Edelman Financial Engines®

Thought Leadership Series, 3rd Issue

Tapping Retirement Assets Early

Improving and Protecting Your Employees' Personal Finances and Retirement Income – and Your Company's Financial Results

Economic and stock market uncertainty due to Covid-19 is inflicting additional trauma on an already fragile state of financial security and retirement readiness in America. Our research reveals that employers and plan sponsors can help by providing financial advice via the workplace.

Edelman Financial Engines 2020 Thought Leadership Series

Building the case for more financial help through the workplace

Core problem Financial stress	**1st issue: Covid-19 and Financial Well-being** 1 in 2 employees has "a lot of financial stress", which many say has a detrimental impact on their job.[1]
Compounding problem Lack of access to financial advice	**2nd issue: Closing the Financial Advice Gap** Only 22% of employees have a professional financial advisor, resulting in many turning to the wrong source for advice when they are stressed and need help.[1]
Resulting Action Poor/regrettable decisions	**3rd issue: Tapping retirement assets early** 44% of plan participants have accessed retirement assets early or are considering it, compromising their long-term financial security.[2]
Solutions Policy updates & enhanced advisor access	**4th & 5th issues: Policy POV & Default Sequencing** Policy makers and employers can evaluate policies, benefits, and auto-enrollment opportunities to enhance employee access to financial advice and ensure they're benefiting from it when they need it most.

[1] Edelman Financial Engines Research. April 2020. [2] Edelman Financial Engines Research. August 2020.

Table of Contents

Introduction

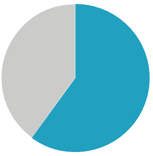
Edelman Financial Engines conducted an extensive study of U.S. companies and their employees, from Aug. 20-Sept. 2, 2020. Our findings reveal Covid-19's financial impact on employees – and actions they subsequently took, including borrowing from retirement plans. This paper offers solutions that plan sponsors and employers can adopt to improve employees' financial security and retirement readiness.

U.S. workers face an acute financial crisis amidst the Covid-19 pandemic. Mounting financial stress is causing half of all employees to take actions detrimental to their long-term financial security, including borrowing against their retirement plans.

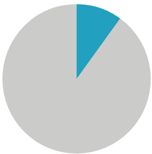
Not only have 1 in 3 active plan participants accessed money from their retirement accounts early, 60% of them would do it again. Another 10% are considering taking their first loan or hardship withdrawal.

The absence of financial education and personal coaching, coupled with easy access to retirement funds (made even easier by the CARES Act), is letting workers plunge themselves into a debilitating financial crisis. They know it, too: Nearly 60% of 401(k) borrowers regret their actions – actions they admittedly took without understanding the implications of their decisions.

1 in 3
Accessed money from their retirement accounts



60%
Would borrow again



10%
Considering taking their first loan

Employers and Plan Sponsors Want to Help

Employers and plan sponsors have long recognized their role in improving financial well-being – and not just because of their own fiduciary concerns. Organizations realize that a financially secure workforce reduces absenteeism and presenteeism, improves worker retention, increases productivity, and reduces costly workplace incidents.

That's why 90% of companies either have a financial wellness strategy or are developing one.[1] Financial wellness is a broad term with many types of offerings, from making student loan payments to building emergency savings to providing financial planning services.[1]

Yet, nearly two-thirds of companies are not providing what employees want most: personal, one-on-one financial advice. Indeed, only 39% of employees say their employer offers comprehensive financial advice, according to our research.[2]

39%

say their employer offers comprehensive financial advice

Instead, the most common "help" employers and plan sponsors provide is pre-retirement access to retirement plan assets. More than 90% of 401(k) plans have loan provisions[3] and 76% of the 92 plan sponsors interviewed by Edelman Financial Engines have adopted one or more CARES Act provisions for their retirement plans.[4] The increased ease of obtaining a plan loan, along with a sharply higher incidence of pay cuts and employee terminations – all due to Covid-19 – is putting millions of employee in financial jeopardy. After all, it's harder to repay loans when hours are cut, and borrowed funds must be repaid immediately upon termination. Employees unable to repay their loans face increased default risk and pose greater fiduciary risks for plan sponsors. Everyone loses.

76% of plan sponsors interviewed by Edelman Financial Engines have adopted one or more CARES Act provisions for their retirement plans

Companies that anticipate further layoffs due to Covid-19 must consider their obligations as fiduciaries to educate plan participants about the impact on their retirement security if they are unable to repay a loan upon termination.

Fiduciary Responsibility

Plan sponsors with discretionary authority over plan design are liable for advising participants of all material aspects of the plan, including all plan options. This responsibility includes educating participants on the consequences of their plan-permitted actions.

The plan's loan provision might be appealing to participants, but when seeking a loan, many are unaware of the significant harm that borrowing potentially inflicts on their future retirement security. Borrowers later realize the damage they've done, reflected by the fact that many who obtained loans or hardship withdrawals later had regrets. Further, 85% who have regrets say it's because they didn't understand the implications of their actions.

Companies must consider their fiduciary obligations to plan participants. If further layoffs due to Covid-19 are anticipated, there is a duty to warn participants that being unable to repay a loan upon termination could adversely impact their future retirement security. Yet, Covid-19 has prompted only 25% of employers to offer emergency funds, financial education and individual counseling.[1]

85%

of borrowers who have regrets say it's because they didn't understand the implications of their actions

Employees Are Seeking Help from Their Employers

There is no reason for employers to hesitate in providing additional help to their workforce – employees want their employers to help them. Indeed, the 2nd issue in this series, Closing the Financial Advice Gap, showed that 84% of employees want this kind of help from their employers and 85% say a comprehensive financial benefit would help them become better prepared for retirement.[2] Also, 81% of plan participants who borrowed from their future retirement income say talking to an advisor beforehand could have been helpful.

How Employers Can Help Their Employees

Borrowing from retirement funds is not just bad for employees. It's bad for the plans themselves, as reduced account balances can increase plan costs. A variety of options to reduce the frequency and size of loans are available to employers and plan sponsors. They are summarized here and explained in detail later in this paper.

Policy and Process Solutions

- Modify loan limits and qualification criteria, including re-evaluation of the CARES Act.
- Introduce more stringent requirements for borrowing retirement funds, including mandatory counseling prior to obtaining loans and extended waiting periods between loans.
- Engage your recordkeeper and managed account provider for a multi-pronged plan to review leakage activity, determine at-risk participants, and develop targeted mitigation plans.

Product Solutions

- Offer an employer-sponsored, personal finance education program, covering every subject from credit and debt to estate planning, and curated for the needs of your workforce and designed to best meet a fiduciary standard of care.
- Give employees considering a loan or hardship withdrawal access to financial advisors and coaches (who serve as fiduciaries), to help understand the implications of accessing their retirement funds prematurely and learn about less-detrimental options.
- Enroll employees with existing loans into an education program focused on preventing additional borrowing and accelerating repayment of current loans.

Key Findings

Employees took harmful financial actions during the pandemic and could have benefited from financial advice.

- In August, half of U.S. employees said they took actions detrimental to their long-term financial security due to the pandemic; a 50% increase from April.
    - 45% of these actions directly harm their retirement plan accounts, such as changing portfolio allocations, reducing savings rates and borrowing from their plan.
    - 30% of their actions increased their debt.
    - 21% of their actions reduced or depleted their emergency savings.
- 44% of employees said they could have benefited from financial advice.

"Because I don't have anything in my savings, I figure I'm going to work until I die."

– Plan participant, Fortune 75 company

There's a high prevalence of early retirement access – and Covid-19 may be accelerating the trend.

- One in three plan participants have accessed funds from their retirement plan; of those, 43% have done so multiple times.
- 16% of plan participants are considering a loan or hardship withdrawal, with 1 in 2 of them directly attributing it to Covid-19.
- Almost half (46%) who are considering a 401(k) loan say the primary reason is related to the pandemic.

"Retiring is almost impossible in this economy as a lower middle-class person."

– Plan participant, Fortune 500 company

Employees pay a high cost to borrow.

- Employees may lose as much as half of their potential retirement savings from a single loan event.

Employees often have questionable reasons for accessing their retirement funds early.

- Borrowing money from a retirement account is never ideal. But life sometimes makes it unavoidable. For example, the funds might be needed for medical care, to avoid eviction, or to buy a car or pay for auto repairs so the employee can go to work.
- The number one reason participants took out a 401(k) loan, however, was to pay down credit card debt. Other nonessential reasons cited included "vacations," "wedding," and "fun spending."

Accessing 401(k) savings early is a life-changing decision, but employees lack the resources needed to help them make good decisions.

- More than 50% who accessed their funds prior to retirement regret doing so. More than 4 in 5 (81%) said a financial advisor could have helped them make better decisions.

Employers can help their employees improve their personal finances, and many already are.

- Offer retirement plans and encourage employee participation. Employees who participate in a 401(k) plan are twice as likely to have a written financial plan as those who don't participate (42% vs. 23%).
- Adopt provisions of the CARES Act. Of the plan sponsors interviewed by Edelman Financial Engines, 76% have adopted at least one of the law's provisions for their plan participants' benefit.
- Offer financial education and access to fiduciary financial advisors. 84% of employees would value a financial advice benefit offered by their employer.

Stressing Over Money Leads to ... More Stress Over Money

One in two U.S. employees is experiencing financial stress. While some are facing difficulty due to their own poor behavior (taking vacations they can't afford, for example), most are stressed because of bills they couldn't avoid.

These include:

- Medical bills.
- Costs of caring for a child with special needs.
- Elder care responsibilities.
- Supporting family members who are spendthrifts.
- Struggles due to addiction.

Whatever the cause of their financial stress, employees' actions reflect the dire straits they find themselves in – with many turning to actions that may be harmful to their long-term financial security. Indeed, with very few exceptions, 98% of the financial actions taken by employees this year can have a lasting adverse impact on their future financial security.

Impacted Retirement Account	45%
Depleted Emergency Savings	21%
Activated Forbearance	16%
Added to Their Debt	14%
Other	4%

But there's a limit on how often they can take the actions shown in the chart above. So, when problems persist but the lifeline is gone (because the retirement funds have been depleted or borrowing limits reached), the financial stress grows. It's a vicious cycle.

Afflicted employees aren't the only victims. Employers suffer, too, because employees who are financially stressed are less focused and suffer increased tension while at work. The result is more workplace incidents and lower productivity.

The Pandemic Is Not Just a Health Crisis – It's Also Escalating the Retirement Crisis

The CARES Act, signed into law March 27, 2020, attracted national attention by addressing the economic hardships associated with the pandemic. It provided much-needed economic relief to Americans across many aspects of their personal finances, but pervasive issues such as low financial literacy, debilitating stress levels, and limited consumer education, have thwarted the law's effectiveness.

Among other provisions, the law gives plan sponsors options to temporarily ease access to retirement savings in two ways: It lets qualified borrowers avoid the 10% early withdrawal penalty and increases the maximum loan size up to $100,000.

Plan sponsors implemented aspects of the CARES Act that they concluded are in the best interests of their plan participants. Of the 92 plan sponsors interviewed for this study,[4] Edelman Financial Engines found that 76% have adopted at least one coronavirus aid package provision.

Plan Sponsor Adoption of CARES Act Provisions

79%

Allowed hardship withdrawals up to $100,000 as a "COVID-19 emergency" distribution

69%

Suspended RMDs to those 70½+ in 2019 for the balance of 2020

69%

Delayed loan repayment up to 12 months for those self-certifying as affected by coronavirus

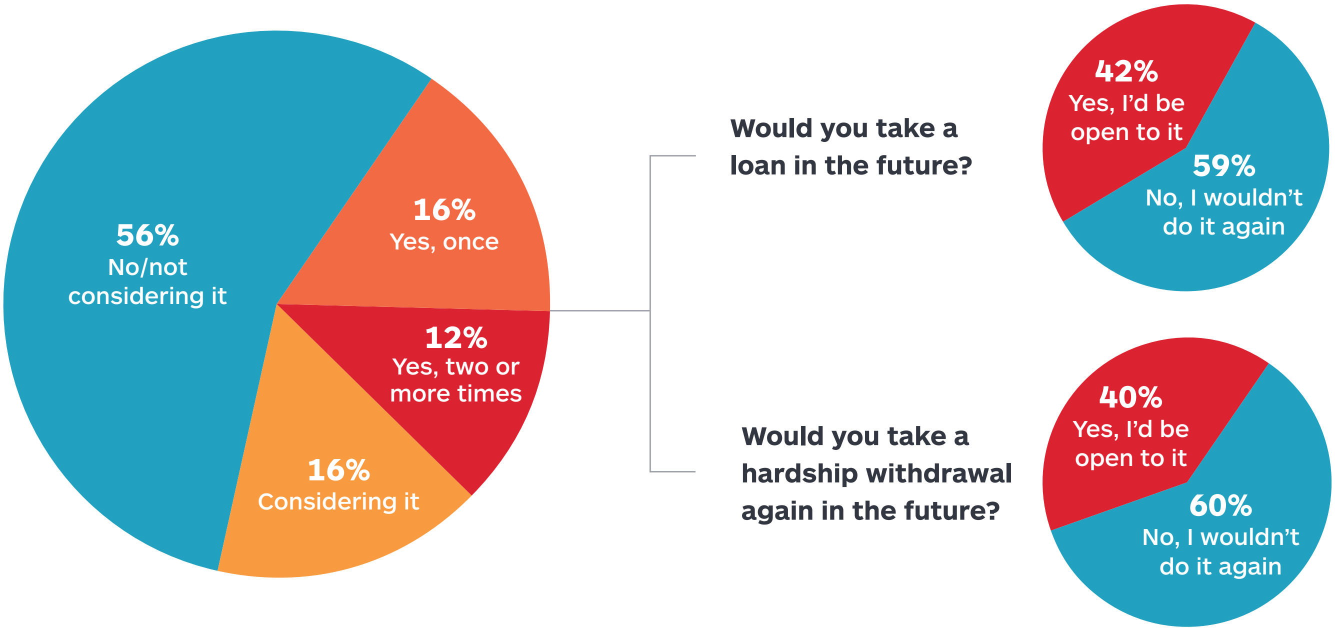
54%

Increased loan amounts up to $100,000 for those self-certifying as affected by coronavirus

Those Who Borrow Often Borrow Again

Nearly half of employees (44%) have accessed their retirement accounts early or are considering it – and 60% of those accessing early are open to doing it again.

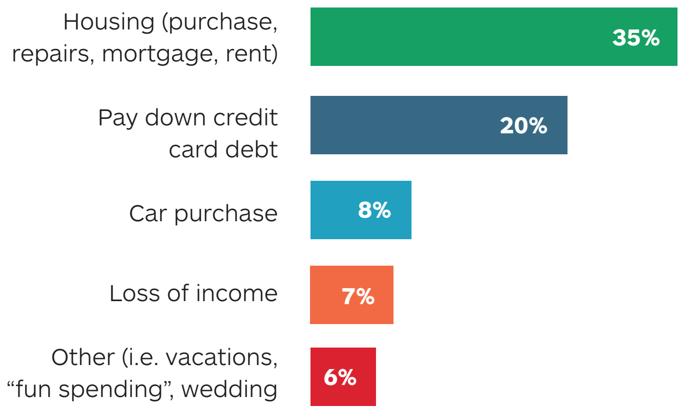
Have you taken a loan or hardship withdrawal?



Employees Who Access Their Retirement Funds Lack Important Information

Our research reveals that participants withdrawing from their retirement funds often do so for unnecessary or even downright frivolous reasons.

The Reasons Range From Trivial to Essential



What employees do not know, is that other options are often readily available, even for urgent needs. Indeed, participants who have taken two or more hardship withdrawals are 2.3 times more likely to grade their financial knowledge as D or F than those who have not taken any hardship withdrawals.

“Plan participants are often surprised to learn that money in their 401(k) is protected from bankruptcy, creditors and litigation. They lose that protection when they borrow or withdraw the money. So when I hear that a participant is struggling financially, we look for other ways to solve their problems that don’t put their retirement savings at risk.”

– Kevin Yorkey, Director, Financial Planning, Edelman Financial Engines, Burlington, MA

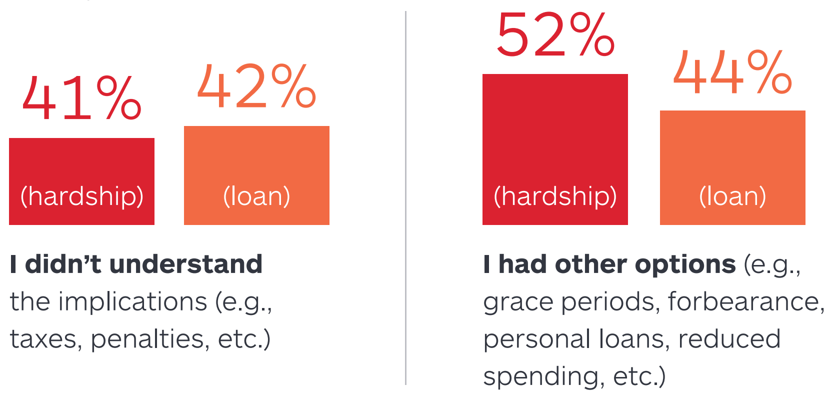
An example of borrowers’ lack of knowledge is that 35% of them listed “housing” as their reason for withdrawal. Yet, the CARES Act protected homeowners with federally insured or funded mortgages from foreclosure, and suspended evictions for renters. Had these borrowers known about the law, they might not have taken the actions they took.

Offering educational support and fiduciary advisory access: 81% of 401(k) loan borrowers said talking to an advisor prior to taking a loan may have been helpful.

Realizing they didn’t make the best decision, most who took early access (55%) now regret their actions, and they blame their lack of understanding about the implications and lack of awareness of other options that are available to them.

55% of Borrowers Regret Their Decision

% Respondents



“I managed to keep my house but set myself back years in terms of money saved to retire.”

– Plan participant, Fortune 100 company

Employee Retirement Savings Loss

The devastating impact of accessing retirement savings is well documented, but our current situations heighten the risk to participants, plans and plan sponsors. Market volatility, economic uncertainty and even family pressures associated with Covid-19 can trap potential borrowers in a devastating situation.

A Single 401(k) Loan Can Cut Your Retirement Savings in Half

Age: 45

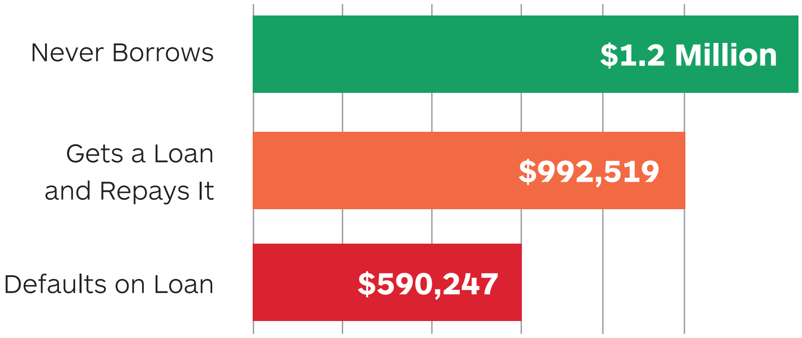
401(k) Balance: $100,000

Loan Amount: $50,000

Contribution: John contributes 6% annually; his employer provides a 3% matching contribution

To illustrate the devastating effects of a 401(k) loan, let's consider three scenarios for a hypothetical employee named John.

John's Account Balance at Age 70



No Loan	Loan	Default
$ 1,169,843	$992,519	$590,247
–	-15%	-50%

Assumptions: 5% loan interest rate; 7% average annual investment return; 3.75% annual salary increase; contributions to plan prohibited until loan is repaid; default occurs after two years; taxes and penalties incurred and removed from the default scenario. This is a hypothetical illustration.

In the best case, John never borrows from his 401(k) and continues to contribute to his account. By the time he's age 70, his account is worth nearly $1.2 million.

But his situation turns into a bad case if he takes a loan. Even if he repays the debt on schedule, the damage is done: His account will be worth only $992,519 at age 70 – 15% less than if he had never taken out a loan.

Millions of U.S. employees suffer similar bad case scenarios.

They often believe that 401(k) loans are harmless because “I’m borrowing from myself” and “I am paying myself interest” – misunderstandings that are often perpetuated by a lack of education or downright misleading information provided by coworkers, friends and the internet.

Too often, employees obtaining loans do not realize that:

- They incur fees to obtain loans, and they pay interest when repaying them. They also incur penalties if they do not repay the loan on time.
- The interest, fees and penalties do not incur to their benefit and thus do not get added to their account balance.
- The term “borrow” is a misnomer; there’s really no such thing. In reality, the “loan” is a withdrawal of the funds from their 401(k) account; mutual fund shares in the employee’s account are sold to provide the “loan.” Those shares therefore no longer exist – causing the employee to miss out on the shares’ investment gains until they are repurchased with money provided by loan repayments.
- Employees are often not permitted to continue contributing to their 401(k) until the loan is fully repaid. Company matching contributions also discontinue. These add to the missed market gains during the years the loan is being repaid. Being unable to contribute to the plan also increases his take-home pay, which increases his tax liability. (If he doesn’t adjust his paycheck withholding, he could owe the IRS a substantial amount of money when he prepares his tax return.)
- The interest expense incurs double taxation. That’s because interest is repaid with after-tax dollars but is subject to taxation again when withdrawn in retirement. This inefficiency interferes with the goal to achieve retirement security.
- Money held in a 401(k) plan is protected from creditors, but once employees remove it – via a loan or withdrawal – the liability protection is lost. Creditors can sue employees, forcing them to repay, negotiate a settlement or seek shelter in bankruptcy court.

As bad as the bad case is, its harm is paltry compared to the worst case, which occurs if John defaults. As we can see, his account balance at retirement is a shocking 50% less than it otherwise would have been, leaving John with less than $600,000 instead of the nearly $1.2 million he would have accumulated.

Typically, default occurs because an employee leaves the company – a common occurrence. If separation is due to a furlough, layoff or termination, John would likely find himself in financial difficulty, with little to no money in cash reserves or other assets to rely on during his transition. (This is evidenced by taking a loan from the 401(k) plan.) Upon separation, outstanding loan balances must be repaid quickly, usually within 90 days. Borrowers often are not aware of this fact until separation, and many are unable to repay the loan by the deadline. This is true even for employees who voluntarily separate, as new job offers rarely come with signing bonuses. (If the employees were able to repay their loans, they likely wouldn't have had to borrow money in the first place.)

For all employees who borrow money from their 401(k)s – and especially for those who default, often because of unexpected furloughs or layoffs – the loans create financial devastation from which few can recover. No wonder 60% of loan borrowers regret their actions, with 80% of them admitting they did not understand the implications before they acted.

60% of loan borrowers regret their actions, with 80% of them admitting they did not understand the implications before they acted

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Plan sponsors are in a difficult position, as they are liable for communicating all plan options (including loan and hardship withdrawal provisions) while also educating participants on the consequences and impacts of choosing those options. Plan sponsors can address these challenges through clear communication, personalized educational content and action plans, and access to qualified financial advisors and coaches.

Five Problems – and How to Resolve Them

1. **Acknowledge and address financial stress.** Plan sponsors and employers can work with their advice partners to develop and distribute programs that help employees who are facing crucial life events – as well as changes in the economy or stock market. Corporate developments should also be addressed, from new hire orientation to layoffs and reductions in force, in partnership with your advice provider.
2. **Increase financial literacy.** All employees should have access to comprehensive financial education to help them understand important financial concepts, from budgeting and managing debt to saving for homes, college and retirement. The full spectrum of topics should be covered – including education on buying insurance, maximizing Social Security benefits, reducing taxes, designing an estate plan, protecting their privacy, and caring for elders. All these subjects are of vital interest and concern to every company's employees. Giving employees the information they need to make effective decisions increases their confidence and reduces their stress – while improving their on-the-job performance.
3. **Improve financial resilience.** Employees should be able to access calculators, tools, and advice that are relevant and timely for their situation. Improving financial literacy helps employees control their spending, reduce their debt, and establish cash reserves – making them more prepared when adverse financial events would otherwise propel them into chaos.
4. **Impose prerequisites before allowing employees premature access to retirement funds.** Plan sponsors can require that participants complete education programs and undergo individual counseling, so they'll learn the implications of obtaining retirement funds prematurely. Additionally, plan sponsors can impose limits on the amount that can be borrowed with each loan, the number of loans each worker can obtain and how frequently those loans can be obtained.
5. **Give employees access to quality education and objective advice.** Providing access to fiduciary advisors at key life moments – such as onboarding and while transitioning from the firm – can help employees when they're facing life-altering financial decisions.

78%

of employees do not have a financial advisor[2]

84%

of employees would value a financial advice benefit from their employer[2]

Employees Want Advice – and They Want to Get It at Work

Employees and plan participants want financial education and advice. Employers know these benefits can reduce their workers' financial stress and improve retirement outcomes – and it's easy and cost-effective to implement.

81%

of plan participants who obtained a loan said it would have been helpful to have talked to an advisor before getting the loan[2]

80%

of employees say a comprehensive financial benefit would help them become better prepared for retirement[2]

About Edelman Financial Engines

Since 1986, Edelman Financial Engines has been committed to acting in the best interest of our clients. We were founded on the belief that all American investors – not just the wealthy – deserve access to personalized, comprehensive financial planning and investment advice.

Today, we are America's top independent financial planning and investment planner, recognized by both Investment News[5] and Barron's[6] with 150+ planner offices across the country and entrusted by more than 1.3 million clients to manage more than $220 billion in assets. We create access to everyone – no matter the size of their account or level of expertise. The average balance of our clients in the workplace is $151,000, and the median balance is $63,000.

Thousands of America's employers have entrusted Edelman Financial Engines to provide financial help to more than 10.9 million retirement plan participants. Our unique approach to serving clients combines our advanced methodology and proprietary technology with the attention of a dedicated personal financial planner. Every client's situation and goals are unique, and the powerful fusion of high-tech and high touch allows Edelman Financial Engines to deliver the personal plan and financial confidence that everyone deserves.[7]

Please contact Edelman Financial Engines for more information on how we can help provide independent, unconflicted financial advice to your employees.

EdelmanFinancialEngines.com

Survey Methodology

Edelman Financial Engines conducted an online survey of America's employees Aug. 20-Sept. 2, 2020. The survey included 1,902 retirement plan participants located in the United States. Aggregate statistics have up to a +/- 3% margin of error at 99% confidence. Respondent quotas for age, gender, race, employer size and retirement plan participation were set to increase representativeness of U.S. workers. Fielding was conducted on the Qualtrics Insight Platform.

Sources and Disclosures

[1] EBRI: Employee Benefits Research Institute: EBRI 2020 Financial Wellbeing Symposium, September 22, 2020; reporting results from the 2020 Financial Wellness Survey: Employer Perspectives with Special Focus on the Impact of COVID 19.

[2] Edelman Financial Engines Advice Gap, September 2020.

[3] Timothy (Jun) Lu, Olivia S. Mitchell, Stephen P. Utkus, and Jean A. Young. (2014, February). Borrowing from the Future: 401(k) Plan Loans and Loan Defaults, Wharton/Vanguard Pension Research Counsel Working Paper.

[4] Edelman Financial Engines conducted a moderated survey from March 2020 through June 2020 to assess what defined contribution (DC) plan sponsors have done in response to the CARES Act. The survey includes responses from 92 plan sponsors who are clients of Edelman Financial Engines.

[5] InvestmentNews ranking and status for 2020. For independence methodology and ranking, see InvestmentNews Center.

[6] The 2019 Top 50 Independent Advisory Firm Ranking issued by Barron's is qualitative and quantitative, including assets managed, the size and experience of teams, and the regulatory records of the advisors and firms. Firms elect to participate but do not pay to be included in the ranking. Investor experience and returns are not considered. The 2018 ranking refers to Edelman Financial Services, LLC, which combined its advisory business in its entirety with Financial Engines Advisors L.L.C. (FEA) in November 2018. For the same survey, FEA received a precombination ranking of 12th.

[7] Data as of June 30, 2020.