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BY JACK VANDERHEI, PHD

Reviewed by James E. McWhinney

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'CARES Act: Implications for Retirement Security of American Workers'

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed in March 2020, was designed to help mitigate the economic impact of the COVID-19 pandemic by making it easier for workers to borrow from their defined contribution plan balances. Plan participants can borrow up to $100,000 (or 100 percent of the vested account balance) and have up to three years to repay the loan. "While the CARES Act provisions provide much-needed liquidity for cash-strapped workers during the current pandemic," researcher Jack VanDerhei, PhD, of the Employee Benefit Research Institute argues that encouraging workers to use their retirement savings as a short-term emergency savings vehicle provides short-term relief but has the potential to cause long-term damage to retirement security.

To evaluate "the cost of effectively using defined contribution plans as emergency savings vehicles," VanDerhei analyzed "the impact of four different scenarios on the reduction in retirement balances at age 65 as a multiple of pay:"

1. One-time withdrawal with no payback
2. One-time withdrawal with payback over three years
3. "Extra" loan with a dollar-for-dollar offset for loan payments against employee contributions
4. Withdrawal every ten years with no payback[1]

Although it should come as no surprise that borrowing from retirement savings reduces the amount of money available in the future, thereby reducing retirement security for workers, the variation in reduction based on various scenarios ranges from modest to catastrophic.

RESULTS

In scenario 1, plan participants withdraw $100,000 while continuing to make "employee contributions to their defined benefit contribution plan accounts." They do not repay the borrowed amount. Under this scenario, participants experience a 20 percent "median reduction in retirement balances as a multiple of pay." The number more than doubles to "45 percent for those 60–64." Participants "ages 25–29" experience a notably lower decline (10 percent) because "their current account balances are too small for many of them to take the full withdrawal."

Scenario 2 makes the same assumptions as scenario 1, with the exception that payback of the withdrawal is completed over a three-year timeframe. "Overall, the projected median reduction in retirement balances … is relatively small, at 2.3 percent. However, it more than doubles for older participants—5.8 percent for those 60–64." The difference can be attributed to older participants reaching age sixty-five before payback is complete.

Scenario 3 assumes the $100,000 withdrawal with every dollar used to repay the loan resulting in a one-for-one "reduction in new contributions to the defined benefit plan account." The median reduction is 5.9 percent. It is "smaller for young participants: 3.4 percent for those currently ages 25–29 vs. 8.8 percent for those 55–59 and 5.5 percent for those 60-64."

The last scenario is based on employees taking out $100,000 in 2020 and again every ten years. "Essentially, we are assuming that a crisis of some sort (e.g., the financial crisis of 2008–2009 or the current pandemic) happens every decade and that policy-makers respond each time by loosening withdrawal provisions within defined benefit plans ... In such a scenario, the median reduction is large: 54 percent." Younger people fare the worst, with a 70-percent reduction for those in the youngest quartile.

CONCLUSIONS

VanDerhei concludes, "There are limited reductions of retirement balances as a multiple of pay at age 65 in scenarios where employees pay back" the loans—even if repayment comes at the cost of reduced contributions. On the other hand, failure to pay back the loans results in "potentially significant reductions in retirement balances." The "scenario in which policymakers essentially turn defined contribution plans into de facto emergency savings vehicles" results in what the researcher describes as "the most catastrophic scenario" with "the overall median reduction in retirement balances as a multiple of pay at age 65" coming in at 54 percent.

The author notes that "analysis of potential actual utilization of CARES Act provisions" shows that "aggregate reductions were very small ... even in the scenario in which employees fail to pay back" the loans. This is attributed to "low estimated actual implementation and utilization of CARES Act provisions" which are "estimated to be less than one-half a percent." He goes on to state that additional analysis will be conducted on "the aggregate impact of CARES Act provisions on retirement income adequacy when participant-level information becomes available. This will provide crucial information for policymakers, plan sponsors, and providers as they assess ongoing approaches to helping workers navigate emergency savings needs."

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ENDNOTE

1. This scenario is admittedly ad hoc, but it was designed to provide a rough estimate of allowing this type of flexibility from regional catastrophes in recent years.

REFERENCE

VanDerhei, J. 2020. CARES Act: Implications for Retirement Security of American Workers. Employee Benefit Research Institute (July 30). https://www.ebri.org/content/cares-act-implications-for-retirement-security-of-american-workers.

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