OASDI Trustees' Report* and use their medium level for annual earnings. Employee contributions are 6 percent and receive a 3 percent employer matching contribution. Loans incur a $100 fee deducted from the account balance, are taken out at the beginning of the year that the individual reaches the age indicated, and are repaid for a year at a fixed interest rate equal to the rate of return at the time the loan is made and then the borrower defaults on the outstanding balance. This outstanding balance is treated as an early withdrawal and incurs a 10 percent tax penalty for early withdrawal.

Loan defaults may affect participants differently, depending on whether job separation is voluntary or involuntary. For example, loan defaults can adversely affect participants who, after securing a loan from their account, suddenly find themselves laid off by their employers. These participants will typically be required to repay the amount of the loan back to the plan in full within a short time frame. Participants who cannot or do not repay their loan balance in full must generally pay the 10 percent penalty and income taxes on the outstanding amount that is distributed to them as income, resulting in a loss of retirement savings.[13]

[13]According to Treasury officials, a distribution from a 401(k) accounts as a result of a loan default could compel some lower-income earners to pay income taxes when they otherwise would not be compelled to do so.

Plans Used Various Means to Inform Participants about Withdrawal Provisions, but Few Alerted Them to the Negative Long-term Implications

Plans Used Various Means to Inform Participants about Leakage Provisions

Federal law requires plans to provide several mandatory written communications to participants that contain information on the various provisions affecting cashouts, hardship withdrawals, and loans. As shown in table 7, for each document, the law defines the type of information to be included and the timing of the delivery.

Table 7: Mandatory Disclosures Provided to 401(k) Plan Participants

Document	Information included	Timing
Summary plan description (SPD)	Plans must provide information to plan participants about the plan, and how it operates, and must apprise participants of their benefits, rights, and obligations under the plan. The SPD would include the availability of loan, hardship withdrawal, and cashout provisions. (29 C.F.R. § 2520.102-2 and § 2520.102-3)	Sent to participants within 90 days of becoming covered by the plan. The SPD must be furnished every 5 years, if amended or otherwise once every 10 years. (29 C.F.R. § 2520.104b-2)
Summary of material modifications (SMM)	Plans must provide a new SPD or SMM whenever the SPD is amended. The SMM must describe plan modifications and changes. Distribution of an updated SPD fulfills this requirement. The SMM may include any changes in the availability of loan, hardship withdrawal, and cashout provisions. (29 C.F.R. § 2520.104b-3)	Provided no later than 210 days after the end of the plan year in which the change is adopted.
402(f) special tax notice	Plans must provide a tax notice to participants at termination explaining the rollover rules, the special tax treatment for lump-sum distributions, and the mandatory 20 percent withholding rules. The notice may be sent via mail or e-mail. This notice is sent to all terminating participants. (26 C.F.R. § 1.402(f)-1, Q/A-2; Q/A-5)	Provided no more than 90 days (as much as 180 days for plan years that begin after December 31, 2006) and no fewer than 30 days before making an eligible rollover distribution.

Source: GAO analysis of law and regulations from the Internal Revenue Service and the Department of Labor.

Plan officials we contacted told us that one way participants could learn about their plans' loan and withdrawal provisions is through the summary plan description (SPD). Some plan officials told us that they developed reader-friendly highlights of the SPD to communicate the plan procedures to participants. For example, the SPD highlights from one plan explained the following provisions on one page: participant eligibility, contribution amount, rollover contributions, the employer match, vesting, the investment choices, loans, and withdrawals. Officials that we contacted told us that the highlights documents are kept intentionally vague out of concern that participants might rely on these documents, rather than the actual SPD. However, one plan official and one expert stated that the extent to which participants understand the information and use it to make informed choices about their accounts remains unknown.

Plans that we contacted provided participants with information on leakage at three distinct points determined by federal requirements: at enrollment, when a loan or hardship withdrawal is requested, and at job termination. Some plans that we contacted provided participants with information about loans and hardship withdrawals in the participant's initial enrollment package. Other plans that we contacted provided participants with information beyond federally required notices at the participant's request. Another plan sent out a termination package when a plan sponsor sent notification of a participant's termination date, while another plan waited for the participant to contact the plan upon job termination. According to some plan officials, participants inquire about plan provisions when a triggering event occurs, such as when the participants need access to money in their account or when they are separating from their job. Participants, however, may request information about withdrawing money from their accounts at any time.

Apart from meeting federal requirements, plans have varying levels of involvement with participants, ranging from plans seeking to protect participants from making poor decisions with respect to cashouts, hardship withdrawals, or loans, to plans giving participants little advice on how leakage would affect their retirement accounts. Some plans we contacted provided participants with detailed information that went beyond the legally mandated disclosures about the implications of cashouts, hardship withdrawals, and loans. Some plan officials we contacted stated that they gave no information to participants about the effects of cashouts, hardship withdrawals, and loans on retirement account balances to participants for fear of being perceived as offering advice and potentially violating their fiduciary duty to the plan. According to EBSA officials, providing investment advice is not a per se violation of

fiduciary duty. Other plan officials that we contacted told us that while they wanted to make sure that participants understood the impact of withdrawing money from their accounts, they did not want to tell participants that they should not take a distribution.

Some plans that we contacted also staffed call centers to answer participants' questions about their accounts, which they said also included topics related to the principal forms of leakage. Call center representatives had immediate access to participant account information, could inform participants about their range of options for withdrawing money from their accounts, and could discuss the mandatory federal disclosures with the participants. At one participant call center, plan officials demonstrated how the representatives would respond to a participant requesting information about acquiring a loan, about a hardship withdrawal, or about the management of their account balance at job termination. Some plan officials said that they trained call center representatives to inform participants of the available options, while other plans told us that they sought to dissuade participants from taking a hardship withdrawal. One plan that we contacted required participants to contact the call center at job termination, so that the representative could counsel the participant on the best option for that individual.

Plan officials told us that younger participants preferred to use the plan Web sites to locate the information they needed. Some plans that we contacted had plan documents available online, such as hardship withdrawal applications and procedures, providing participants with immediate access to information about the processes and impacts of withdrawing money from their account. Plan officials told us that some Web-based communications often provided the same information available to plan participants in print, while other Web-based communications were less comprehensive than the written information available to participants. Some plans that we contacted also utilized plan Web sites to notify participants of the amount of money available for a cashout, hardship withdrawal, or loan. One plan also provided a 5- to 10-minute online course outlining the impact of leakage on the participant's long-term savings. Two plans that we contacted included information on leakage in articles on plan Web sites to educate participants about the consequences of borrowing from their 401(k) accounts. However, few plans that we contacted had tools on their Web sites for participants to project the potential impact of cashouts, hardship withdrawals, and loans on their future retirement savings.

Some plan officials told us that plans had begun providing just-in-time information on 401(k) leakage to participants entering certain life phases to better meet the participants' needs. Regarding cashouts, for example, one plan provided each separating participant with a worksheet that contained a personalized projection of their current 401(k) account balance, comparing dollar-for-dollar the advantages of keeping the account tax-deferred by rolling it over into a qualified plan or IRA with the consequences of cashing the balance out and paying the associated penalties and taxes. Officials at another plan told us that when an employer notified them that a large number of employees were facing an imminent layoff, they would create a campaign to educate participants about the steps they needed to take to preserve their account balances after the layoff. Regarding hardship withdrawals, some plans told us that they contacted participants after the 6-month suspension period to inform them that they could reenroll in the 401(k) plan. Another plan automatically reenrolled participants in their 401(k) plan after the 6-month suspension period. Officials at one plan told us that they sought to intercept participants requesting a disbursement from their retirement account, discussing with the participant on the telephone the consequences of withdrawing the money. Regarding loans, some plans request that the plan administrator set up on-site seminars to cover various topics, such as the consequences of job termination on a participant's outstanding loan.

Most Plans Informed Participants about the Short-term Costs of Leakage, but Few Informed Participants about the Long-term Implications

Almost all of the plans contacted told us that they sent a termination package to participants at job separation that outlined the available options for their account balance, but that these documents did not contain information on the long-term implications of choosing to take a cashout. These options included leaving the balance in the plan, rolling the balance over into another employer-sponsored plan or IRA, or cashing out their account balance. For example, one plan's standard termination package included a document with information on the options available to participants at termination, and on whom to call for more information, and included a one-page summary illustrating the short-term effects of cashing out of the plan. Few plans that we contacted told us that they had tools on their Web sites, such as calculators, for participants to project the potential effect on their future retirement savings of taking a cashout.

Plan officials told us that they included information on the short-term costs of hardship withdrawals, as required, whenever a participant requested the hardship withdrawal. Hardship withdrawals come with a number of short-term costs, including the 10 percent early withdrawal

penalty, the 6-month contribution suspension period, the inability to return the withdrawn sum back to the plan, and the participant's potential personal tax liability resulting from the withdrawal.[14] Many of the plans that we contacted required participants to send a hard-copy of the hardship withdrawal application to the plan, and some plans required participants to contact their plan administrator or sponsor to request a hardship withdrawal. While participants received information on the short-term costs associated with a hardship withdrawal, the plans that we contacted provided little information on the long-term implications of a hardship withdrawal on retirement savings. Some plan officials told us that they did not provide participants with any information on the long-term effects on retirement of taking a hardship withdrawal.

Plan officials told us that plans informed participants about the short-term costs of loans—including the loan amount, repayment schedule, and tax consequences—through the plans' call centers, Web sites, or publications. Some plan officials told us that even though they informed participants of the short-term costs associated with taking a loan, information about the long-term implications was largely omitted because as long as the loan is repaid, it has a small overall impact on account balances. Some plan officials that we contacted said that the loan check sent to the participant also included a loan repayment schedule, information on the tax consequences of taking the loan, and the effects of defaulting on the loan. Plans that we contacted also told us that plan Web sites offered participants loan calculators to help the participant determine how much the loan repayment would cost per pay period, and also offered articles designed to educate participants about the consequences of borrowing from their account. Some plans that we contacted offered loan modeling tools that allowed participants to estimate the short-term impact of the loan on their retirement balance. For example, one plan provided participants with an online calculator tool that allows participants to determine what effect a loan and its associated tax implications might have on their future retirement benefit. However, few plans that we contacted provided participants with information on the long-term consequences of taking loans from their accounts.

[14]These costs are short term because participants experience them shortly after taking a hardship distribution. However, each of these costs has long-term implications on a participant's retirement balance.

Experts Said That Some Statutory Provisions Have Helped Reduce Leakage

Three Statutory Provisions Are Said to Have Helped Reduce Leakage

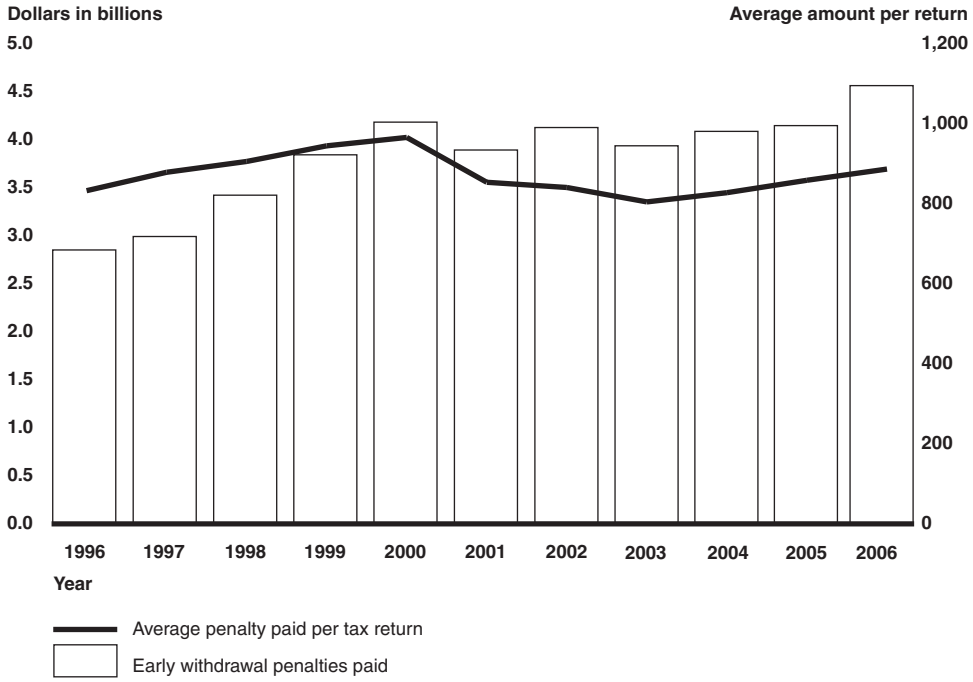
Early Withdrawal Penalty Provision

The experts that we contacted said that the 10 percent penalty on early withdrawals had likely reduced the incidence and amount of leakage among 401(k) participants, but that its function as a disincentive could be strengthened. One expert told us that he believed that the penalty had significantly reduced the number of cashouts being taken from 401(k) plans. Other experts noted that the penalty served as a deterrent because participants were generally reluctant to pay penalties, regardless of the amount. A plan administrator told us that many participants contacting the call center to inquire about a hardship withdrawal had reacted negatively to the information that they would be required to pay a 10 percent penalty. Some experts questioned whether the 10 percent penalty's power as a disincentive needed to be strengthened to further discourage participants from removing money from their accounts. Some felt that the percentage was too low to have any major impact as a deterrent and suggested that the penalty needed to be increased to further discourage participants from taking early withdrawals. For example, one expert noted that young workers who receive a distribution after leaving their first job may regard the distribution as free money, and the penalty would only reduce the amount of free money they received. Another expert said that the penalty served more as a speed bump than as a deterrent for participants earning higher incomes. Other experts noted that the provision did not deter participants who were facing true hardships and needed money from their accounts, regardless of the penalty assessed.

Because the incidence and amount of leakage from 401(k) accounts have remained relatively steady, the 10 percent penalty has continued to provide a steady source of revenue to IRS. Officials told us that the penalty serves a dual purpose: it deters participants from tapping into their 401(k) account when they have other sources of money available, and it allows the federal government to recoup a portion of the subsidy provided to

keep the money tax-deferred. According to published IRS data on early withdrawals from qualified retirement plans, including 401(k) plans and IRAs, more than 5 million tax filers paid $4.6 billion in early withdrawal penalties in tax year 2006. As shown in figure 8, the amount of early withdrawal penalties paid has increased since 1996, while the average penalty paid per tax return has stayed about the same.

Figure 8: Penalty Taxes Paid on Early Withdrawals from Qualified Retirement Plans and Average Penalty Paid, 1996 through 2006



Source: GAO analysis of IRS data.

Note: These IRS data include 401(k) participants as well as participants in other qualified retirement plans, including IRAs. As a result, we were unable to isolate the total amount of penalties paid by 401(k) participants. All dollar amounts are reported in constant 2008 dollars.

Automatic Cashout Provision

Experts said that the provision that lowered the threshold for plan sponsors to cash out the accounts of separating participants automatically has likely reduced the overall incidence of leakage. Prior to this provision, employers could compel mandatory cashouts for separating participants with account balances under $5,000. The change reduced the threshold for an automatic cashout to account balances valued at less than $1,000. For account balances valued at between $1,000 and $5,000, employers were required to preserve the tax-deferred status of the accounts, either by

keeping the assets in the plan or rolling the balances over into an IRA. Several experts noted that the provision had dramatically reduced the incidence of leakage for participants with balances of between $1,000 and $5,000, but the overall effect was marginal because this group represents a small proportion of the participant population.

We developed an illustration to show the maximum savings that could be preserved over the course of a participant's working career under the automatic cashout provision. Our illustration showed that the reduction in the maximum cashout amount could result in greater savings over time. (See table 8.)

Table 8: Illustration of the Effect of the Reduction in the Cashout Amount on the Account Balance of a Medium-Income 401(k) Participant at Age 65

Age when cashout occurs	Decrease in account balance, with maximum $5,000 cashout	Decrease in account balance, with maximum $1,000 cashout	Maximum amount preserved under the cashout provision
25	$41,405	$8,281	$33,124
30	30,479	6,096	24,383
35	23,952	4,790	19,162
40	19,614	3,923	15,691
45	15,123	3,025	12,099
50	11,484	2,297	9,187
55	8,704	1,741	6,963

Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's most recent *2009 OASDI Trustees' Report*. Involuntary cashouts, as evaluated, are not rolled over to a qualified retirement account, are taken out at the beginning of the year that the individual reaches the age indicated, and incur the 10 percent tax penalty for early withdrawal.

Loan Exhaustion Provision

Experts said that the provision requiring participants in 401(k) plans to exhaust their plan's loan provisions before taking a hardship withdrawal had likely reduced leakage by promoting the use of loans that are generally repaid and returned to the plan. Experts said that the provision, which reduces hardship withdrawals, was a good rule and made financial sense. One expert said that because loans remain in the plan as an investment and retain assets when repaid, they resulted in minimal leakage. In contrast, hardship withdrawals result in the permanent removal of assets from the plan and cannot be returned to a tax-deferred account. Thus, taking a loan prior to a hardship withdrawal would preserve more assets for retirement. One expert told us that it was important for participants to exhaust their loans to reaffirm that the

hardship exists and is long-term in nature, and the expert emphasized that it was the responsibility of the plan administrator to demonstrate that the hardship withdrawal was the participant's loan of last resort. Another expert noted that while the rule made financial sense, plan sponsors needed to more actively encourage this practice, and not simply allow participants to take a hardship withdrawal each time they faced a situation that fell within the IRS definition of a hardship.

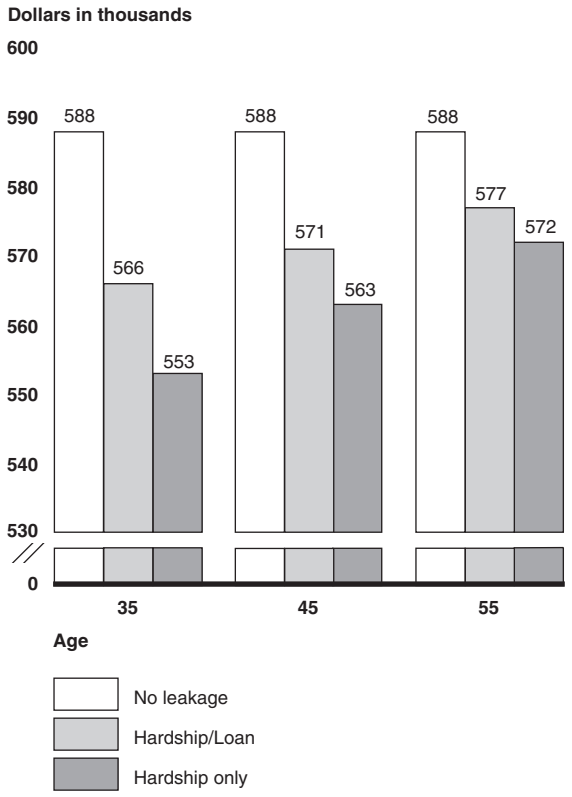
In January 2009, as a result of its compliance monitoring examinations, IRS reported the failure of plans to meet hardship distribution requirements as one of the top 10 issues facing 401(k) plans. Among other things, IRS found that administrators of plans that offer participant loans and hardship withdrawals are allowing participants to take hardship withdrawals without first exhausting the plan's loan provisions, as is currently required.[15] Plan administrators that we contacted said that most of their plans strictly adhered to this provision; however, others stated that some plans were not enforcing the provision. Several plan administrators told us that some plans took participants at their word that they were facing a hardship or believed that it was the plan sponsor's decision whether to fulfill this requirement. For example, officials at one plan told us that they asked participants whether they had taken a loan before granting a hardship withdrawal, but that they did not verify the participants' responses. Other plan administrators told us that they believed that the requirement applied to some but not all 401(k) plans. Under current rules, the loan exhaustion provision applies to all plans that offer loans and hardship withdrawals, but there is no requirement for plans to document compliance with this provision.

Our illustration shows the amount of retirement savings that could be preserved by adhering to this provision. Specifically, we calculated the effect on the growth in retirement savings for a medium-income participant who obtained a combination of a $2,500 loan and a $2,500 hardship withdrawal, rather than taking a $5,000 hardship withdrawal. As shown in figure 9, participants obtaining even a portion of the needed

[15]IRS Reg. 26 C.F.R. § 1.401(k)-1(d)(3)(iv)(E), which applies to all 401(k) plans, states that a distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if (1) the employee has obtained all other currently available distributions and loans under the plan and all other plans maintained by the employer and (2) the employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 6 months after receipt of the hardship distribution.

amount in the form of a loan could result in additional retirement savings over the course of a working career.

Figure 9: Illustration of the Effect of Removing $5,000 from a 401(k) Account by Taking a Loan before a Hardship Withdrawal, on the Account Balance of a Medium-Income Participant at Age 65



Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's most recent *2009 OASDI Trustees' Report* and use their medium level for annual earnings. Employee contributions are 6 percent and receive a 3 percent employer matching contribution. Loans incur a $100 fee deducted from the account balance, are taken out at the beginning of the year that the individual reaches the age indicated, and are repaid in 5 years at a fixed interest rate equal to the rate of return at the time the loan is made. Hardship withdrawals incur a 10 percent tax penalty for early withdrawal, are taken out at the beginning of the year the individual reaches the age indicated, and participant contributions and employer matching contributions are suspended for a period of 6 months. The simple hardship withdrawal case assumes a $5,000 withdrawal, while the hardship withdrawal and loan combination divides the $5,000 into a $2,500 loan and a $2,500 hardship withdrawal. While the individual's contributions are suspended for 6 months subsequent to receiving a hardship withdrawal, loan repayments continue for the entire 5-year repayment period, including the 6 months during which regular and matching contributions are suspended.

Experts Said That the Provision Requiring Suspension of Contributions May Exacerbate the Long-term Effects of Leakage

Experts noted that the statutory provision requiring a 6-month suspension of participant contributions following a hardship withdrawal may increase the amount of leakage by prohibiting those participants who can contribute to their 401(k) accounts from doing so. Treasury officials told us that the suspension period was intended to serve as a test to ensure that the hardship was real, and that the participant did not have other assets available to address the hardship. Many of the experts noted that the provision did little to deter participants from taking hardship withdrawals. For example, one expert told us that while the provision may have had some effect as a deterrent to taking a hardship in theory; in practice, it only affected people already experiencing a hardship.

Other experts noted that the provision seemed to contradict the goal of creating retirement income. One expert said that the provision unnecessarily kept able participants from making contributions, such as an employee who needed an infusion of cash for a discrete, one-time event, such as a home purchase. Other experts characterized the suspension period as excessive and more of an inconvenience than an effective deterrent. For example, one expert noted, participants who need money and initiate hardship withdrawals must pay taxes and penalties and are prevented from making contributions, leaving them with 50 percent or less of the money they had withdrawn. Several experts suggested remedies, such as shortening or repealing the suspension period, or allowing participants to at least keep their employer match during the suspension period to begin making up lost ground.

Our illustration shows the effect of the 6-month suspension on the accumulation of retirement income. As shown in table 9, the suspension period would have the greatest impact on the retirement savings of midcareer participants earning a medium income.

Table 9: Illustration of the Effect of Suspending Participant Contributions Following a $5,000 Hardship Withdrawal on a Medium-Income Participant's Account Balance at Age 65

	401(k) account balance at age 65		
Age at which hardship withdrawal is taken	With no suspension	With 6-month suspension	Potential losses attributable to suspension of contributions
25	$540,023	$533,886	$6,137
35	560,661	552,574	8,088
45	570,933	562,860	8,073
55	578,337	572,064	6,272

Source: GAO.

Note: These illustrations are based on an individual who is born at the beginning of 1970, begins participating in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We adopt the intermediate interest and rate-of-return assumptions as reported in past and projected in Social Security's most recent *2009 OASDI Trustees' Report*. Employee contributions are 6 percent and receive a 3 percent employer matching contribution. The $5,000 hardship withdrawals incur a 10 percent tax penalty for early withdrawal and are taken out at the beginning of the year that the individual reaches the age indicated. We contrast the age 65 401(k) account balance when participant contributions and employer matching contributions are suspended for a period of 6 months and when contributions continue without suspension. In this table, we calculated the forgone savings associated with the suspension of a 6 percent employee contribution and a 3 percent employer matching contribution for a period of 6 months. Totals do not add due to rounding.

Finally, several experts noted that the 401(k) hardship withdrawal definition was too broad and gave participants access to money for circumstances that were both voluntary and foreseeable. For example, under current rules, participants may take a hardship withdrawal for purchasing their primary residence, which some experts said did not constitute an immediate and heavy financial need. Moreover, the 401(k) definition of hardship differs from hardship equivalents under other qualified plans, such as 457(b) retirement plans.[16] Under a 457(b) plan, for example, a participant may take a hardship distribution only when faced with an unforeseeable emergency, which the regulations define as a severe financial hardship resulting from an illness or accident, loss of property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary. In addition, the regulations also state that the

[16]The 457(b) plans are deferred compensation plans available for certain state and local governments and nongovernmental tax-exempt entities.

purchase of a home and the payment of college tuition are generally not unforeseeable emergencies.

Conclusions

There are many reasons why participants may choose to use their retirement savings prior to retirement, and some of these choices may involve a rational trade-off between immediate financial emergencies and future retirement needs. U.S. workers continue to feel the effects of the current economic downturn in the form of job losses, home foreclosures, and the depreciation of 401(k) retirement savings. With home values down and lending sometimes difficult to obtain, some workers may see their accrued 401(k) savings as their last protection against financial hardship. Yet, even small amounts of leakage can have a significant impact on the retirement savings of some plan participants.

While tapping into a 401(k) account to meet short-term needs may be rational under certain circumstances, some leakage could be mitigated if participants had adequate information on the long-term implications of their actions. Cashouts can be the most damaging form of 401(k) leakage, are the least regulated, and appear to run counter to the goal of retirement savings. However, many participants continue to take this option when separating from their employer, in part because the option is often presented to them with little or no information on its long-term consequences. With better information on the consequences of the various forms of leakage, participants may choose to preserve their retirement savings, resulting in a better retirement outcome.

Participants facing sudden and unanticipated hardships would also benefit from the assurance that they are using the most appropriate and least damaging option, thereby minimizing the negative impacts on their overall retirement preparedness. For example, to avoid unnecessary leakage, employers should not approve participants for hardship withdrawals until they are certain that participants have exhausted the plans' loan provisions. In addition, under current hardship rules, participants who could continue making retirement contributions after taking a hardship withdrawal are barred from doing so. This suspension of contributions also prevents participants from receiving employer matching contributions and will likely leave them with a lower account balance at retirement. Ensuring that participants choose the path that causes the least harm to their retirement accounts and continue to make retirement contributions whenever possible may help mitigate the adverse impacts of leakage that otherwise will linger into retirement.

Matter for Congressional Consideration

To help participants recover more quickly from a hardship situation, Congress should consider changing the requirement for the 6-month contribution suspension following a hardship withdrawal.

Recommendations for Executive Action

To support the goal of providing plan participants with understandable and useful information about their employer-provided retirement plan benefits, we recommend that the Secretary of Labor promote industry best practices by encouraging plans to take the following actions:

- Include on their participant Web sites information on their plan loan, hardship withdrawal, and cashout provisions, including examples of the long-term consequences of each provision. For example, plans could place a copy of the summary plan description in an electronic form that participants could reference as needed, or provide modeling tools.
- Provide separating participants with a projection of their account balance under different scenarios, such as when assets are left in a tax-deferred retirement account compared with those assets cashed out in the form of a lump-sum distribution.

To prevent unnecessary leakage and increase compliance with existing regulatory requirements, we recommend that the Secretary of the Treasury clarify that the loan exhaustion provision applies to all plans that permit both participant loans and hardship withdrawals, and require plans to document that participants have exhausted available plan loans before allowing a hardship withdrawal.

Agency Comments

We provided a draft of this report to the Secretary of Labor and the Secretary of the Treasury for review and comment. In comments on a draft of this report (which are reprinted in app. III), the Department of Labor agreed to consider our recommendations as it developed regulations and other guidance to assist plan participants and beneficiaries in understanding their benefits and distribution options. Labor also provided technical comments on a draft of this report, which we incorporated as appropriate. In its comments (reprinted in app. IV), the Department of the Treasury agreed to publish an article highlighting the requirements of the hardship withdrawal provisions, giving special attention to the scope of the loan exhaustion requirement and the need for plans to document compliance.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to relevant congressional committees, the Secretary of Labor, the Secretary of the Treasury, and other interested parties. In addition, the report will be made available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or bovbjergb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made contributions to this report are listed in appendix V.

Sincerely yours,

Barbara D. Bovbjerg
Director, Education, Workforce,
and Income Security Issues

Appendix I: Scope and Methodology

The objectives of this study were to identify (1) the incidence, amount, and relative significance of the different forms of 401(k) leakage; (2) how 401(k) plans inform participants about hardship withdrawal provisions, loan provisions, and options at job separation, including the short-term and long-term costs associated with each; and (3) what is known about how various policies may affect the incidence of 401(k) leakage. We conducted this performance audit from August 2008 to August 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We determined that the data that we analyzed were sufficiently reliable for the purposes of this report.

Incidence and Amount of 401(k) Leakage

To determine the principal forms of 401(k) leakage, we interviewed industry and academic experts, reviewed laws and regulations, and analyzed existing studies on leakage. We then identified cashouts at job change, hardship withdrawals, and participant loans as the three principal forms of leakage.

To determine the incidence and amount of these principal forms of leakage over time, we analyzed data from the 1996, 2001, and 2004 panels of the U.S. Census Bureau's Survey of Income and Program Participation (SIPP), using the data from survey respondents on their participation in 401(k) plans contained in the Pension and Retirement Topical Module (collected in 1998, 2003, and 2006). We excluded SIPP participants who were younger than age 15 or older than age 60 at the time of the interview, and used this subset of the SIPP data to develop estimates of the number of 401(k) plan participants who reported taking a cashout, hardship withdrawal, or loan from their account prior to retirement. Because SIPP is based upon a probability sample, we followed the Census Bureau technical documentation in deriving all percentage and dollar-value estimates and the 95 percent confidence intervals that correspond to these estimates.

To determine the aggregate loan default amounts over time, we analyzed published annual statistics from 1996 through 2006 the Department of Labor's *Private Pension Plan Bulletins Abstract of Form 5500 Annual*

Reports and tabulated the amount of loan defaults that plan sponsors reported releasing to participants.[1] To determine the amount of early withdrawal penalties on qualified retirement accounts that plan participants paid, we analyzed published annual Internal Revenue Service (IRS) statistics from 1996 through 2006 on estimated individual income tax liabilities, credits, and payments. Because IRS reports the penalty amounts in aggregate for all qualified plans, including individual retirement accounts (IRA) and 401(k) plans, we were unable to isolate the penalties paid only by 401(k) participants.

To determine the recent prevalence of leakage, we analyzed summary data on the incidence and amount of hardship withdrawals and loans from 2005 through 2008 that we obtained from major 401(k) plan administrators, which represented about 22 million 401(k) participants and over $1 trillion in 401(k) plan assets. We were not able to acquire similar year-to-year data on cashouts from 401(k) plans. While the data that we received were not nationally representative, they provided a snapshot of the incidence and amount of the two forms of leakage in recent years at several of the largest 401(k) plan administrators.

Relative Significance of Leakage Forms

To illustrate the relative significance of leakage over time, we developed a model to tabulate 401(k) account balances for various hypothetical individuals at age 65 that differed depending on when and whether these individuals tapped into their 401(k) account prior to retirement. We ran a range of scenarios to simulate the effect that various forms and amounts of leakage would have on a participant's retirement savings. In developing these scenarios, we considered such factors as the participant's age, earnings, wages, contribution rates, years until retirement, as well as historical and projected interest rates and earnings levels, loan administration fees, and penalties associated with leakage. We based our illustrations on an individual who was born at the beginning of 1970, began participating in a 401(k) plan at age 21 in 1991, and will retire at age 65 in 2035. We used historical values and future projections for interest rate and

[1]Labor collects information on 401(k) participant loan defaults through the Form 5500. This form (1) includes information on the plan's sponsor, the features of the plan, and the number of participants and (2) provides more specific information, such as plan assets, liabilities, insurance, and financial transactions. Filing this form satisfies the requirement for the plan administrator to file annual reports concerning, among other things, the financial condition and operation of plans. Labor uses this form as a tool to monitor and enforce plan sponsors' responsibilities under the Employee Retirement Income Security Act.

rate-of-return assumptions as reported in past and projected under the intermediate cost assumptions in Social Security's *The 2009 Annual Reports of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (also known as the *2009 OASDI Trustees' Report*). Also, we used scaled earnings for low, medium, and high annual earners as reported in past and projected in the *2009 OASDI Trustees' Report*. We assumed that employee contributions to the 401(k) are 6 percent of the individual's wages and received a 3 percent employer matching contribution. Loans taken from the 401(k) incur a $100 fee that is deducted from the account balance, were taken out at the beginning of the year that the individual reached the age indicated in our analyses, and were repaid over a 5-year period at a fixed interest rate equal to the rate of return at the time that the loan was made. Hardship withdrawals from the 401(k) incur a 10 percent tax penalty for early withdrawal and are taken out at the beginning of the year that the individual reaches the age indicated in our analyses, and participant contributions and employer matching contributions are suspended for the subsequent 6-month period. Partial and full cashouts also incur a 10 percent tax penalty for early withdrawal and are taken out at the beginning of the year that the individual reaches the age indicated in our analysis. We generally assume (except where otherwise specified in the report) that the individual does not resume his or her own and employer matching contributions to a 401(k) account for 12 months. Finally, we calculated the amount of forgone retirement savings at age 65 for an individual who took a loan, hardship withdrawal, or partial cashout in the amount of $5,000.

Participant Information

To determine how plans inform participants about leakage, we interviewed 26 plan administrators representing at least 80 percent of 401(k) participants and 65 percent of 401(k) assets. We selected our sample of administrators using industry rankings of the leading firms that were based on the number of plans and participants, the value of the plan assets, and the quality of their participant services. To ensure a range of views, we contacted 401(k) plan recordkeepers, plan sponsors, and third-party administrators representing large and small 401(k) plans. As part of these efforts, we conducted 10 site visits during which we interviewed representatives and toured a participant call center. The documents that we reviewed included plans' mandatory tax notices, summary plan descriptions, plan brochures, loan and hardship withdrawal forms, and prototype plan documents. We also reviewed selected 401(k) plan sponsor and administrator Web sites, current law, and regulations. To learn about industry standards and practices, we interviewed 401(k) plan

administrators; plan sponsors; industry and academic experts; and Labor, Department of the Treasury, and IRS officials and reviewed relevant literature.

Policy Provisions Affecting 401(k) Leakage

To identify what is known about how various policy options may affect the incidence of leakage, we reviewed provisions in current law, regulations, and legislative proposals and identified nine policy options likely to affect leakage. Next, we interviewed selected industry and academic experts to gather their opinions on which of these policy provisions would likely affect leakage. We selected experts who were cited in the literature on retirement leakage, were referred to us during interviews, and are known in the pension and retirement field. To ensure that we had a range of views, we included experts from academic, practitioner, participant advocacy, and industry backgrounds. We analyzed the experts' responses and identified the provisions that they indicated were likely to affect leakage. We then used our illustration model to simulate the effect that each of the identified provisions may have on a hypothetical 401(k) participant's retirement savings at age 65. These illustrations are based on an individual who is born at the beginning of 1970, begins to participate in a 401(k) plan at age 21 in 1991, and retires at age 65 in 2035. We use historical values and future projections for interest rate and rate-of-return assumptions as reported in past and projected in Social Security's most recent *2009 OASDI Trustees' Repor*t under the intermediate cost assumptions. We used scaled earnings for low, medium, and high annual earners as reported in past and projected in the *2009 OASDI Trustees' Report*. In each scenario, we assumed that employee contributions of 6 percent of the participant's earnings to the 401(k) and received a 3 percent employer matching contribution. We used the following assumptions to distinguish each form of leakage:

- Loans taken from the 401(k) incurred a $100 fee that is deducted from the account balance. We assumed that loans were taken out at the beginning of the year that the individual reached the age indicated in our analyses, and that loans were repaid over a 5-year period at a fixed interest rate equal to the rate of return at the time that the loan is made.

- Hardship withdrawals from the 401(k) incurred a 10 percent tax penalty for early withdrawal and were taken out at the beginning of the year that the individual reached the age indicated in our analyses. Participant contributions and employer matching contributions were suspended for the subsequent 6-month period.

- Partial and full cashouts incurred a 10 percent tax penalty for early withdrawal and were taken out at the beginning of the year that the individual reached the age indicated by in our analyses. We generally assumed (except where otherwise specified in the report) that the individuals taking a cashout did not resume their elective or employer matching contributions to their 401(k) accounts for 12 months.

  Next, we ran five separate scenarios to simulate the effect of selected provisions on our hypothetical individual's retirement savings at age 65. Specifically, we simulated the effect of each of the following scenarios:

- effect of a total cashout of an entire 401(k) account at various ages;
- effect of a loan default on a $5,000 loan after 1-year repayment;
- effect of reducing the involuntary automatic cashout from $5,000 to $1,000;
- effect of exhausting a plan's loan provision before taking a hardship withdrawal; and
- effect of a 6-month contribution suspension following a hardship withdrawal.

Appendix II: 401(k) Administrators That GAO Contacted

ADP Retirement Services
Aon
Barclays
Capital Research
Centier Bank
Charles Schwab
Diversified Investment Advisors
Fidelity
Hewitt Associates
ING
JP Morgan Chase
John Hancock Financial Services
Marshall & Ilsley Trust Company
Merrill Lynch
Mercer
MetLife
Mass Mutual
Nationwide
New York Life
Prudential
State Street
T. Rowe Price
Vanguard
Wachovia
Watson Wyatt
Wells Fargo & Company

Appendix III: Comments from the Department of Labor

U.S. Department of Labor

Employee Benefits Security Administration
Washington, D.C. 20210

July 10, 2009

Ms. Barbara D. Bovbjerg
Director, Education, Workforce, and
Income Security Issues
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Bovbjerg:

We have reviewed the Government Accountability Office's (GAO) draft report entitled "401(k) PLANS: Policy Changes Could Reduce the Long-Term Effect of Leakage on Workers' Retirement Savings," (GAO-09-715) and the recommendation contained therein as it relates the Secretary of Labor.

Specifically, the GAO is recommending that the Secretary promote industry best practices by encouraging plans to 1) include on the participant Web site information on their plan's loan, hardship withdrawal, and cashout provisions, including examples of long-term consequences of each. For example, plans could place a copy of the summary plan description in an electronic form that participants could reference as needed, or provide modeling tools; and 2) provide separating participants with a projection of their account balance under different scenarios, such as when assets are left in a tax-deferred retirement account compared to those cashed out in the form of a lump-sum distribution.

The Department shares the GAO's interest in helping participants and beneficiaries to understand the importance of retirement savings and the implications of their benefit distribution options. In this regard, the Department's participant and plan sponsor outreach and education programs as well as its numerous publications all seek to advance this goal. As we move forward in the development of regulations and other guidance designed to assist plan participants and beneficiaries in understanding their benefits and distribution options, we will give serious consideration to the recommendation contained in your report.

EBSA is committed to protecting the employer-sponsored benefits of American workers, retirees, and their families. We appreciate having had the opportunity to review and comment on the draft report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,

Michael L. Davis
Deputy Assistant Secretary

Appendix IV: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

AUG 0 7 2009

Ms. Barbara D. Bovbjerg
Director, Education, Workforce, and
Income Security Issues
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Bovbjerg:

We appreciate the opportunity to comment on the Government Accountability Office's draft report titled *401(k) plans: Policy Changes Could Reduce the Long-Term Effects of Leakage on Workers' Retirement Savings ((GAO-09-715)*. The report includes recommendations of steps that could be taken to reduce the incidence of retirement savings leakage.

The report describes the provision of the section 401(k) regulations that requires a participant to exhaust the availability of a loan under a plan before the participant is permitted to take a hardship withdrawal and notes that several experts have endorsed this provision. The IRS has recently reported that failure to comply with the section 401(k) hardship withdrawal requirements is among the top ten section 401(k) plan compliance issues. To reduce retirement savings leakage due to hardship withdrawals, the report recommends that Treasury take steps to clarify that the plan loan exhaustion requirement applies to all plans that permit both participant loans and hardship withdrawals and to require plans to document compliance with the requirement.

Treasury and the IRS are committed to ensuring that retirement plans accomplish their stated goal of providing retirement income. In particular, to improve compliance with the section 401(k) regulatory provision that requires the exhaustion of plan loans before any hardship withdrawal may be taken, the IRS will publish an article in an upcoming edition of the Employee Plans News (which is distributed to more than 57,000 subscribers) highlighting the requirements of the hardship withdrawal provisions. The article will give special attention to the scope of the loan exhaustion requirement and the need to document compliance.

If you have questions concerning this response, please contact me.

Sincerely,

J. Mark Iwry
Senior Advisor to the Secretary
Deputy Assistant Secretary for
Retirement and Health Policy

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Barbara D. Bovbjerg, (202) 512-7215 or bovbjergb@gao.gov

Staff Acknowledgments

In addition to the individual listed above, David Lehrer, Assistant Director; Jonathan S. McMurray, Analyst-in-Charge; Nicole Harkin; and Gene Kuehneman made key contributions to this report. Carl Barden, Susannah Compton, Cathy Hurley, Ed Nannenhorn, Roger Thomas, and Walter Vance also made important contributions.

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