EBRI
EMPLOYEE BENEFIT RESEARCH INSTITUTE®

Notes

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Executive Summary:

Finances of Employee Benefits: Health Costs Drive Changing Trends

- ***Rising health costs driving shift in benefits:*** The most recent data provide further evidence that rising health costs are driving a major shift in the finances of employee benefits. For decades, retirement costs accounted for the bulk of *total* spending on benefits by employers, but health costs are rapidly catching up.
- ***Health costs account for the bulk of voluntary employer-provided benefits***: Voluntary health care costs (spending on health insurance premiums) surpassed employer spending on voluntary retirement benefits (defined contribution and defined benefit plans) in 1989.
- ***Benefits take a growing share of total compensation:*** Since employers tend to budget for total annual compensation costs (including wages, salaries, and benefits), these data show they are devoting a growing share to benefits (especially health benefits) and a declining share to wages and salaries. Wages and salaries remain overwhelmingly the dominant share of employers' total compensation costs (81 percent), but significantly less than the share was about 50 years ago (95 percent in 1950).

Lump-Sum Distributions

- ***Workers are increasingly offered a lump-sum distribution of retirement assets:*** As more workers are participating in defined contribution plans (such as a 401(k) plan) and are in defined benefit plans that allow a lump-sum distribution, more of them are faced with the decision of what to do with retirement assets upon changing jobs. Even among private-sector workers with a traditional pension plan, a growing proportion now have the option to take their benefit in a lump sum: 48 percent of full-time employees in 2002, up from 15 percent in 1995.
- ***Increasing rollovers but leakage still significant:*** An increasing percentage of employment-based retirement plan participants are rolling over all of their lump-sum distributions and fewer are spending any of their distributions on consumption. But about 60 percent of those who took a lump-sum payment cashed out at least some of it.
- ***Education and/or incentives needed:*** To significantly reduce the number of retirement plan participants who cash out their lump-sum distributions, more education or possibly incentives are needed to make them understand the importance or retaining these assets for retirement.

Finances of Employee Benefits: Health Costs Drive Changing Trends

by Ken McDonnell, EBRI

Introduction

The most recent federal data provide further evidence that rising health costs are driving a major shift in the finances of employee benefits. For decades, retirement costs accounted for the bulk of total spending on benefits by employers, but health costs are rapidly catching up. In fact, voluntary health care costs (spending on health insurance premiums) surpassed employer spending on voluntary retirement benefits (defined contribution and defined benefit plans) in 1989. Since employers tend to budget for total annual compensation costs (including wages, salaries, and benefits), these data show they are devoting a growing share to benefits (especially health benefits) and a declining share to wages and salaries. Wages and salaries remain overwhelmingly the dominant share of employers' total compensation costs (81 percent), but significantly less than it was about 50 years ago.

The Finances of Employee Benefits, 1950–2004

Financing of the U.S. employee benefit system is a joint effort by employers and employees. Both employers and employees make payments to *voluntary* employee benefit programs that provide health insurance coverage, retirement benefits, and other benefits. In addition, employers and employees make payments to *mandatory* government social insurance programs—most notably Social Security and Medicare—which provide retirement income and health care coverage, respectively, for the elderly and disabled workers and their dependents.

Whether voluntary or mandatory, each of these systems is employment-based and financed primarily from earmarked employment-based contributions by employers and/or workers. This article uses the latest data (for 2004) from the U.S. Commerce Department's Bureau of Economic Analysis (BEA), National Income and Product Accounts of the United States. These benefit programs provide substantial financial support for individuals during their working lives (i.e., health insurance and unemployment insurance) and during retirement (i.e., Social Security, pension plans, and Medicare).

Benefit Payments to Individuals

In 2004, Americans received a gross total of about $2.08 trillion from major employee benefit programs. Of this amount, *retirement benefit payments* of $1.07 trillion accounted for 51.5 percent of total benefit payments (Figure 1). Of that amount, $485.9 billion was paid by the Social Security Old-Age, Survivors and Disability Insurance (OASDI) program, $331.8 billion by private pension and profit-sharing plans, and $255.0 billion by public employer retirement plans, including those for federal civilian and state and local government employees, railroad employees, and military personnel.

Health benefit payments of $859.0 billion accounted for 41.2 percent of total benefit payments (Figure 1). Sixty-four percent of this (or $553.6 billion) was paid by private group health insurance programs, while 35.3 percent ($303.3 billion) was paid by Medicare.

Payments from *other voluntary and mandatory employee benefit programs*, including unemployment insurance, workers' compensation, group life insurance, disability, and veterans' benefits, totaled $152.7 billion, or about 7.3 percent of total benefit payments in 2004.

Employer Spending on Benefits

In 2004, employers spent $1.3 trillion on major voluntary and mandatory employee benefit programs, including $610.7 billion for retirement programs (47.1 percent of all benefit spending), $559.6 billion for health benefit programs (43.1 percent), and $126.5 billion for other benefits (9.8 percent) (Figure 2). While total retirement benefits currently constitute the largest single share of employer spending on benefits, health costs are growing fast, and are on a course that could soon make them the largest portion of benefits expense.

Figure 1

Payments to Individuals From Employee Benefit Plans, Selected Years 1950–2004

	1950	1960	1970	1980	1990	2000	2004
				($ billions)			
All Benefits	$10.0	$30.5	$90.3	$352.0	$870.0	$1,572.2	$2,084.4
Retirement Income Benefits	2.7	16.8	50.7	201.8	481.9	862.9	1,072.7
Social Security Old-Age, Survivors, and Disability Insurance	1.0	11.1	31.4	118.6	244.1	401.2	485.9
Private employer pension & profit sharing	0.4	1.7	7.4	35.3	136.2	270.1	331.8
Public employer retirement plans	1.3	4.0	11.9	47.8	101.6	191.6	255.0
federal civilian employee retirement[a]	0.3	0.9	3.0	15.5	32.0	49.8	56.7
state and local government retirement	0.4	1.4	4.0	15.1	40.6	100.3	146.1
military retirement[b]	0.3	0.8	3.2	12.5	21.9	33.2	43.2
railroad retirement	0.3	0.9	1.7	4.8	7.2	8.3	9.0
Health Benefits	0.9	4.3	22.3	99.0	300.3	596.8	859.0
Medicare Hospital Insurance and Supplementary Medical Insurance	c	c	7.3	36.2	107.6	219.6	303.3
Group health insurance	0.9	4.3	14.8	62.4	191.2	376.0	553.6
Military health insurance[d]	c	c	0.2	0.4	1.5	1.2	2.1
Other Employee Benefits	6.5	9.4	17.3	51.2	87.8	112.5	152.7
Unemployment insurance[e]	1.5	3.1	4.2	16.1	18.2	20.4	36.4
Workers' compensation[f]	0.6	1.5	3.0	12.5	38.0	48.2	56.9
Group life insurance	0.3	1.1	2.9	6.6	12.3	17.0	22.8
Miscellaneous disability[g]	0.0	0.1	0.5	2.6	3.6	3.7	4.4
Veterans' benefits[h]	4.0	3.7	6.6	13.4	15.8	23.2	32.1
				(percentage)			
All Benefits	100%	100%	100%	100%	100%	100%	100%
Retirement Income Benefits	26.5	55.0	56.2	57.3	55.4	54.9	51.5
Social Security Old-Age, Survivors, and Disability Insurance	10.0	36.3	34.8	33.7	28.1	25.5	23.3
Private employer pension & profit sharing	3.7	5.6	8.2	10.0	15.7	17.2	15.9
Public employer retirement plans	12.9	13.0	13.2	13.6	11.7	12.2	12.2
federal civilian employee retirement[a]	2.7	3.1	3.4	4.4	3.7	3.2	2.7
state and local government retirement	3.8	4.5	4.5	4.3	4.7	6.4	7.0
military retirement[b]	3.5	2.5	3.5	3.5	2.5	2.1	2.1
railroad retirement	3.0	2.9	1.9	1.4	0.8	0.5	0.4
Health Benefits	8.9	14.2	24.7	28.1	34.5	38.0	41.2
Medicare Hospital Insurance and Supplementary Medical Insurance	c	c	8.1	10.3	12.4	14.0	14.6
Group health insurance	8.9	14.2	16.4	17.7	22.0	23.9	26.6
Military health insurance[d]	c	c	0.2	0.1	0.2	0.1	0.1
Other Employee Benefits	64.6	30.9	19.1	14.6	10.1	7.2	7.3
Unemployment insurance[e]	15.0	10.1	4.7	4.6	2.1	1.3	1.7
Workers' compensation[f]	6.4	4.8	3.4	3.6	4.4	3.1	2.7
Group life insurance	3.3	3.5	3.3	1.9	1.4	1.1	1.1
Miscellaneous disability[g]	0.0	0.3	0.6	0.7	0.4	0.2	0.2
Veterans' benefits[h]	40.0	12.1	7.3	3.8	1.8	1.5	1.5

Source: Employee Benefit Research Institute tabulations based on U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov/bea/dn/nipaweb/index.asp

[a] Consists of civil service, foreign service, Public Health Service officers, Tennessee Valley Authority, and several small retirement programs.
[b] Includes the U.S. Coast Guard.
[c] Program not yet enacted.
[d] Consists of payments for medical services for dependents of active duty military personnel at nonmilitary facilities.
[e] Consists of state, railroad employee, and federal employee unemployment benefits; special unemployment benefits; and supplemental unemployment benefits.
[f] Includes payments from private, federal, and state and local workers' compensation funds.
[g] Includes federal black-lung payments and payments from state and local temporary disability insurance.
[h] Consists of pension and disability, readjustment, and other veterans' benefits.

Mandatory vs. Voluntary—Employers are required to offer some benefits (Social Security, Medicare, workers' compensation), but others (health insurance and retirement benefits) are offered voluntarily by the employer. This distinction is important, because employers have no control over *mandatory* benefits. From 1948–1981, employer spending on *voluntary* retirement benefits accounted for 60 percent or more of total voluntary benefit spending, while voluntary health insurance spending steadily increased (Figure 3). Beginning in the late 1980s, retirement benefits declined significantly as a percentage of total voluntary spending, while health insurance grew. By 2004, employers spent $839.9 billion on voluntary benefits: Most (57.4 percent) was on health insurance, followed by retirement benefits (41.2 percent) and other benefits (1.4 percent) (calculated from Figure 2).

Figure 2

Employer Spending on Employee Benefit Plans, Selected Years 1950–2004

	1950	1960	1970	1980	1990	2000	2004
				($ billions)			
Total Compensation	$155.2	$296.4	$617.0	$1,651.1	$3,337.5	$5,781.1	$6,686.2
Wages and Salaries[a]	147.3	272.8	551.5	1,377.4	2,754.0	4,829.2	5,389.4
All Benefits	8.0	23.6	65.5	273.7	583.5	952.6	1,296.8
Retirement Income Benefits	4.5	14.1	40.1	160.1	292.9	458.8	610.7
Social Security Old-Age, Survivors, and Disability Insurance	1.3	5.6	16.2	55.6	137.3	233.3	265.0
Private employer pension and profit sharing	1.7	4.9	13.1	55.3	63.8	113.5	198.8
Public employer retirement plans	1.5	3.7	10.8	49.2	91.8	112.0	146.9
federal civilian employee retirement[b]	0.3	0.8	2.0	15.9	28.7	41.3	47.5
state and local government retirement	0.5	1.8	5.1	19.1	33.0	39.6	50.6
military retirement[c]	0.3	0.8	3.2	12.5	27.5	28.2	46.2
railroad retirement	0.3	0.3	0.5	1.7	2.6	2.9	2.5
Health Benefits	0.7	3.4	14.6	73.0	211.9	399.6	559.6
Medicare Hospital Insurance	d	d	2.3	11.6	33.5	67.0	75.0
Group health insurance	0.7	3.4	12.1	61.0	176.9	331.4	482.5
Military medical insurance[e]	0.0	0.0	0.2	0.4	1.5	1.2	2.1
Other Employee Benefits	2.7	6.1	10.9	40.6	78.6	94.2	126.5
Unemployment insurance[f]	1.5	3.0	3.8	17.2	24.5	29.8	42.0
Workers' Compensation	1.0	2.0	4.6	19.3	46.9	52.0	72.8
Group life insurance	0.3	1.1	2.4	4.1	7.2	12.4	11.7
				(percentage)			
Total Compensation	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Wages and Salaries[a]	94.9	92.0	89.4	83.4	82.5	83.5	80.6
All Benefits	5.1	8.0	10.6	16.6	17.5	16.5	19.4
Retirement Income Benefits	2.9	4.8	6.5	9.7	8.8	7.9	9.1
Social Security Old-Age, Survivors, And Disability Insurance	0.8	1.9	2.6	3.4	4.1	4.0	4.0
Private employer pension and profit sharing	1.1	1.6	2.1	3.3	1.9	2.0	3.0
Public employer retirement plans	0.9	1.2	1.8	3.0	2.8	1.9	2.2
federal civilian employee retirement[b]	0.2	0.3	0.3	1.0	0.9	0.7	0.7
state and local government retirement	0.3	0.6	0.8	1.2	1.0	0.7	0.8
military retirement[c]	0.2	0.3	0.5	0.8	0.8	0.5	0.7
railroad retirement	0.2	0.1	0.1	0.1	0.1	0.1	0.0
Health Benefits	0.5	1.1	2.4	4.4	6.3	6.9	8.4
Medicare Hospital Insurance	d	d	0.4	0.7	1.0	1.2	1.1
Group health insurance	0.5	1.1	2.0	3.7	5.4	5.7	7.2
Military medical insurance[e]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Employee Benefits	1.8	2.1	1.8	2.5	2.4	1.6	1.9
Unemployment insurance[f]	1.0	1.0	0.6	1.0	0.7	0.5	0.6
Workers' Compensation	0.6	0.7	0.7	1.2	1.4	0.9	1.1
Group life insurance	0.2	0.4	0.4	0.2	0.2	0.2	0.2

Source: Employee Benefit Research Institute tabulations based on U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov/bea/dn/nipaweb/index.asp

[a] Includes paid holidays, vacations, and sick leave taken.

[b] Consists of civil service, foreign service, Public Health Service officers, Tennessee Valley Authority, and several small retirement programs.

[c] Includes the U.S. Coast Guard.

[d] Program not yet enacted.

[e] Consists of payments for medical services for dependents of active duty military personnel at nonmilitary facilities.

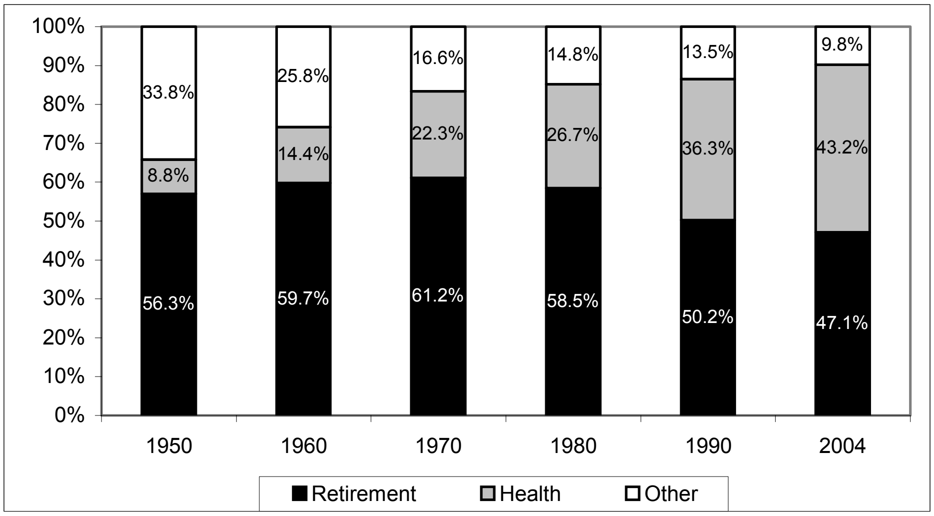
[f] Consists of state, railroad employee, and federal employee unemployment benefits; special unemployment benefits; and supplemental unemployment benefits.

Wage and Salary Annual Growth Rates—Employer spending on wages and salaries increased in the 1950s at an average annual rate of 6.4 percent, in the 1960s at an average annual rate of 8.1 percent, in the 1970s at an average annual rate of 10.7 percent, in the 1980s at an average annual rate of 8.0 percent, and in the 1990s at an average annual rate of 6.4 percent. Some analysts have stated that the slower growth of employer spending on wages and salaries was due in part to an increase in employer spending on health care benefits. Although spending on health care benefits increased at a faster rate in the 1950s, 1960s, and 1970s, 17.1 percent, 17.6 percent, and 19.6 percent respectively, health care benefit spending growth slowed in the 1980s to an average annual growth rate of 12.6 percent and an even slower rate of 7.3 percent in the 1990s.

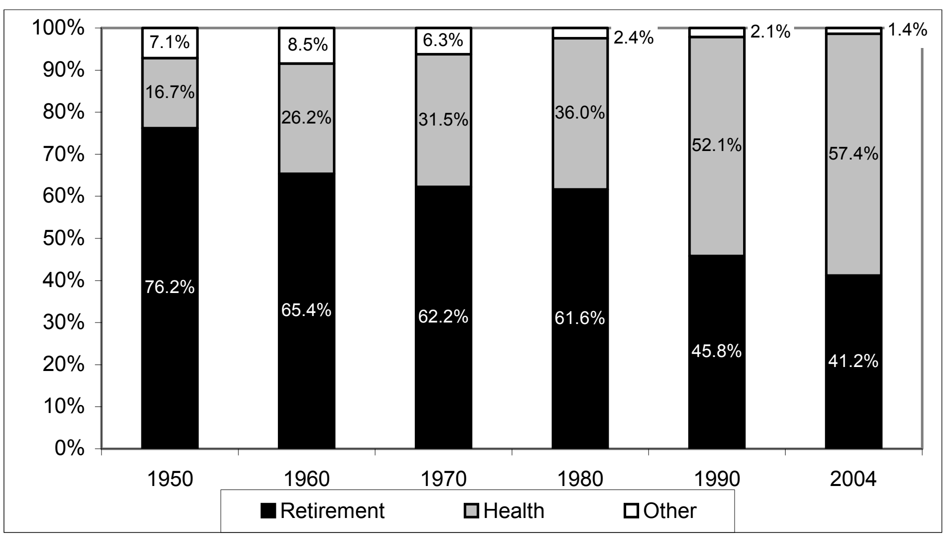
Of the three major employee benefit categories, health benefits increased the most as a percentage of benefit spending, and if current trends continue will displace retirement costs as the largest sector in benefit costs. In 1950, health benefits accounted for 8.8 percent of all benefit spending, retirement benefits 56.3 percent, and other benefits 33.8 percent. By 2004, health benefits accounted for 43.2 percent of all benefit spending, retirement benefits 47.1 percent, and other benefits 9.8 percent (Figure 3). Since 1950, wages and salaries have declined as a share of total compensation (from 95 percent in 1950 to 81 percent in 2004), while benefits (driven mainly by health costs) have more than doubled from 5.5 percent to 19.0 percent over the same period (Figure 4).

Figure 3
The Changing Share of Employer Spending on Benefits, 1950–2004

Total Benefit Spending, Mandatory Plus Voluntary



Employer Spending on Voluntary Benefits



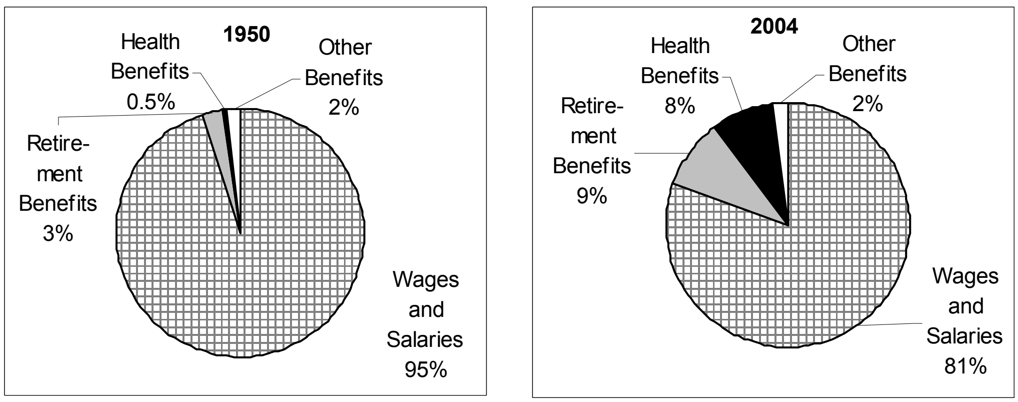
Source: Employee Benefit Research Institute tabulations based on U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov/bea/dn/nipaweb/index.asp

Individual Spending on Benefits

Individuals paid $693.0 billion into the benefit system in total personal spending in 2004. Personal contributions to retirement income benefits, including contributions to Social Security OASDI and public-sector retirement plans, totaled $312.3 billion (or 45.1 percent) (Figure 5). Private-sector employee contributions for pension (defined benefit) and profit-sharing (such as 401(k)) plans are not reported separately by the BEA. In the National Income and Product Accounts (NIPA), data on individual contributions to salary reduction plans (such as 401(k) plans) are included in the line item of personal savings. Personal savings is shown as a *net residual,* equal to personal income minus contributions to social insurance, personal tax and nontax payments, and personal outlays. When personal savings (reported by NIPA) are added into retirement income contributions (reported by BEA), the total figure sums to $464.1 billion, or 67.0 percent of total individual contributions to employee benefits.

Individual contributions to health benefits totaled $228.6 billion (or 33.0 percent) in 2004. In NIPA, individual contributions to health benefits include premiums paid by individuals for health insurance purchased in the individual market. The dataset cannot break out contributions to employment-based health insurance from premiums paid for health insurance purchased in the individual market.

Figure 4
Changes in Total Compensation, 1950 and 2004
(including wages & salaries and benefits)



Source: Employee Benefit Research Institute tabulations based on U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov/bea/dn/nipaweb/index.asp

Figure 5
Individual Spending on Employee Benefit Plans and Personal Saving, Selected Years 1950–2004

	1950	1960	1970	1980	1990	2000	2004
				($ billions)			
All Benefits and Savings	$18.3	$36.3	$87.0	$296.4	$543.8	$610.9	$693.0
Retirement Income Benefits	2.4	7.8	21.6	66.1	156.7	269.5	312.3
Social Security Old-Age, Survivors, and Disability Insurance (OASDI)	1.3	5.5	16.2	55.2	136.4	231.3	264.0
Private employer pension & profit sharing	a	a	a	a	a	a	a
Public employer retirement plans	1.1	2.3	5.4	11.5	20.3	38.2	48.3
federal civilian employee retirement	0.4	0.8	1.9	3.8	4.5	10.9	14.6
state and local government retirement	0.4	1.2	3.1	7.1	14.6	25.8	32.2
railroad retirement	0.3	0.3	0.4	0.6	1.2	1.4	1.5
Health Benefits	0.8	1.8	7.8	28.2	87.5	172.8	228.6
Medicare Hospital Insurance	b	b	2.3	11.6	33.4	68.4	76.9
Medicare Supplemental Medical Insurance	b	b	1.1	3.0	10.7	20.4	31.2
Health insurance	0.8	1.8	4.4	13.6	43.4	84.0	120.5
Other Employee Benefits							
Unemployment insurance	0.0	0.0	0.0	0.1	0.2	0.1	0.3
Personal Savings[c]	15.1	26.7	57.6	201.4	299.4	168.5	151.8

(continued on next page)

Figure 5 *(continued)*

Individual Spending on Employee Benefit Plans and Personal Saving, Selected Years 1950–2004

	1950	1960	1970	1980	1990	2000	2004
				(percentage)			
All Benefits and Savings	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Retirement Income Benefits	13.0	21.5	24.8	22.5	28.8	44.1	45.1
Social Security Old-Age, Survivors, and Disability Insurance (OASDI)	7.1	15.2	18.6	18.6	25.1	37.9	38.1
Private employer pension & profit sharing	a	a	a	a	a	a	a
Public employer retirement plans	5.8	6.3	6.2	3.9	3.7	6.2	7.0
federal civilian employee retirement	2.0	2.2	2.2	1.3	0.8	1.8	2.1
state and local government retirement	2.2	3.3	3.6	2.4	2.7	4.2	4.6
railroad retirement	1.6	0.8	0.5	0.2	0.2	0.2	0.2
Health Benefits	4.4	5.0	9.0	9.5	16.1	28.3	33.0
Medicare Hospital Insurance	b	b	2.6	3.9	6.1	11.2	11.1
Medicare Supplemental Medical Insurance	b	b	1.3	1.0	2.0	3.3	4.5
Health insurance	4.4	5.0	5.1	4.6	8.0	13.8	17.4
Other Employee Benefits							
Unemployment insurance	d	d	d	d	d	d	d
Personal Savings[c]							

Source: Employee Benefit Research Institute tabulations based on U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov/bea/dn/nipaweb/index.asp

[a] Private-sector employee contributions for pension and profit-sharing plans are not reported separately. Such contributions are included in personal saving, as reported in this table.

[b] Program not yet enacted.

[c] Personal saving is a net residual, equal to personal income minus personal contributions to social insurance, personal tax and nontax payments, and personal outlays. It therefore includes savings attributable to income from employer contributions to private and public pension and profit-sharing plans and benefits paid by government employee retirement plans because these flows are defined as components of personal income. Personal saving also includes life insurance savings attributable to premiums paid by individuals and individual contributions to individual retirement accounts and employment-based retirement plans. However, because of the possible failure of some employers to report amounts voluntarily contributed by employees to retirement plans through pretax salary reduction, personal saving (and total compensation) may understate such amounts. However, employee contributions to public pension plans are not included. Employees' voluntary contributions to private retirement plans through pretax salary reduction are included in personal savings to the extent that they are reported by employers as wage and salary disbursements in their reports for unemployment insurance.

[d] Less than 0.5 percent.

■ Lump-Sum Distributions

by Craig Copeland, EBRI

As more workers are participating in defined contribution plans (such as a 401(k) plan) and are in defined benefit plans that allow a lump-sum distribution, more of them are faced with the decision of what to do with the assets that they have earned in these plans upon changing jobs. Previously, under "traditional" defined benefit pension plans, benefits typically were paid out as a life annuity (monthly installments for the life of the retired worker). Even among private-sector workers with a pension plan, a growing proportion now have the option to take their benefit in a lump sum: 48 percent of full-time employees in 2002, up from 23 percent in 1997 and just 15 percent in 1995.[1]

Today, after leaving employment from a plan sponsor, a worker typically has three choices for his or her retirement account:

- Leave the money in the plan.
- Roll it over to another tax-qualified savings vehicle (another employment-based plan or an individual retirement account (IRA)).
- Cash it out (to spend or to invest in another manner than through a tax-qualified savings vehicle).

This choice can profoundly affect participants' financial resources in retirement, particularly in the case of younger workers and those with large balances.[2] Consequently, to determine whether individuals are accumulating and retaining the assets they would need for financial adequacy in retirement, or whether these assets are lost to the retirement system, it is important to understand what they do with their retirement plan assets when leaving a job.

This article focuses on the decisions that workers make upon receipt of a lump-sum payment from an employment-based retirement plan: rolling the account balance over to another tax-qualified savings vehicle, spending the assets, or investing the assets in another manner. The number and amounts of lump-sum distributions are estimated, followed by a discussion of what individuals are doing with these distributions and analysis of important determinants of the decision to roll over the distribution versus using the assets for other reasons. These results are derived from recently released data from the U.S. Census Bureau—the Pension and Retirement Plan Coverage Topical Module 7 of the 2001 Survey of Income and Program Participation (SIPP)—which includes lump-sum data for individuals through 2003.[3] This research updates prior studies on lump-sum distributions done by the Employee Benefit Research Institute.[4]

Lump-Sum Distributions: An Overview

The 2001 Panel of SIPP indicates that approximately 16.0 million Americans age 21 and over reported ever having received a lump-sum distribution from a retirement plan on a previously held job through April of 2003.[5] Respondents were asked further questions about their distribution (or, if they had more than one, their most recent distribution) to better understand the uses (rollover, consumer spending, education expenses, housing purchase/improvement, starting a business, or some other investment) and size of these distributions. The size or amount of the distribution was reported in the survey as the value of it at the time of the distribution. However, since some of these distributions were taken many years ago, the distributions' relative value to current prices is not the same. Consequently, the amount of the distributions are presented both in terms of the value when the distribution was received and in 2003 dollars by adjusting the reported values by the consumer price index so that all values are in the same dollar terms.

The mean (average) amount of these distributions in 2003 dollars was $30,072, with a median of $8,118 (Figure 1). In terms of the value at the time of the distributions, the mean amount was $21,907 and the median was $6,000. For distributions taken in 1980 or after, the average and median amounts declined with time. For example, for distributions taken from 1980 to 1986, the mean distribution in 2003 dollars was $43,810, compared with $21,946 for distributions taken between 1999 and 2003. The median also declined from $13,890 to $5,380. (For the value of the distribution when taken, a similar decline occurred, as the mean distribution decreased from $22,965 to $20,848.)

The amounts of the lump-sum distributions for the most part were relatively small, with 5.7 percent of recipients reporting a distribution of less than $500 (in 2003 dollars), 5.4 percent reporting from $500 to less than $1,000, and 15.1 percent reporting from $1,000 to less than $2,500—for a total of 26.2 percent of the distributions being less than $2,500 (Figure 2). The rest of the distributions, except for the 15.2 percent that were $50,000 or more, were between $2,500 and $50,000, with those distributions being almost equally divided (at about 15 percent of the total) among the $2,500–$4,999, $5,000–$9,999, $10,000–$19,999, and $20,000–$49,999 distribution categories.

Approximately 42 percent of the lump-sum distribution recipients reported having received their most recent distribution from 1999 to 2003, whereas only 4.4 percent received their most recent distribution before 1980 (Figure 3). Furthermore, another 25.4 percent of the most recent distributions were taken from 1994 to 1998. Consequently, two-thirds of the distributions took place in the most recent 10 years of the study. As for the age at which the recipients received these most recent distributions, nearly 60 percent were between the ages of 21 and 40 (Figure 4).

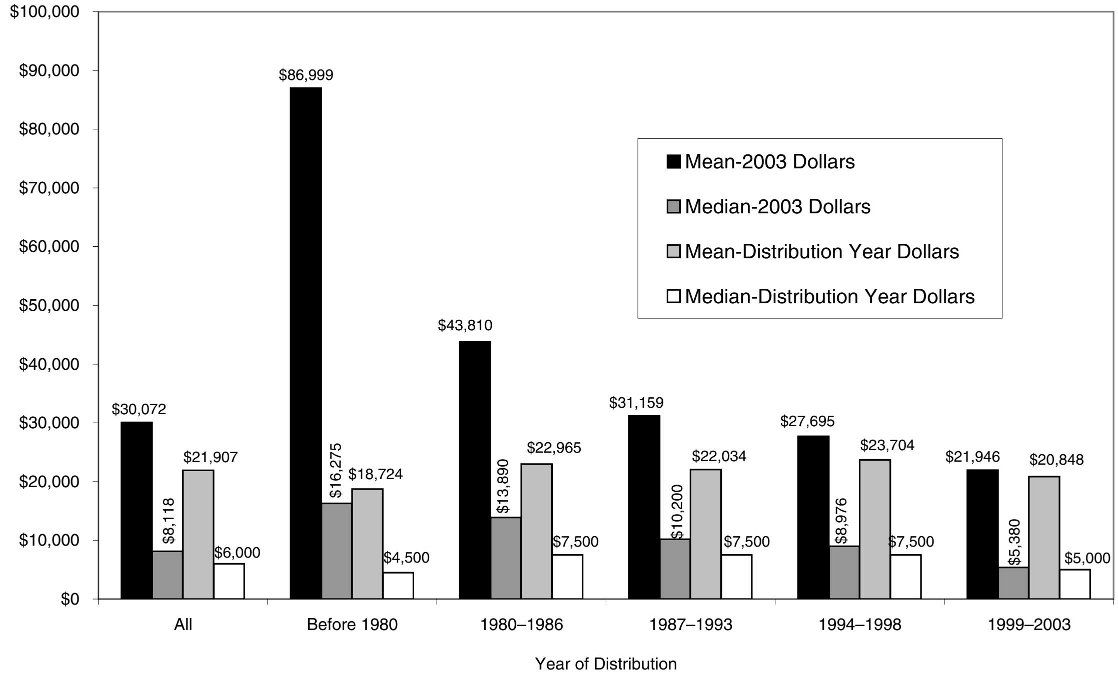
Benefit Preservation Trends

The goal of retirement saving plans such as a 401(k) plan is to provide income for individuals in their retirement. For this to happen, participants in these plans must preserve their benefits until retirement by retaining any existing plan balance on job termination. This section looks at the percentage of lump-sum recipients who roll over their assets to a tax-qualified plan (an IRA or another employment-based retirement plan), thereby preserving, at least initially, their benefits rather than cashing them out.

Among those who reported in 2003 ever having received a distribution, 46.7 percent reported rolling over at least some of their most recent distribution to tax-qualified savings,[6] and 10.0 percent reported using some portion for non-tax qualified savings[7] (Figure 5). This combination of these savings uses is

Figure 1

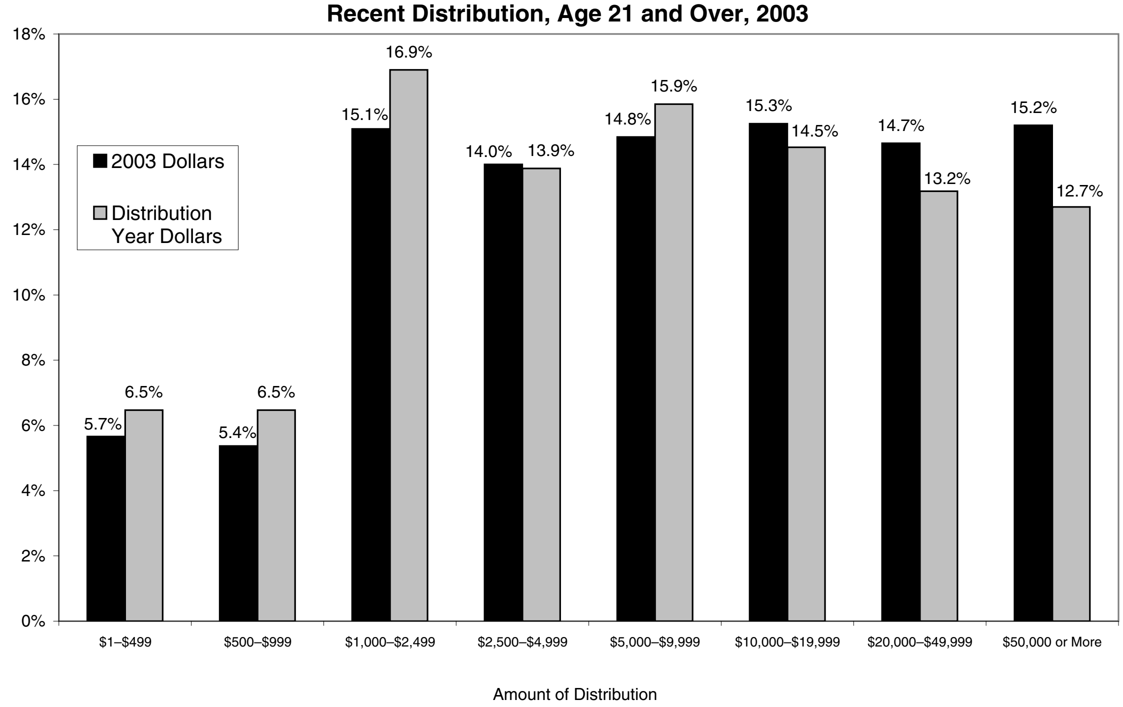
Mean and Median Amounts of Lump-Sum Distributions, by Year of Most Recent Distribution Received, Civilians Age 21 and Over, Through 2003



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

Figure 2

Proportion of Lump-Sum Recipients, by Amount of Most Recent Distribution, Age 21 and Over, 2003



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

less than what was reported for workers receiving distributions most recently through 1993, when 41.5 percent of the lump-sum recipients rolled over at least some portion of the distribution to tax-qualified savings and 17 percent used at least some portion for non-tax-qualified savings, but higher than for those receiving their most recent distributions through 1998.[8] However, among those who received their most recent distributions through 2003, the percentage who used any portion of it for consumption[9] was also lower, at 25.2 percent (compared with 38.3 percent of those whose most recent distributions were received through 1993).

The percentage of lump-sum recipients who used the entire amount of their most recent distribution for tax-qualified savings increased significantly, to 43.4 percent of those who received their most recent distribution through 2003, compared with 19.3 percent of those who received their most recent distribution through 1993 (Figure 6). Furthermore, the percentage of recipients whose most recently received distribution was entirely spent on consumption was 15.1 percent for those whose distributions were received through 2003, compared with 22.7 percent for those who received distributions through 1993.

An important factor in the change in the relative percentages between the 1993 and 2003 data is the percentage of lump sums that were used for only one purpose. Among those who received their most recent distributions through 2003, 92.9 percent of those who rolled over at least some of their most recent distribution rolled over the entire amount, whereas only 46.5 percent of those who rolled over at least some of their most recent distribution through 1993 did so.[10, 11] Therefore, while a trend toward more benefit preservation does not like look promising when analyzing the use of *any* portion of the assets, a trend for more preservation is revealed to be quite substantial on an *entire use* basis, as virtually all of those who roll over their lump sum roll over the entire amount. In contrast, the decline in the use of all of a distribution for consumption flattened out in 2003.

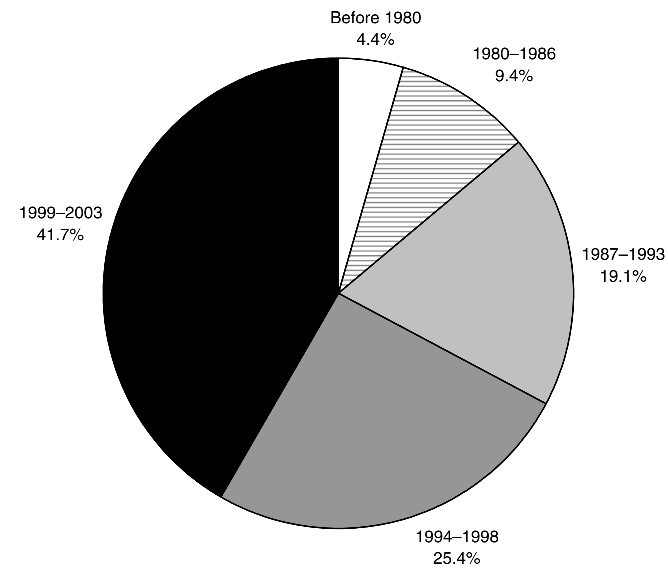
Another technique to check the trend in the percentage of workers who roll over their assets relative to cashing them out is to use the 2001 SIPP Topical Module data to examine when the most recent distributions were received within the dataset, instead of across datasets. The most recent distributions from these data are broken down into five categories: before 1980, 1980–1986, 1987–1993, 1994–1998, and 1999–2003. In this analysis, the likelihood of any of the most recent distributions being used for tax-qualified savings increased with time before declining for the most recent distributions.[12] Among workers who received their most recent distributions between 1994 and 1998, 52.3 percent used some portion for tax-qualified savings, whereas only 24.0 percent of those who received their distributions before 1980 used some portion for tax-qualified savings (Figure 7). However, only 47.2 percent of those who received a distribution from 1999 to 2003 used some portion of it for tax-qualified savings.

The percentage of recipients using any portion of their most recent lump-sum distribution for consumption followed the opposite pattern, including a decreasing trend for the most recent distributions. Among those who received distributions before 1980, 36.4 percent used some proportion for consumption, compared with only 23.4 percent of those who received distributions from 1999 to 2003 (Figure 8).

Both analysis techniques show that the percentage of lump-sum recipients using some portion of their most recent distribution for tax-qualified savings has increased over time (except for the decline for just the most recent distributions within the 2001 SIPP), while the percentage who used any portion of their distribution for consumption has significantly decreased. Consequently, the preservation of benefits appears to have improved from 1993 to 2003. Moreover, recipients who did not use the lump sum for tax-qualified savings were more likely to use it to improve their financial condition by paying off debt or buying a home rather than spending it on additional consumption.

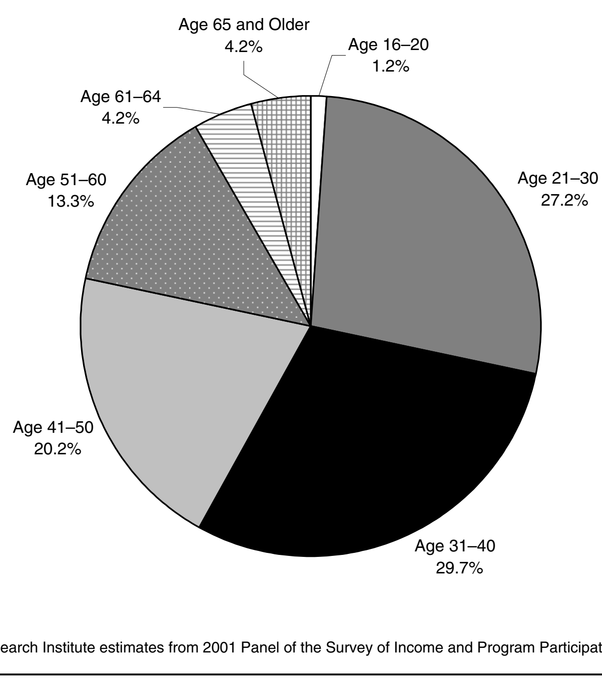
A possible major driver of the trend to roll over the entire distribution was the federal government's establishment of a 20 percent withholding tax on distributions not directly rolled over after 1993. Other reasons include better education and the likelihood that the plan was the worker's only retirement savings vehicle. However, the decrease in benefit preservation associated with the most recent distributions, which is evident in the most recent data, may be attributable to economic circumstances such as the downturn in the economy, the need to pay off debts, or the higher down payments required for home purchase in areas of the country where housing costs have increased substantially.

Figure 3
Percentage of Lump-Sum Recipients, by Year of Most Recent Distribution Received, Civilians Age 21 and Over, 1998



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

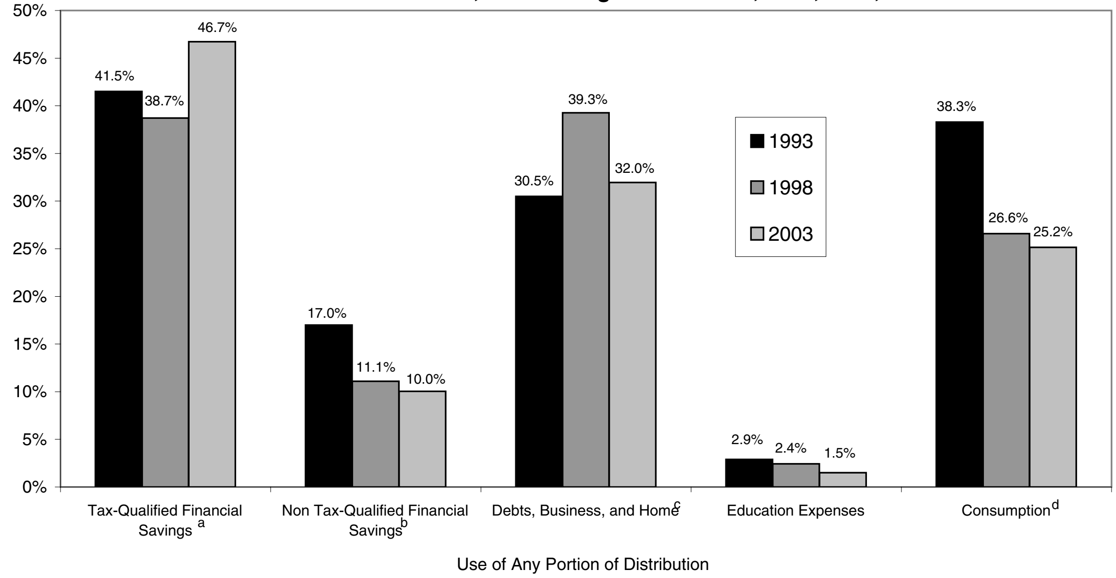
Figure 4
Proportion of the Most Recent Lump-Sum Distribution, by the Age of the Recipients, 2003



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

Figure 5

Proportion of Lump-Sum Recipients Reporting Various Uses for Any Portion of Their Most Recent Distribution, Civilians Age 21 and Over, 1993, 1998, and 2003



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7, 1996 Panel of the Survey of Income and Program Participation Topical Module 7, and April 1993 Employee Benefits Supplement to the Current Population Survey.

[a] Includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

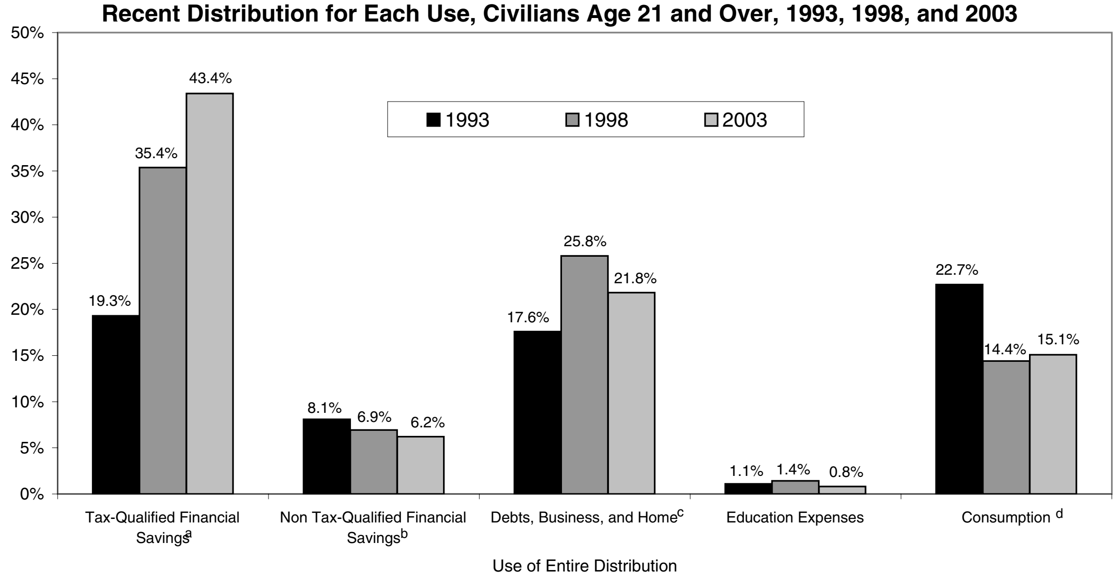
[b] Includes savings accounts, other financial investments, and other savings.

[c] Includes purchase of home, start or purchase of a business, payments toward debt, bills, loans, or mortgage.

[d] Includes purchases of consumer items (car, boat), medical and dental expenses, general everyday expenses, and other spending.

Figure 6

Proportion of Lump-Sum Recipients Reporting Using Entire Portion of Their Most Recent Distribution for Each Use, Civilians Age 21 and Over, 1993, 1998, and 2003



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7, 1996 Panel of the Survey of Income and Program Participation Topical Module 7, and April 1993 Employee Benefits Supplement to the Current Population Survey.

[a] Includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

[b] Includes savings accounts, other financial invesments, and other savings.

[c] Includes purchase of home, start or purchase of a business, payments towards debt, bills, loans, or mortgage.

[d] Includes purchase of consumer items (car, boat), medical and dental expenses, general everyday expenses, and other spending.

Determinants of Benefit Preservation

Two important factors in the use of lump-sum distributions exclusively for tax-qualified savings appear to be the age of the recipient and the size of the distribution. The likelihood of the distribution being rolled over entirely to tax-qualified savings increased with the age of the recipient at the time of receipt until age 60 before a substantial decline for older ages. Among recipients ages 51–60, 55.5 percent used their distribution entirely for tax-qualified savings, compared with 32.7 percent of recipients ages 21–30 (Figure 9).[13] Similarly, the larger the distribution, the more likely it was kept entirely in tax-qualified savings. Among recipients with distributions of $1 to $499 (in 2003 dollars), 19.9 percent used their distributions exclusively for tax-qualified savings, compared with 68.1 percent of those with distributions $50,000 or more (Figure 10).

Conclusion

Defined contribution retirement plans have the potential advantage of assets possibly experiencing real growth, instead of just nominal growth, through investment returns when individuals change jobs. This is in contrast to defined benefit plans, in which the benefits are based on the participants' years of participation and wage history at the time of job termination and remain at that relative value until the benefits commence. However, this advantage will result in increased retirement savings only if defined contribution plan participants do *not* cash out their benefits prior to retirement, and invest their account assets wisely.[14] This article assesses the likelihood that lump-sum recipients will cash out or retain benefits from employment-based retirement plans once the decision is made to take a distribution from a plan.

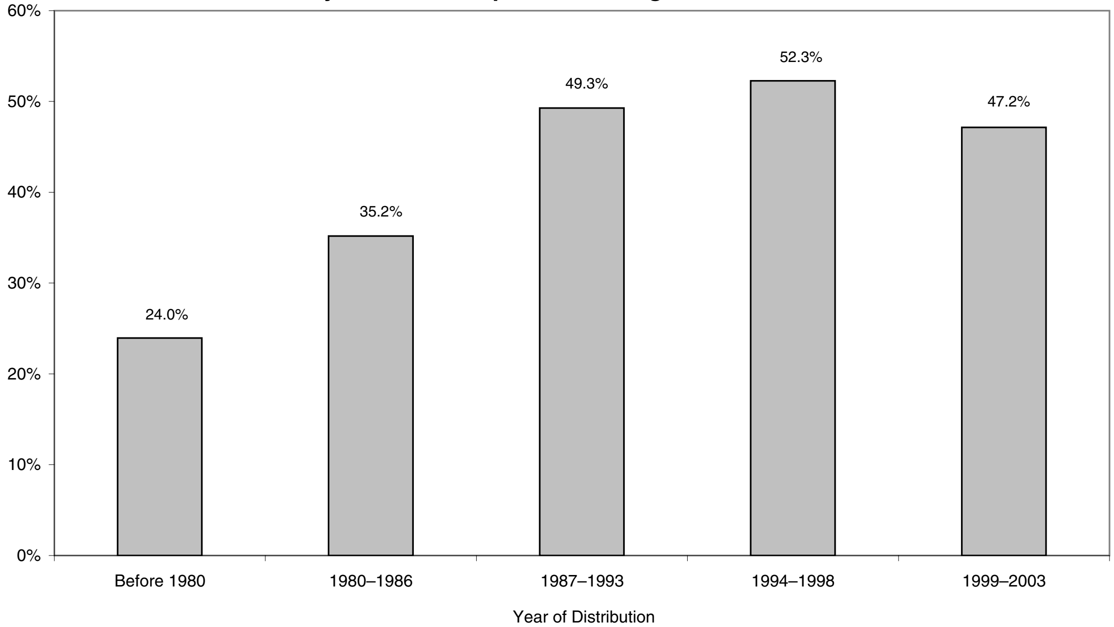
The data show that an increasing percentage of employment-based retirement plan participants are rolling over all of their lump-sum distributions and fewer are spending any of their distributions on consumption. However, the data also show that approximately 60 percent of those who took a lump-sum payment cashed out at least some of it (Figure 5), although not all of those distributions were spent on new pure consumption but instead were used for home purchases, starting a business, or paying down debts. This varied significantly across participants' age at the time of the distribution and the amount of the distribution, with older individuals and those with higher balances more likely to roll over their assets. This suggests that individuals, particularly younger ones, do not understand or care that a small amount saved can generate significant retirement assets due to compound interest. By cashing out even small amounts, younger participants are sacrificing a potentially important asset for their retirement.[15]

One possible reason that a large percentage of small balances are being cashed out is the ability of private-sector plan sponsors to require individuals to take a lump sum if their balance is less than $5,000. Consequently, many individuals with these small balances may be unaware of the tax implications and cash the check they receive from the plan sponsor after job termination. However, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) established a rollover IRA as the default option for lump-sum distributions of less than $5,000 but no less than $1,000. Thus, more individuals will have a rollover IRA established for them, which will likely lead to a larger percentage of those with small balances retaining their assets in tax-qualified savings.[16]

While EGTRRA is likely to help increase the percentage of those choosing a rollover, it will not prevent many individuals from taking the money and spending it when they leave a job, particularly those with less than $1,000 in their accounts. Therefore, to significantly reduce the number of retirement plan participants who cash out their lump-sum distributions, more education or possibly incentives are needed to make them understand the importance of retaining these assets for retirement. Taking a lump-sum distribution from a defined benefit plan, where the alternative payment method is an annuity (lifetime monthly payment), adds to the issue of not preserving benefits until retirement: The recipient explicitly foregoes the protection of this lifetime payment (and takes on the risk of running out of money in retirement), since approximately 50 percent of all individuals will live longer than their average remaining life expectancy once reaching retirement.

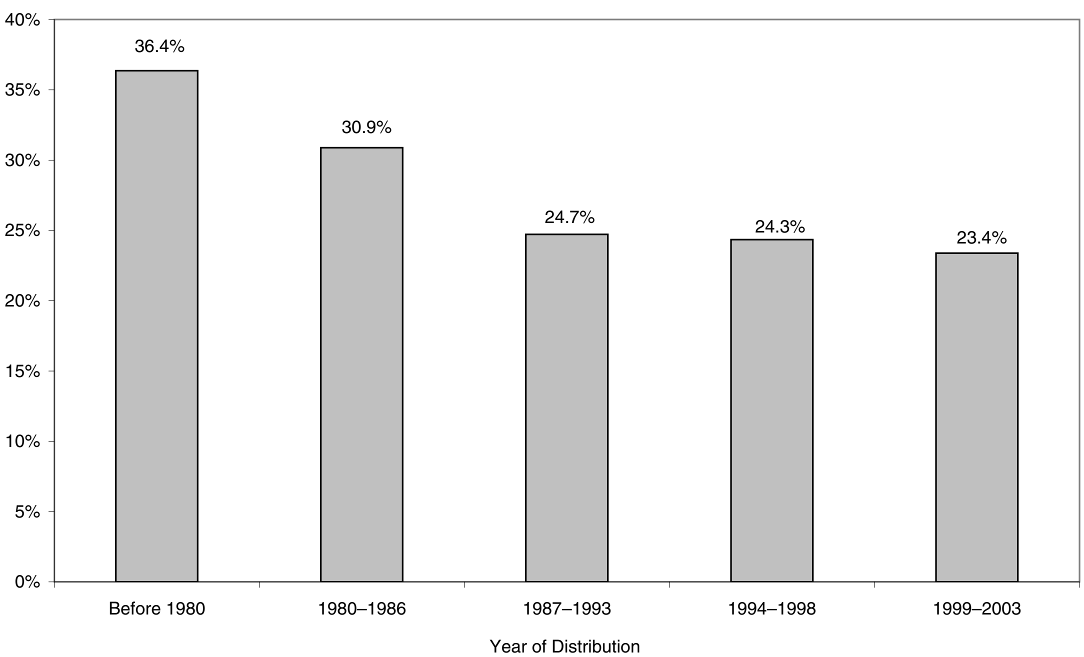
Consequently, many workers are likely to rely only on the funds that they have accumulated during their job closet to retirement (if they were eligible to participate in a plan), or Social Security alone, to provide their retirement income. This could result in the government (taxpayers) being called upon to provide retirees with retirement income protection at a time when both Social Security and Medicare are projected to be unable to fund the full level of benefits now established by law.

Figure 7
Proportion of Lump-Sum Recipients Reporting Using Any Portion of Their Most Recent Distribution for Tax-Qualified Financial Savings,[a] by Year of Receipt, Civilians Age 21 and Over



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.
[a] Includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

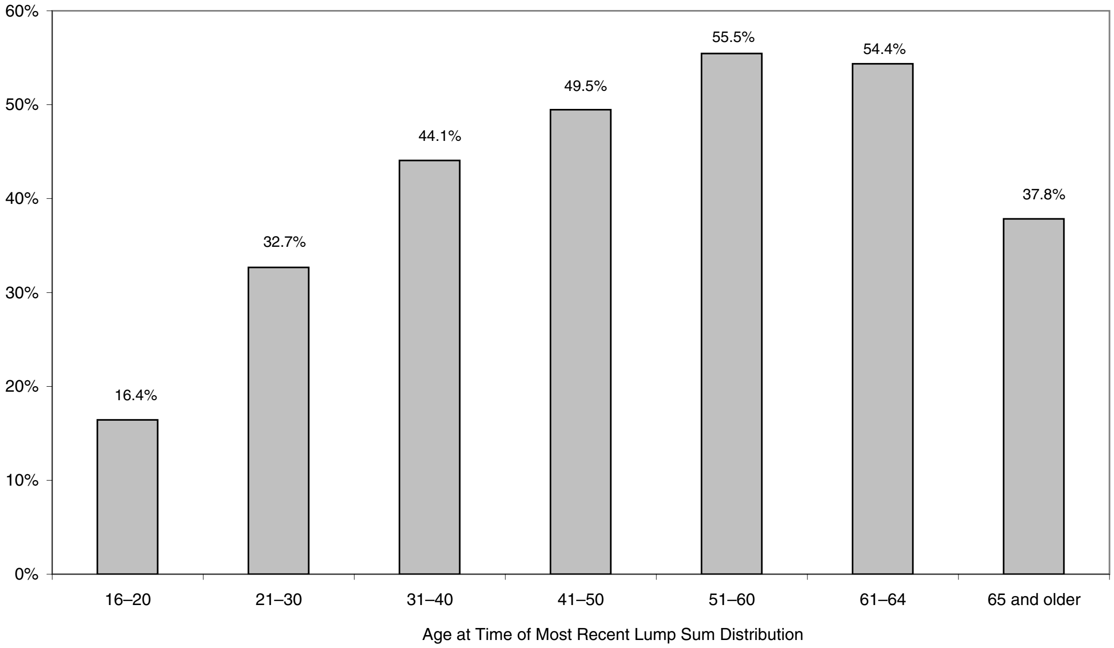
Figure 8
Proportion of Lump-Sum Recipients Reporting Using Any Portion of Their Most Recent Distribution for Consumptiona, by Year of Receipt, Civilians Age 21 and Over



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.
[a] Includes purchases of consumer items (car, boat), medical and dental expenses, general everyday expenses, and other spending.

Figure 9

Proportion of Lump-Sum Recipients Using Entire Portion of Their Most Recent Distribution for Tax-Qualified Financial Savings,[a] by Age at Time of Most Recent Distribution, Civilians Age 21

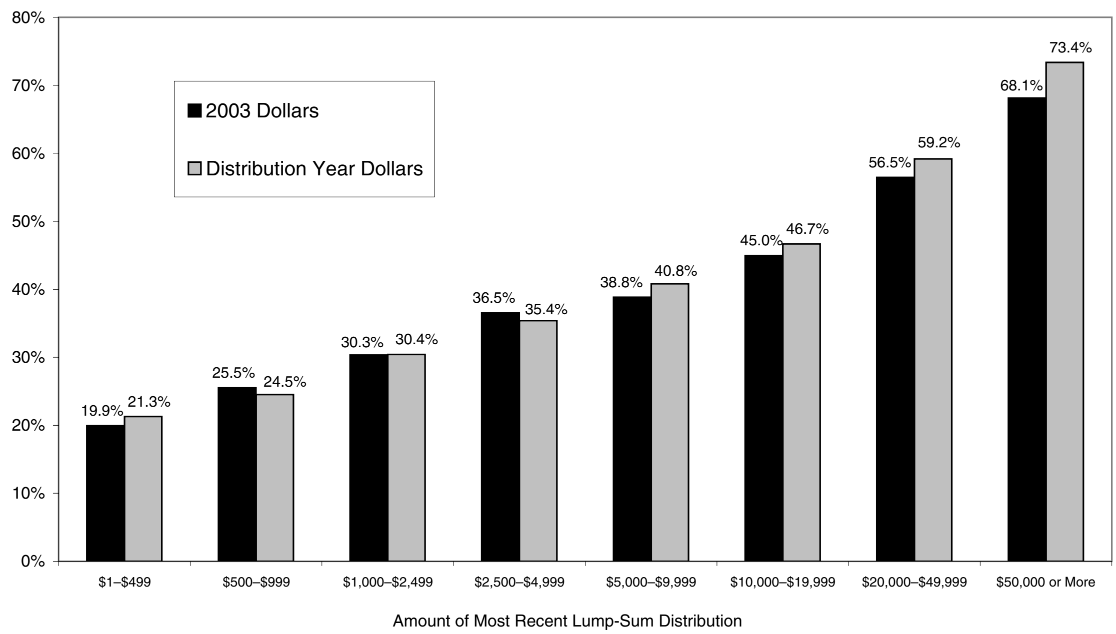


Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

[a] Includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

Figure 10

Proportion of Lump-Sum Recipients Using Entire Portion of Their Most Recent Distribution for Tax-Qualified Financial Savings,[a] by the Amount of the Most Recent Distribution, Civilians Age 21 and Over



Source: Employee Benefit Research Institute estimates from 2001 Panel of the Survey of Income and Program Participation Topical Module 7.

[a] Includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

Endnotes

[1] In Craig Copeland, "Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data," *EBRI Notes, no. 9* (Employee Benefit Research Institute, September 2005): 1–12, 57.7 percent of employment-based retirement plan participants considered a defined contribution plan to be their primary retirement plan, compared with 25.8 percent in 1988. For those participating in a defined benefit plan, lump-sum distributions are increasingly available. For example, from the U.S. Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2002–2003* (2005), www.bls.gov/ncs/ebs/sp/ebbl0020.pdf, 48 percent of full-time employees in the private sector were eligible for a lump-sum distribution in 2002, compared with 23 percent and 15 percent of full-time workers participating in a defined benefit plan in a medium or large establishment who were offered a lump-sum distribution in 1997 and 1995, respectively, found in U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments, 1997* (1999), www.bls.gov/ncs/ebs/sp/ebbl0017.pdf, and U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments, 1995* (1998), www.bls.gov/ncs/ebs/sp/ebbl0015.pdf.

[2] For example, a 25-year-old who leaves an employer after accumulating a $5,000 account balance would have approximately $24,600 at age 65, assuming a constant 4 percent rate of return compounded monthly.

[3] The 2001 Panel of the Survey of Income and Program Participation (SIPP), conducted by the U.S Census Bureau, follows the same households for a three-year period asking various questions on their economic and demographic status. The survey participants are interviewed at four-month intervals about a core set of demographic and economic issues. In addition, topical modules that ask more specific questions about important economic issues are also asked. The Retirement and Pension Plan Coverage Topical Module 7 was fielded in January–April 2003 and asked questions about workers' participation in retirement and/or pension plans in addition to the questions on lump-sum distributions.

[4] See Craig Copeland, "Lump-Sum Distributions: An Update," *EBRI Notes, no. 7* (Employee Benefit Research Institute, July 2002): 1–8 and the citations therein from both academic studies and service provider studies on lump-sum distribution decisions. Also see Craig Copeland, "Retirement Plan Participation and Features, and the Standard of Living of Americans 55 or Older," *EBRI Issue Brief*, no. 248 (Employee Benefit Research Institute, August 2002) for more results from the 1996 Panel of SIPP.

[5] This includes individuals who were participants in the plan along with any survivors of those who were in a plan.

[6] This includes investment in individual retirement accounts (IRAs), rollovers to IRAs, individual annuities, and other employment-based retirement plans.

[7] This includes savings accounts, other financial investments (e.g., stocks and bonds), and other savings.

[8] The results for the lump-sum distributions most recently received through 1993 are tabulated from the April 1993 Employment Benefits Supplement to the Current Population. See Employee Benefit Research Institute, "Employment-Based Retirement Income Benefits: Analysis of the April 1993 Current Population Survey," *EBRI Issue Brief,* no. 153 (Employee Benefit Research Institute, September 1994), for further information and results from this survey. The results for the most recent distributions through 1998 are from the 1996 Panel of the Survey of Income and Program Participation Retirement and Pension Plan Coverage Topical Module 7; see Copeland (2002), op. cit., for further results from this dataset. It is possible that some individuals could have had a lump-sum distribution both before 1993, between 1994 and 1998, and between 1999 and 2003, where the 1996 SIPP would only be asking about the distribution that occurred between 1994 and 1998 and 2001 SIPP would only be asking about the distribution that occurred between 1999 and 2003. Therefore, the change could result both because some individuals chose to do something different with their distribution the next time as well as additional individuals having a lump-sum distribution. The next section will examine only those distributions occurring most recently through 2003 or only results from the 2001 SIPP.

[9] This includes purchases of consumer items (e.g., car, boat), medical and dental expenses, general everyday expenses, and other spending.

[10] This is calculated by taking the percentage of those using the entire portion of their lump-sum distribution for tax-qualified savings and dividing it by the percentage that used at least some portion of their lump-sum distribution for tax-qualified savings for the respective year.

[11] This increase in the percentage of the entire use of the distribution being used for one purpose correlates with the introduction of the 20 percent withholding tax requirement for any lump-sum distribution from an employment-

based retirement plan not directly rolled over to another tax-qualified savings vehicle established in the 1992 Unemployment Compensation Amendments.

[12] These results are only from the 2001 SIPP concerning their most recent distribution through 2003, so there is no replacement issue similar to those in the earlier results.

[13] Starting at age 59-½, retirement plan participants can take tax penalty free account withdrawals.

[14] As mentioned above, a greater availability of lump-sum distributions under defined benefit plans mitigates this potential advantage of benefit preservation under this type of plan. Consequently, the decision to take a lump-sum distribution is pertinent to participants of both types of plans.

[15] In some cases, spending the account balance for certain purchases that could be considered as investments, such as educational expenses or home purchases, could allow for a more secure retirement than just keeping the asset.

[16] These data cannot be used to assess this impact as they are from 2003 or earlier, which is before the effective date of this rule under EGTRRA, but they do provide a benchmark for comparison when data become available.

■ New Publications and Internet Sites

Employee Benefits

Rosenbloom, Jerry S. *The Handbook of Employee Benefits: Design, Funding and Administration*. Sixth Edition. $129.95. The McGraw-Hill Companies, 1221 Avenue of the Americas, New York, NY 10020, (877) 833-5524, fax: (614) 759-3749, e-mail: pbg.ecommerce_custserv@mcgraw-hill.com, www.books.mcgraw-hill.com.

Financial Planning

Morton, H. *Financial Literacy: A Primer for Policymakers*. $20 + $7 S&H. National Conference of State Legislatures, Attn: Publications Order Desk, 7700 East First Place, Denver, CO 80230-7143, (303) 364-7812, fax: (303) 364-7800, e-mail: books@ncsl.org, www.ncsl.org/bookstore.

Health Care

Institute of Management and Administration. *What Works Now: Employer Strategies and Tactics for Controlling Health Care Costs*. $495 + $9.95 S&H. IOMA, 3 Park Ave., 30th Floor, New York, NY 10016-5902, (800) 401-5937, ext. 2, fax: (212) 564-0465, www.ioma.com/research.

Investments

Burroughs, Eugene B. *Investment Policy Guidebook for Trustees*. Fifth Edition. IFEBP members, $37; nonmembers, $53. International Foundation of Employee Benefit Plans, Publications Department, P.O. Box 68-9953, Milwaukee, WI 53268-9953, (888) 334-3327, option 4; fax: (262) 786-8780, e-mail: books@ifebp.org.

Social Security

Diamond, Peter A., and Peter R. Orszag. *Saving Social Security: A Balanced Approach*. Revised Edition. $22.95. Brookings Institution Press, Hopkins Fulfillment Service, P.O. Box 50370, Baltimore, MD 21211-4370, (800) 537-5487 or (410) 516-6956, fax: (410) 516-6998, e-mail: hfscustserv@press.jhu.edu, www.brookings.edu.

Stock Options

Rosen, Corey, John Case, and Martin Staubus. *Equity: Why Employee Ownership Is Good for Business*. $27.50. Harvard Business School Publishing, Attn: Customer Service, 60 Harvard Way, Boston, MA 02163, (800) 988-0886, fax: (617) 783-7555, e-mail: corpcustserv@hbsp.harvard.edu.

Retiree Health Benefits Sites

AARP Policy & Research
www.aarp.org/research/work/benefits/aresearch-import-883-2004-08.html

Centers for Medicare & Medicaid Services
www.rds.cms.hhs.gov/

CoverTheUninsuredWeek.org
covertheuninsuredweek.org/factsheets/display.php?FactSheetID=113

Employee Benefit Research Institute
www.ebri.org/

Employment Policy Foundation
www.epf.org/pubs/factsheets/2004/fs20041007.pdf

Kaiser Family Foundation
www.kff.org/medicare/med121404pkg.cfm

U.S. Department of Labor Employee Benefits Security Administration
www.dol.gov/ebsa/publications/retiree_health_benefits.html

Web Documents

The Automatic 401(k): A Simple Way to Strengthen Retirement Savings
www.brookings.edu/dybdocroot/views/papers/20050228_401k.pdf

Consumer-Directed Health Plan Report—Early Evidence Is Promising
www.mckinsey.com/clientservice/payorprovider/Health_Plan_Report.pdf

Containing Rising Healthcare Costs: Ten Innovative Strategies for Employers to Consider
www.haygroup.com/mediafiles/downloads/wp-Containing_Rising_Healthcare_Costs.pdf

The Cost and Characteristics of Family and Medical Leave
www.epf.org/pubs/newsletters/2005/pb20050419.pdf

Frequently Asked Questions on Association Health Plans
www.actuary.org/pdf/health/ahp_mar05.pdf

HSAs: Need Only the Healthy and Wealthy Apply?
www.cahi.org/cahi_contents/resources/pdf/n130hsa.pdf

Milliman Medical Index 2005
www.milliman.com/mmi/Milliman_Medical_Index_Final.pdf

Pension Insurance Data Book 2004
www.pbgc.gov/publications/databook/databook04.pdf

The Perils of Holding Company Stock in Sponsored Plans
www.chubb.com/businesses/csi/chubb3650.pdf

The Segal Company's 2004 Survey of Consumer-Driven Health Plans: Highlights
www.segalco.com/publications/surveysandstudies/spring05CDHP.pdf

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