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Pension Issues: Lump-Sum Distributions and Retirement Income Security

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Patrick J. Purcell
Specialist in Social Legislation
Domestic Social Policy Division

ABSTRACT

This report discusses the disposition of pre-retirement lump-sum distributions from pension plans and presents estimates of the potential losses in retirement wealth that can occur when these distributions are spent rather than saved. It summarizes previous research findings and presents the results of a Congressional Research Service (CRS) analysis of data from the Survey of Income and Program Participation. Policy implications are discussed in the context of the Tax Reform Act of 1986 and the Unemployment Compensation Amendments of 1992, both of which changed the tax treatment of early distributions from pensions.

Pension Issues: Lump-Sum Distributions and Retirement Income Security

Summary

About half of all workers age 25 and older participate in an employer-sponsored pension or retirement savings plan, but not all of these employees will receive a pension or retirement annuity from the jobs they now hold. Many will receive "lump-sum distributions" from their retirement plans when they change jobs. A typical 25-year-old today will work for seven or more employers before reaching age 65, and thus could receive several such distributions before reaching retirement age.

Lump-sum distributions promote "portability" of retirement assets for workers who change jobs. Portability allows workers to invest their retirement assets so that they will continue to grow until retirement. However, lump-sum distributions can result in "leakage" of retirement assets if the recipient uses some of the distribution for current consumption rather than placing it in another retirement plan. To encourage individuals to "roll over" these distributions into other retirement plans, Congress in 1986 enacted a 10% excise tax on pre-retirement pension distributions that are not rolled over. In 1992, Congress required employers to withhold 20% of distributions that are paid to recipients rather than rolled into another retirement plan.

According to data collected by the Bureau of the Census, 43.6 million workers age 25 or older were included in retirement plans in 1995 that offered lump-sum distributions as a payment option. This represents 82% of the 53.5 million workers who were covered by a pension, profit-sharing, or retirement savings plan in 1995. Approximately 13.6 million people reported that they had received at least one lump-sum distribution since 1975. Expressed in 1995 dollars, the mean value of these distributions was $13,200 and the median value was $5,500. The average recipient was between 37 and 40 years old at the time of the most recent distribution. Thus, most recipients of lump sums were more than 20 years away from retirement age.

Of those who reported that they had received at least one lump-sum distribution since 1975, 33% said that they had rolled over the *entire amount* of the most recent distribution into another retirement plan, accounting for 48% of the dollars distributed as lump sums. Another 35% of recipients said that they had saved at least *part* of the distribution in some other way. Of those who reported receiving a distribution since 1990, 39% said that they had rolled over the *entire amount* into another plan, accounting for 56% of the dollars distributed as lump-sums. Another 30% of this group said that they had saved at least *part* of the distribution.

Retirement assets lost through lump-sum distributions that are not rolled into other retirement accounts are potentially large. If a recipient of the average age in the Census sample had rolled over a distribution equal to the mean value ($10,300 in 1995 dollars) into an account that grew at the same historical rate as the New York Stock Exchange Index and at 10% in the future, it would reach $81,000 by age 65. A distribution equal to the median value ($4,200 in 1995 dollars) would grow to $32,000. If a distribution of the mean value had been rolled over into an account that paid the same rate of return as U.S. Treasury bonds, it would grow to $41,000 by the age of 65. A distribution of the median value would grow to $16,400.

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Overview: Pension Coverage and Tax Policy

In the United States, about half of all workers age 25 and older participate in an employer-sponsored pension or retirement savings plan.[1] (**Table 1**) Not all of these employees, however, will receive a pension or retirement annuity from the jobs they now hold. Some workers will not participate in their employer's retirement plan long enough to earn the right to a pension – a process called "vesting." Others will receive a "lump-sum distribution" from the plan when they retire or when they change jobs. Considering that the typical 25-year-old today will work for seven or more employers before reaching age 65,[2] most workers can expect to receive at least one such distribution before they reach retirement age. What an individual does with a lump-sum pension distribution – even a relatively small one – can have a significant impact on his or her wealth and income during retirement. Lump-sum distributions that are spent on current consumption rather than saved for retirement obviously will not be available to augment a worker's retirement income.

Today, most retirees rely on Social Security for the majority of their income. In 1998, nearly two-thirds (63%) of the program's beneficiaries received more than half of their annual income from Social Security, and Social Security was the *only* source of income for nearly one in five (18%) beneficiaries.[3] Workers whose employer sponsors a pension or retirement saving plan have the opportunity to achieve higher standards of living and greater financial independence in retirement than those who must rely on Social Security alone. To the extent that workers *spend* lump-sum distributions from employer-sponsored plans rather than *save* them, they may be undermining their future financial security.

Congress has provided incentives for workers to prepare for retirement by granting favorable tax treatment to private pensions and savings plans that meet certain requirements as to eligibility, benefits, and funding. Employers are permitted to deduct from income amounts they contribute to employee pension plans. These pension contributions are not taxed as income to participating employees until they begin receiving distributions from the plan. Employers who sponsor pensions or

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[1] This figure includes full-time and part-time workers in both the public and private sectors. Among private-sector workers ages 25 to 54 who worked year-round, full-time in 1998, 57% were included in a pension or retirement savings plan.

[2] Estimated by the Congressional Research Service, from data published by the U.S. Department of Labor.

[3] Social Security Administration, *Fast Facts and Figures about Social Security, 1998.*

retirement savings plans do so voluntarily. However, an employer who chooses to sponsor a retirement plan must comply with both the *Employee Retirement Income Security Act of 1974* (P.L. 93-406), popularly known as "ERISA," and the Internal Revenue Code. A plan that fails to meet the standards set forth in federal law may be denied the status of a "tax-qualified" plan.

The tax revenue forgone by the federal government as a result of the deductions and exclusions granted to qualified pension plans is substantial. According to the congressional Joint Committee on Taxation, the net exclusion for employer pension plan contributions and earnings will result in $416 billion in forgone tax revenue over the 5 years from FY2000 to FY2004.[4] This item has been the largest so-called "tax-expenditure" in the federal budget for many years.

Pension Portability, Asset Preservation, and Lump-Sum Distributions. Pension plans and retirement savings plans such as the popular "401(k)" promote financial security in retirement by setting aside income during employees' working years.[5] This pool of assets is invested in securities that earn interest, dividends, and capital gains. In retirement, these assets can be used to purchase an "annuity" – a lifetime stream of monthly income – or, alternatively, the retiree can spend the accumulated assets over the course of his or her retirement. Sometimes, however, pension assets are distributed before retirement. This can happen in the event that a plan is terminated or, more commonly, when a worker moves from one job to another. In such cases, the current value of the benefit that the employee has earned to date – his or her "accrued benefit" – is typically paid out in a single lump-sum distribution from the plan. In the case of a 401(k)-type plan, the distribution would be equal to the balance in the employee's account: employee contributions, earnings on those contributions, and the part of employer contributions and earnings to which the employee has earned a legal right through length of service (a process called *vesting*).[6] In the case of a traditional pension, the lump-sum would be equal to the *present value* of the employee's accrued benefit. The present value calculation *discounts* the stream of benefits that would be paid in the future to an amount that could, if invested by the recipient, pay an equivalent income at retirement.

Lump-sum distributions promote "portability" of retirement assets for workers who change jobs. Portability allows workers to invest their retirement assets so that

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[4] Pension-Related Exclusion Again Tops List of Estimated Federal Tax Expenditures. *Daily Tax Report*. Bureau of National Affairs. Washington, December 23, 1999.

[5] "401(k)" refers to the section of the Internal Revenue Code (IRC) that excludes from taxable income amounts contributed to, and earnings on, these plans. 401(k) plans are authorized for private, for-profit employers. A similar arrangement for non-profit employers is authorized by Section 403(b). (Employees of state and local governments can participate in deferred compensation arrangements authorized under IRC Section 457).

[6] ERISA allows plan sponsors to choose between two methods of vesting plan participants in their pension rights. Under "cliff" vesting, a participant is 100% vested after 5 years of participation, but has no vested rights to a benefit under the plan before that time. Under "graded" vesting, a participant is 20% vested after 3 years, 40% vested after 4 years, 60% vested after 5 years, 80% vested after 6 years, and fully vested after 7 years. Employers can, if they choose, vest participants in their accrued benefits immediately.

they will continue to grow until retirement. For workers who are leaving a retirement plan with limited investment choices, portability of retirement assets can result in more investment options for the participant. A transfer of assets from one tax-qualified retirement plan to another is referred to as a "rollover" of assets into another plan. A pre-retirement distribution that is not rolled over into another retirement plan is said to have "leaked" from the pool of retirement assets.

Lump-sum distributions can result in leakage of retirement assets if the recipient uses some of the distribution for current consumption rather than rolling over the full amount into another retirement plan. To discourage such leakage, Congress has amended the Internal Revenue Code to provide incentives for individuals to "roll over" these distributions into other retirement plans. The *Tax Reform Act of 1986* (P.L. 99-514) established a 10% excise tax – in addition to ordinary income taxes – on lump-sum distributions received before the age of 59½ that are not rolled over into an Individual Retirement Account (IRA) or another employer's tax-qualified retirement plan.[7] The *Unemployment Compensation Amendments of 1992* (P.L. 102-318) required employers who sponsor retirement plans to give departing employees the option to have lump-sum distributions directly transferred to an IRA or to another employer's plan. If the participant chooses to receive the lump-sum distribution directly, the employer is required to withhold 20%, which is to be applied to any taxes due on the distribution. If the participant does not deposit the distribution into an IRA or another tax-qualified plan within 60 days, he or she will owe both regular income taxes and the 10% excise tax on the entire amount of the distribution.[8]

Obviously, there are times when the recipient of a lump-sum distribution may face short-term expenses that are more pressing than concerns about retirement. This is especially so when the recipient is in a period of unemployment or must pay for the care of a relative who is ill or disabled. Previous research has shown that the event precipitating a lump-sum distribution (losing one's job, for example), is a key determinant of whether the distribution is rolled over into another retirement plan, saved in some other way, or spent on current consumption. Surveys of employers and employees indicate that the *availability* of lump-sum distributions has a positive effect on employee participation retirement plans. Consequently, Congress has sought to *encourage* recipients to roll over pre-retirement distributions, rather than *require* that such distributions be rolled over into an IRA or another retirement plan. Allowing lump-sum distributions but placing an excise tax on amounts that are not rolled over represents a compromise among several policy objectives: preserving assets until retirement, promoting pension participation, providing access to assets in time of need, and assuring that revenue losses do not exceed the minimum necessary to encourage employer sponsorship and employee participation.

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[7] The 10% penalty is waived if the distribution is part of a pension plan's early retirement provisions and the recipient is age 55 or older. It also is waived if the participant dies, becomes disabled, or has medical expenses that exceed 7.5% of adjusted gross income.

[8] If the distribution is not rolled over within 60 days, the 20% withheld is applied to the taxes owed on the distribution. If the distribution is rolled over within the 60-day limit, the 20% withheld is credited toward the individual's total income tax owed for the year. Note that to roll over the full amount after receiving a lump-sum distribution, the recipient must have access to other funds that are at least equal to the amount withheld.

Table 1. Participation in Employer-Sponsored Pension and Retirement Savings Plans, 1995
(*all workers age 25 and older*)

Participate in a Retirement Plan?	Yes	No	Persons (thousands)
Age			
25 to 34	43.8%	56.2%	32,990
35 to 44	53.2%	46.8%	35,050
45 to 54	56.8%	43.2%	24,870
55 or older	42.2%	57.8%	14,850
Race			
White	49.4%	50.6%	92,160
Black	54.6%	45.4%	11,350
Other	42.1%	57.9%	4,250
Gender			
Male	50.6%	49.4%	58,530
Female	48.5%	51.5%	49,220
Marital Status			
Married	51.2%	48.8%	72,490
Not Married	46.4%	53.6%	35,260
Education			
HS or less	42.7%	57.3%	48,230
Some college	50.8%	49.2%	27,270
College graduate	59.0%	41.0%	32,250
Earnings in 1995			
Under $20,000	30.8%	69.2%	46,250
$20,000-$40,000	61.2%	38.8%	40,170
More than $40,000	68.8%	31.2%	21,340
Establishment Size*			
Under 10 people	26.5%	73.5%	19,200
10 to 24 people	38.6%	61.4%	13,950
25 to 99 people	58.0%	42.0%	22,520
100 or more people	75.0%	25.0%	39,950
Total	**49.6%**	**50.4%**	**107,800**

Source: CRS analysis of the Survey of Income and Program Participation.

* Establishment size was missing on 11.8% of records representing 12.1 million workers.

Bills in the 106th Congress

Several bills introduced in the 106th Congress would speed up the vesting process through which participants become legally entitled to benefits. Some would allow penalty-free distributions from plans in the event of a merger or acquisition. Several would make it easier to roll over retirement assets from one plan to another.

H.R. 833 (Gekas), the *Bankruptcy Reform Act of 2000*, was passed by the House of Representatives on May 5, 1999. On February 2, 2000, the Senate passed H.R. 833, into which it had substituted the language of **S. 625 (Grassley)**. As passed by the Senate, H.R. 833 contains several provisions that would affect pre-retirement distributions from employer-sponsored retirement plans. The Senate-passed bill, for example, would shorten the time it takes for an employee to vest in employer matching contributions to a retirement plan, thus making larger lump-sums available to employees who depart after a relatively short period of service. It would make it easier to roll over funds among the three most common employer-sponsored retirement savings plans: 401(k) plans in the private-sector, 403(b) plans of non-profit organizations, and the 457 plans of state and local governments. It also would allow rollovers from IRAs into employment-based plans, and allow rollovers of after-tax contributions. The bill would ease restrictions on pension distributions made in the event of a merger or acquisition (the so-called "same-desk" rule). The Senate version of the Bankruptcy Act also would modify the current-law requirement that an employer must secure a departing employee's written permission to distribute as a lump sum a benefit with a present value of $5,000 or more. It would allow employers to disregard amounts that had been rolled over *into* the plan when they are determining if the employee's accrued benefit exceeds the $5,000 limit. Many of the provisions of the Senate-passed H.R. 833 are included in other bills introduced in the 106th Congress, such as **S. 8 (Daschle)**, **H.R. 1590 (Gejdenson)**, **H.R. 1213 (Neal)**, **H.R. 739 (Pomeroy)**, and **S. 1357 (Jeffords)**.[9]

H.R. 1102 (Portman), like S. 625, would make it easier for workers who change jobs to roll over retirement funds among 401(k), 403(b), and 457 plans, and would permit rollovers from IRAs into employment-based plans. It, too, would shorten the maximum vesting period and repeal the same-desk rule to allow distributions in the case of certain mergers or acquisitions. H.R.1102 also would allow employers to disregard amounts that had been rolled into the plan when determining whether the employee's accrued benefit exceeds $5,000. In addition, it would index the $5,000 limit on distributions that can be made without the employee's written consent to inflation by increasing it in $500 increments based on the cumulative year-to-year changes in the Consumer Price Index (CPI).

S. 476 (Schumer) would treat loans from retirement plans as distributions except for specific uses, such as to purchase a home, to pay medical or educational expenses, or to pay expenses while unemployed. This bill also would increase the excise tax on early withdrawals from qualified retirement plans from 10% to 100%.

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[9] For more information, see CRS Issue Brief IB10028, *Pension Plans Offered by Private Employers: Legislative Issues in the 106th Congress*, by James R. Storey.

Trends in Lump-sum Distributions

There is no single data set that combines complete and accurate information about lump-sum distributions with the economic and demographic characteristics of the recipients. Most research has relied on one or more of the following sources:

- information reported to the IRS on the Form 1040 and the Form 1099R,
- proprietary data collected by firms that provide management or consulting services to other businesses, and
- data collected through household surveys, such as the Current Population Survey (CPS), and the Health and Retirement Study (HRS).

Each of these sources has its particular strengths and weaknesses.[10] The most comprehensive – although still incomplete – picture of trends in the frequency and amount of lump-sum distributions can be constructed by examining data from all of the available sources.

Estimates of the number and size of lump-sum distributions from retirement plans vary, in some cases by quite a lot. By any measure, however, both the number of lump-sum distributions and the amount of money distributed are large. According to a recent analysis of data reported to the Internal Revenue Service, 10 million tax-filers reported receiving a lump-sum distribution in 1995, and 5.6 million of these represented full distributions in which a retirement account was liquidated.[11] The total sum distributed amounted to $131 billion, of which $87 billion represented full distributions from liquidated accounts. Pension distributions of *all* kinds in 1995 totaled $328 billion. Lump-sum distributions, therefore, comprised between 26% and 40% of all pension distributions, depending on whether one considers only full distributions or includes partial distributions as well. Of the $131 billion in lump-sum distributions in 1995, approximately $91 billion (70% of the total) were rolled over into IRAs or other tax-deferred retirement plans.

The average amount of a full distribution reported to the IRS in 1995 was $15,600. The average amount of full and partial distributions together was $13,100. These averages are somewhat misleading, however, because they represent the *arithmetic means* of the distributions, which are biased upward by a small number of large distributions. A better measure of the "typical" lump-sum distribution is the *median*, which is found by ordering the individual amounts from largest to smallest and then locating the one at the mid-point. The median lump-sum distribution in 1995 was $2,300. In other words, half of all distributions were amounts less than $2,300 and half were amounts of $2,300 or more.

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[10] For a more detailed description of each source, see the Appendix to this report.

[11] John Sabelhaus and David Weiner. Disposition of Lump-Sum Pension Distributions: Evidence from Tax Returns. *National Tax Journal*, v. 52, no. 3, September 1999.

How Many Workers Are Eligible for Lump-Sum Distributions?

Many employers pay departing employees their accrued pension benefits as a lump-sum, rather than requiring them to wait until reaching the plan's normal retirement age to claim their benefits. Consequently, many workers receive lump-sum distributions long before reaching retirement age. Federal law requires the plan sponsor to secure the employee's written consent before making a lump-sum distribution of $5,000 or more. An accrued benefit of less than $5,000 can be paid as a lump-sum without asking for the employee's permission.[12] Congress allows employers to "cash out" these relatively small pension benefits for departing employees to relieve them of the administrative expenses they would otherwise incur to maintain records for former employees who had earned only a small pension benefit. In the case of defined benefit plans, cashing out the benefit also relieves the sponsor of the obligation to pay monthly premiums to the Pension Benefit Guaranty Corporation (PBGC). Because PBGC premiums are assessed on a per capita basis, they are disproportionately large for those whose accrued benefit is relatively small.[13]

Between October 1995 and January 1996, participants in the *Survey of Income and Program Participation* (SIPP), conducted by the Bureau of the Census, were asked a series of questions on retirement expectations and pension plan coverage. According to this survey, 43.6 million workers age 25 or older were included in retirement plans that offered a lump-sum distribution as a payment option. (**Table 2**) This represents 81.5% of the 53.5 million full-time and part-time workers who were covered by a pension, profit-sharing, or retirement savings plan in 1995.[14]

The number of firms that offer a lump-sum payment option is almost certain to have increased recently as a result of the conversion of several hundred large defined benefit pension plans to "cash balance plans." These are hybrid pensions that have some of the characteristics of defined contribution plans – most significantly in that a participant's accrued benefit is reported as an "account balance" – while still being funded on a group basis, and considered to be defined benefit plans under the Internal Revenue Code. Virtually all cash balance plans offer a lump-sum distribution option to departing employees who are vested in their benefits.[15]

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[12] The $5,000 limit was established by the *Taxpayer Relief Act of 1997* (P.L. 105-34). The amount had been set at $3,500 by *Retirement Equity Act of 1984*. It was originally established at $1,750 by ERISA in 1974.

[13] Cashing Out Terminated Participants' Vested Benefits Simplifies Plan Administration, Reduces PBGC Premiums. *Spencer's Research Reports.* Charles D. Spencer and Associates, Inc. Chicago, IL. October 3, 1997.

[14] CRS classified plans as offering a lump-sum payment option if the employee reported that such an option was available or if the plan was a defined contribution plan such as a 401(k). Among 41.8 million employees who had *vested* in their retirement benefits, 34.3 million (82.0%) reported that their retirement plan offered a lump-sum distribution option.

[15] Portable Accounts Reward Productivity of Mobile Workers, *Business Insurance*, May 17, 1999; Many Mobile Workers Fail to Reap Promise of New-Style Pensions, *The Wall Street Journal*, December 16, 1999; Cash Balance Conversions, *Journal of Accountancy*, v 189, no. 2, February 2000.

Table 2. Percentage of Workers Covered By Retirement Plans that Offered a Lump-Sum Payment Option in 1995
(*workers 25 and older who participate in an employer-sponsored retirement plan*)

Does plan have a lump-sum option?	Yes	No	Persons (thousands)
Age			
25 to 34	85.4%	14.6%	14,460
35 to 44	82.2%	17.8%	18,650
45 to 54	79.5%	20.5%	14,120
55 or older	74.7%	25.3%	6,270
Race			
White	82.3%	17.7%	45,500
Black	74.7%	25.3%	6,190
Other	84.1%	15.9%	1,790
Gender			
Male	81.0%	19.0%	29,600
Female	82.1%	17.9%	23,890
Marital Status			
Married	81.4%	18.6%	37,120
Not Married	81.7%	18.3%	16,370
Education			
HS or less	79.1%	20.9%	20,610
Some college	80.6%	19.4%	13,850
College graduate	84.7%	15.3%	19,030
Earnings in 1995			
Under $20,000	79.4%	20.6%	14,240
$20,000-$40,000	80.6%	19.4%	24,570
More than $40,000	84.9%	15.1%	14,680
Establishment Size			
Under 10 people	20.8%	79.2%	5,090
10 to 24 people	13.0%	87.0%	5,390
25 to 99 people	16.7%	83.3%	13,050
100 or more people	80.1%	19.9%	29,960
Total	**81.5%**	**18.5%**	**53,490**

Source: CRS analysis of the Survey of Income and Program Participation.

How Many People Have Received Lump-Sum Distributions?

Among individuals age 25 or older who responded to the SIPP questions on pension coverage, 8.2% reported that they had received one or more lump-sum distributions at age 25 or older since 1975.[16] (**Table 4**) This represents approximately 13.6 million people who received at least one lump-sum distribution during that time. Expressed in 1995 dollars, the average (mean) value of these distributions was $13,200.[17] (**Table 3**) As was noted earlier, however, the mean value of lump-sum distributions is skewed upward by a few large distributions. The "typical" distribution is more accurately portrayed by the median, which adjusted to1995 dollars, was $5,500. The average recipient was between the ages of 37 and 40 at the time of the most recently received lump-sum distribution. Thus, most people who received these distributions were more than 20 years away from retirement age.

Table 3. Characteristics of Individuals Who Reported Receiving One or More Lump-Sum Distributions since 1975

Recipient age and amount of distribution:	Mean	Median
All recipients of lump-sum distributions:		
Age when lump sum received	40	37
Amount of lump-sum distribution (in 1995 $)	$13,200	$5,500
Recipients who rolled over full amount:		
Age when lump sum received	42	39
Amount of lump-sum distribution (in 1995 $)	$19,200	$10,200
Recipients who did not roll over full amount:		
Age when lump sum received	40	36
Amount of lump-sum distribution (in 1995 $)	$10,300	$4,200

Source: CRS analysis of the Survey of Income and Program Participation.

[16] CRS restricted the sample to lump-sum distributions that had occurred since 1975 to reduce the number of cases where difficulty in recalling long-past events was most likely to be a problem. (Also, prior to 1975 there were no IRAs). We limited the sample to those who had received a distribution at age 25 or later to exclude those who were least likely to have given much thought to saving for retirement.

[17] CRS adjusted the dollar amount of all lump-sum distributions reported on the SIPP to constant 1995 dollars, based on the Personal Consumption Expenditure Index of the National Income and Product Accounts (NIPA).

Table 4. Percentage of Workers Who Have Received at Least One Lump-Sum Distribution from a Retirement Plan since 1975
(*all workers age 25 and older*)

Ever Received a Lump-Sum Distribution?	Yes	No	Persons (thousands)
Age			
25 to 34	5.2%	94.8%	32,990
35 to 44	11.9%	88.1%	35,050
45 to 54	11.9%	88.1%	24,870
55 or older	10.1%	89.9%	14,850
Race			
White	10.2%	89.8%	92,160
Black	6.2%	93.8%	11,350
Other	7.2%	92.8%	4,250
Gender			
Male	9.3%	90.7%	58,530
Female	10.0%	90.0%	49,220
Marital Status			
Married	10.1%	89.9%	72,490
Not Married	8.6%	91.4%	35,260
Education			
HS or less	7.0%	93.0%	48,230
Some college	9.3%	90.7%	27,270
College graduate	13.8%	86.2%	32,250
Earnings in 1995			
Under $20,000	7.7%	92.3%	46,250
$20,000-$40,000	10.2%	89.8%	40,170
More than $40,000	12.8%	87.2%	21,340
Establishment Size*			
Under 10 people	9.1%	90.9%	19,200
10 to 24 people	10.4%	89.6%	13,950
25 to 99 people	9.7%	90.3%	22,520
100 or more people	10.3%	89.7%	39,950
Total	**9.6%**	**90.4%**	**107,800**

Source: CRS analysis of the Survey of Income and Program Participation.

* Establishment size was missing on 11.8% of records representing 12.1 million workers.

How Did Recipients Use Their Lump-Sum Distributions?

Research into lump-sum distributions has consistently found that the majority of *distributions* are *not* rolled over into other qualified retirement savings plans, but that the majority of *dollars are* rolled over. In other words, small distributions are less likely to be rolled over, but large distributions – which account for most of the money distributed – are more likely to be rolled over. Researchers also have found however, that most recipients of lump-sums have saved at least *part* of the distribution, even if none of the money was rolled into another retirement plan.

Of those who reported on the SIPP that they had received at least one lump-sum distribution since 1975, one-third (32.8%) said that they had rolled over the entire amount of the most recent distribution into another tax-qualified plan, such as an IRA.[18] (**Table 5**) These transactions accounted for 47.6% of the dollars distributed as lump sums. (Not shown in table.) Of those who reported receiving a distribution in 1990 or later, 38.9% said that they had rolled over the entire amount into another plan. Among this group, the amount rolled over accounted for 55.8% of the dollars distributed as lump-sums.

Rolling over a lump-sum distribution into another tax-qualified retirement plan is the most efficient way to preserve these assets for retirement, because direct rollovers are not subject to taxes, tax penalties, or employer withholding. Nevertheless, it is not the *only* way to save a lump-sum distribution. Participants in the SIPP who reported that they had neither rolled over the entire amount of a lump-sum distribution nor left it in their previous employer's plan were asked what they did with the money. Eleven options were listed, and respondents could indicate more than one if they used the money for more than one purpose. (Survey participants were asked only *how* they used the money, not *how much* was used for each purpose). Four of the categories listed – purchasing a home/paying off a mortgage, putting it into a savings account, investing in stocks or other assets, and starting or purchasing a business – fit the standard economic definition of "saving" in that they lead to (or are expected to lead to) an increase in a household's net worth.[19]

Among those who reported that they had received a lump-sum distribution since 1975, 67.3% said that they had saved at least *some* of the most recent distribution. (**Table 6**) In addition to the 32.8% who had rolled over the entire amount into another tax-retirement plan, another 34.5% had saved at least part of the distribution in one of the four other ways listed above. Of those who had received their most recent lump-sum distribution since 1990, 69.1% said that they had saved at least part of the distribution. Among this group, 38.9% rolled over the entire amount into another plan, and 30.2% saved at least part of the distribution in some other way.

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[18] Employees who are vested in their retirement benefits and leave them with their former employer when they change jobs can claim their benefits when they reach retirement age. The SIPP includes those who left their accrued benefits in the previous employer's retirement plan with those who rolled over their retirement funds into another plan.

[19] The other categories listed on the survey are: used for children's education; used for a period of unemployment; paid loans or bills or spent on other items; bought a car or boat; paid medical or dental expenses; used for general everyday expenses; and other.

Table 5. Percentage of Lump-Sum Distribution Recipients Who Rolled Over the Entire Amount into Another Retirement Plan
(*all recipients of lump-sum distributions, age 25 or older*)

Was the entire lump sum rolled over?	Yes	No	Persons (thousands)
Age When Received			
25 to 34	27.1%	72.9%	5,759
35 to 44	36.1%	63.9%	3,764
45 to 54	41.8%	58.2%	1,933
55 or older	34.3%	65.7%	2,185
Race			
White	34.1%	65.9%	12,420
Black	12.7%	87.3%	846
Other	36.1%	63.9%	376
Gender			
Male	36.5%	63.5%	6,633
Female	29.4%	70.6%	7,007
Marital Status			
Married	34.7%	65.3%	9,625
Not married	28.5%	71.5%	4,015
Children Present			
No Children	34.4%	65.6%	8,194
One child or more	30.5%	69.5%	5,446
Education			
HS or less	28.1%	71.9%	5,101
Some college	27.7%	72.3%	3,226
College graduate	40.5%	59.5%	5,313
Home ownership			
Home owner	35.9%	64.1%	10,430
Not a home owner	22.8%	77.2%	3,210
Earnings in 1995			
Under $20,000	27.6%	72.4%	6,827
$20,000-$40,000	30.9%	69.1%	4,090
More than $40,000	49.0%	51.0%	2,723
Amount of LSD*			
Less than $3,500	21.7%	78.3%	5,498
$3,500 to $9,999	30.6%	69.4%	3,538
$10,000 to $19,999	46.8%	53.2%	2,000
$20,000 or more	48.8%	51.2%	2,604
Total	**32.8%**	**67.2%**	**13,640**

Source: CRS analysis of the Survey of Income and Program Participation.

* Amount of the lump-sum distribution, adjusted to 1995 dollars.

Table 6. Percentage of Lump-Sum Distribution Recipients Who Saved All or Part of the Distribution

(*all recipients of lump-sum distributions, age 25 and older*)

Was any part of the distribution saved?	Yes	No	Persons (thousands)
Age When Received			
25 to 34	60.2%	39.8%	5,759
35 to 44	65.3%	34.7%	3,764
45 to 54	74.0%	26.0%	1,933
55 or older	84.0%	16.0%	2,185
Race			
White	69.3%	30.7%	12,420
Black	34.3%	65.7%	846
Other	78.5%	21.5%	376
Gender			
Male	70.5%	29.5%	6,633
Female	64.4%	35.6%	7,007
Marital Status			
Married	70.1%	29.9%	9,625
Not married	60.9%	39.1%	4,015
Children Present			
No Children	69.7%	30.3%	8,194
One child or more	63.9%	36.1%	5,446
Education			
HS or less	65.4%	34.6%	5,101
Some college	61.5%	38.5%	3,226
College graduate	72.8%	27.2%	5,313
Home ownership			
Home owner	72.7%	27.3%	10,430
Not a home owner	50.0%	50.0%	3,210
Earnings in 1995			
Under $20,000	68.6%	31.4%	6,827
$20,000-$40,000	59.2%	40.8%	4,090
More than $40,000	76.6%	23.4%	2,723
Amount of LSD*			
Less than $3,500	56.2%	43.8%	5,498
$3,500 to $9,999	68.8%	31.2%	3,538
$10,000 to $19,999	77.0%	23.0%	2,000
$20,000 or more	81.8%	18.2%	2,604
Total	**67.4%**	**32.6%**	**13,640**

Source: CRS analysis of the Survey of Income and Program Participation.

* Amount of the lump-sum distribution, adjusted to 1995 dollars.

How Much Retirement Wealth Was Lost from Lump-Sums that Were Spent Rather than Saved?

Much of the money distributed from pension plans as lump-sum distributions is received by workers who are moving from one job to another and are many years from retirement. According to tax data analyzed by Sabelhaus and Weiner (1999), of $131 billion paid out as lump-sum distributions from pension plans in 1995, 44% – approximately $57 billion – was distributed to persons under age 55. An estimated 21% of the total ($27 billion) was distributed to people under age 45.

Research into lump-sum distributions has consistently found that up to about age 55, older workers are more likely than their younger colleagues to roll over a lump-sum distribution of any given size into an IRA or other retirement plan.[20] For example, according to the SIPP, among workers who received a distribution between the ages of 25 and 34, only 27% rolled over the entire amount into an IRA or other retirement plan. Of those who received a distribution between the ages of 45 and 54, 42% rolled over the entire amount. Younger workers, however, are more likely to receive relatively small lump-sum distributions because they generally have fewer years of service and have lower annual earnings than older workers. Tax data for 1995 show that the average (mean) lump-sum received by individuals of all ages that year was $13,100. The average distribution received by those under age 35 was approximately $4,000, while the average distribution received by individuals ages 45 to 54 was $15,750.

Among participants in the SIPP who had received at least one lump-sum distribution, the average (mean) value of the most recent distribution (adjusted to 1995 dollars) was $13,200. Average values differed sharply for amounts that were rolled over versus those that were not. Among recipients who had rolled over the entire amount, the average distribution was $19,160. Those who had not rolled over the entire distribution received lump-sums worth only about half as much, with a mean value of $10,300.

Although younger workers often receive relatively small lump-sum distributions, substantial amounts of retirement wealth can be lost by spending rather than saving even a small sum, especially in the case of workers who are many years from retirement. To gauge the size of the potential loss in retirement wealth among people who reported on the SIPP that they *had not* rolled over their most recent lump-sum distribution, CRS calculated the amounts that these individuals *could have* accumulated if they had rolled over their entire lump sums into other retirement plans. For each individual who had not rolled over the most recent lump-sum distribution, CRS calculated the amount that would have been accumulated by 1995 (the date of the survey) if the entire lump-sum had been rolled over in the year it was received. The estimated value that the lump sum would have reached in 1995 was based on three possible rates of return:

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[20] Because some workers can take early retirement at age 55, a significant proportion of lump-sum distributions received at this age or older are used for everyday expenses. According to information reported on the SIPP, the likelihood of rolling over a lump-sum distribution falls from 47% for workers ages 50-54 to 33% for workers ages 55 to 59.

- the annual interest rate paid by 3-month U.S. Treasury bills in each year since the year the distribution was received;
- the annual interest rate paid by 30- year U.S. Treasury bonds in each year since the year the distribution was received; and
- the annual percentage change in the New York Stock Exchange (NYSE) index in each year since the year the distribution was received.

In each case, CRS multiplied the nominal value of the recipient's most recent lump-sum distribution by the change in the appropriate index in every year between the year of the distribution and 1995.

If all of the respondents who reported on the SIPP that they had not rolled over their most recent lump-sum distribution would have instead rolled over the full amount into a fund that earned an interest rate equal to that paid by 3-month U.S. Treasury bills, the distributions would have attained a mean value of $12,400 by 1995. If all of the distributions had been rolled over into retirement plans that earned the rate of interest paid by 30-year U.S. Treasury bonds, they would have had a mean value of $15,200 by 1995. If the lump-sums had been rolled over into investments that grew at a rate equal to the annual percentage change in NYSE index, the distributions would have had a mean value of $16,000 by 1995.[21]

As noted earlier, the *mean* value of lump-sum distributions is skewed upward by the effects of a relatively small number of very large distributions. Consequently, the "typical" distribution is more accurately portrayed by the *median*. If all of the distributions that had not been rolled over into another retirement plan had instead been rolled into a retirement account that earned the rate of return paid by 3-month U.S. Treasury bills, the median lump sum would have been worth $5,200 by 1995. If they had been rolled over into retirement plans that earned the rate paid by 30-year U.S. Treasury bonds, they would had a median value of $6,200 by 1995. If invested in stocks that matched the rate of growth achieved by the NYSE index, the lump sums would have grown to a median value of $6,300 by 1995.

What Would these Amounts have been Worth at Retirement?

If we consider age 65 to be retirement age, the typical SIPP respondent who had received a distribution but did not roll it over into another retirement account was from 25 to 29 years away from retirement in the year that he or she received the

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[21] To readers who are familiar with recent stock market returns, the differences among the three values shown here might appear surprisingly small. Recent rates of return in equity markets, however, have been unusually high. For the 5 years from 1995 though 1999, the NYSE index rose by an average rate of 21% per year, while 30-year Treasury bonds paid an average annual return of 6.4%. Over the 25-year period from 1975 through 1999, the NYSE index rose at an average rate of 11.4%, while T-bonds paid an average rate of 8.7%. Total rates of return on equities – including reinvestment of dividends – were higher than the rates of increase in the NYSE index shown here, which reflect only price changes.

distribution.[22] Their *mean* age in the year that they received their distributions was 39.7. Their *median* age in the year of the distribution was 36. In 1995, the mean age of these individuals was 47.8 and their median age was 45.

As noted above, the mean value of the lump-sum distributions that were not rolled over would have reached $16,000 by 1995 if they had been invested in a broad-based stock market index fund. Assuming an average annual rate of return in the stock market of 10%, a 48-year-old who invests $16,000 for17 years would have a total of $81,000 by age 65. This would be enough to purchase a life-long annuity that would provide income of $650 per month.[23] The median value of lump-sums that were not rolled over would have reached $6,300 by 1995 if these distributions had been invested in stocks. If this amount were invested by a 48-year-old at 10.0% until age 65, it would grow to $32,000, enough to provide a monthly annuity of $260.

If the lump sums that were not rolled over had been rolled into an account paying the same rate of return as 30-year Treasury bonds, they would have reached a mean balance of $15,200 in 1995 and a median value of $6,100. Assuming that $15,200 was invested at age 48 at an average rate of return of 6.0%, it would grow to $41,000 by age 65. This would be sufficient capital to purchase a lifetime annuity that would provide a monthly income of $330. A lump sum of $6,100 invested at 6.0% at age 48 and left untouched until age 65 would grow to $16,400. This amount could purchase a lifetime annuity providing a monthly income of $130.

What Factors Influence the Rollover Decision?

Older recipients and those who receive larger-than-average lump sums are relatively more likely to roll over their distributions into an IRA or other tax-qualified retirement plan. In other words, both the recipient's age and the amount of the distribution are *positively correlated* with the probability that a lump-sum distribution will be rolled over into another retirement plan. Simple descriptive statistics such as these, however, can be misleading because they show the relationship between only two variables; for example, between *age* and the likelihood of a rollover, or between the *amount of the distribution* and the likelihood of a rollover. In fact, there are *many* variables that simultaneously affect the rollover decision, and some of them have strong interaction effects on each other. In other words, the decision to roll over a lump-sum or to spend it is affected *not just* by the recipient's age, and *not just* by the size of the distribution, but by both of these factors, and by many others. This decision, like all economic choices, is made in the context of numerous considerations.

To study the relationship between the rollover decision and a set of variables suggested by both economic theory and previous research, CRS developed a regression model based on the data reported on the SIPP. The *dependent*, or response, variable in the model could have two possible values: 1 (true) if the entire lump-sum distribution was rolled over into another retirement plan, and 2 (false) if any

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[22] In fact , over half of retired workers who began receiving Social Security in 1998 (57.8%) elected to receive benefits at age 62. Three-fourths (75.8%) elected benefits before age 65.

[23] Annuity estimates are based on a level, single-life annuity purchased at age 65 at 6.375%.

of the distribution was used for any other purpose. The *independent* variables included the first specification of the model were the individual's age, race, sex, level of education, marital status, presence of one or more children in the family, home ownership, current employment status, monthly earnings, monthly interest income, and the amount of the lump-sum distribution. The recipient's sex, marital status, current employment status, and monthly interest income proved not to be statistically significant and were dropped from the final specification of the model.

The *Tax Reform Act of 1986* placed a 10% excise tax on pension distributions received before age 59½ that are not rolled over into another retirement plan. To test for the effects of this change in tax treatment, we included in the model an indicator for whether the distribution occurred after 1986. Results of this model are shown in **Table 7**. The *Unemployment Compensation Amendments of 1992* required employers to offer a direct rollover option to departing employees and to withhold for income taxes 20% of distributions paid directly to recipients. To test for the effects of these amendments, we ran another version of the model in which we restricted the sample to lump-sums received after 1986 and included an indicator for distributions received after 1992. Results of this model are shown in **Table 8**.

Interpreting the Regression Results

We used a logistic regression or "logit" for our analysis. This is a form of multivariate regression that was developed to study relationships in which the *dependent* (response) variable can have only a limited number of values, such as yes (true) or no (false). In this model, the dependent variable indicates whether a lump-sum distribution was rolled over into another retirement account (1 = yes; 2 = no). The model measures the likelihood of observing the dependent variable having a value of 1 ("yes") when a particular independent variable is changed, given that *every other* independent variable is held constant at its *mean value*. The model estimates a coefficient (also called a *parameter estimate*) for each independent variable and calculates the *standard error* of the estimate. The standard error measures how widely the coefficients are likely to vary from one observation to another. In general, the greater the absolute value of the parameter estimate, the more likely it is to be *statistically significant*. Statistical significance is expressed in *confidence intervals* that are measured as the .10 level, .05 level and .01 level. If a variable is significant at the .05 confidence level, for example, there is only a one-in-twenty chance that it is *not* related to the dependent variable in the way that the model has predicted.

The model also generates for each independent variable a statistic called the *odds ratio*. The odds ratio is a measure of how much more (or less) likely it is for a specific outcome to be observed when a particular independent variable is "true" (*x=1*) than it is when that independent variable is "false" (*x=0*). For example, in this model, home ownership is measured as having a value of 1 if the recipient of a lump-sum distribution was a homeowner and 0 otherwise. In **Table 7**, this variable is shown as having an odds ratio of 1.695. This means that the dependent variable is 70% more likely to have a value of 1 (rollover = yes) when the dependent variable **own home** has a value of 1 (yes) as when it has a value of 0 (no). In other words, *other things being equal* (and measured at their mean values), recipients of lump-sum distributions who owned or were buying their homes were about twice as likely as renters to have rolled over the entire lump sum into another retirement plan.

As had been true of previous studies based on other sources of data, our analysis of data from the SIPP found that the variable with the strongest relationship to the likelihood that a lump-sum distribution was rolled over was the ***amount of the distribution***. In the regression model, lump-sum distributions were divided into four size categories: less than $3,500; $3,500 to $9,999; $10,000 to $19,999; and $20,000 or more.[24] All amounts were adjusted to 1995 dollars. Relative to distributions of less than $3,500, the probability that a distribution was rolled over was positive and statistically significant for all larger amounts. Lump sums of $3,500 to $9,999 were 59% more likely to be rolled over than lump sums of less than this amount. Lump-sum distributions of $10,000 to $19,999 and of $20,000 or more were *three times* more likely to be rolled over than were distributions of less than $3,500.

The variable with the second-largest coefficient was the ***indicator for distributions that occurred after 1986***, when a 10% federal excise tax was first imposed on early distributions not rolled over into another tax-qualified retirement plan. Other things being equal, lump-sum distributions received after the Tax Reform Act of 1986 took effect were more than twice as likely to be rolled over into another retirement account as were distributions received before 1987.[25]

Race had the third-largest coefficient among the independent variables. White recipients of lump-sum distributions were twice as likely as non-white recipients to have rolled over their distribution into an IRA or other retirement plan. On the one hand, this result may be seen as troubling because the regression model controls for the effects of other variables – such as income and education – that correlate with race. On the other hand, given that access to financial information and advice is partly dependent on one's occupation and industry of employment, it may be possible to influence savings behavior through public policies, such as subsidizing the distribution of information to workers about the long-term consequences of spending rather than saving a pre-retirement pension distribution.

Home ownership and the presence of one or more children in the family were also significantly related to the probability that a lump-sum distribution was rolled over. ***Home ownership*** **was positively related to rollovers.** The ***presence of children*** in the family **had a negative relationship**, but it was not as strong statistically. Homeowners were about 70% more likely to have rolled over their most recent lump-sum distribution, while people with children under the age of 18 were about 18% less likely to have rolled over a distribution. Purchasing a home is itself a form of investment, and – controlling for the effects of income – homeowners have what economists call a "revealed preference" for saving and investment compared to renters. The likely reason for the negative impact on rollovers of children in the family is that people with children face numerous expenses that childless individuals do not. These additional financial responsibilities could make the preservation of a lump-sum distribution a lower priority than it otherwise would be.

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[24] We designated $3,500 as the upper limit for the smallest category, because most of the distributions in this analysis occurred in years when $3,500 was the largest amount that an employer could pay to a departing employee without securing written consent.

[25] Chang (1996) estimated that the 10% excise tax imposed by the TRA of 1986 significantly reduced the likelihood that a distribution would be spent rather than saved for retirement.

Age, ***education***, and ***average monthly earnings*** were included in the model in broadly defined categories, both for simplicity of method and ease of interpretation. Recipients were grouped into four age categories according to when they received their most recent distribution: under 35; 35 to 44; 45 to 54; and 55 or older. **Workers aged 35 to 54 were most likely to have rolled over a distribution.** Relative to recipients under age 35, recipients aged 35 to 44 were 34% more likely to have rolled over their most recent distribution, and recipients aged 45 to 54 were 47% more likely than the youngest group to have rolled over their most recently received lump sum. Individuals who were age 55 or older when they received their most recent distribution were marginally *less* likely than the youngest group to have rolled it over into another account, but this result was not statistically significant.

Recipients were classified into three groups designating their highest year of education: up to 12 years of school; 1 to 3 years of college; and 4 or more years of college. **Having completed college bore a significant and positive relationship to the probability that a lump sum was rolled over.** Relative to those with a high school education or less, recipients with 1 to 3 years of college were no more or less likely to have rolled over their distribution into an IRA or other retirement plan. College graduates, however, were 47% more likely than those with just a high school education to have rolled over their most recent lump-sum distribution. This result could be considered encouraging to the prospect that savings behavior can be influenced by efforts to educate workers about the importance of saving pension distributions for their needs during retirement.

The SIPP collected information about respondents' current earnings, but not their earnings in the year they received their most recent lump-sum distribution. Current earnings were entered into the regression model as a proxy for income in the year the distribution was received. This seemed to be a reasonable assumption, given that 45% of the distributions in the sample had occurred since 1990. Three measures of income were tested – average monthly family income, average monthly personal income, and average monthly earnings – and all three measures yielded substantially similar results. The final specification of the model included the respondents' average monthly earnings, which were grouped into three categories: under $1,500; $1,500 to $3,000; and more than $3,000. On an annualized basis, these groupings correspond to yearly earnings of under $18,000, $18,000 to $36,000, and more than $36,000, respectively.

Relative to recipients with monthly earnings of less than $1,500, those who had earnings from $1,500 to $3,000 were neither more nor less likely to have rolled over their most recent lump-sum distribution into an IRA or other retirement account. (The sign for this variable was negative, but the coefficient was not statistically significant). **Monthly earnings of more than $3,000 were significantly and positively related to the likelihood that a distribution was rolled over.** Individuals with monthly earnings of more than $3,000 were twice as likely to have rolled over their most recent lump sum. The coefficient for this variable was strongly significant (at the .01 level).

The second model was similar to the first except that the sample was restricted to people who had received their most recent distribution after 1986, and it included an indicator for distributions that occurred after 1992. Amendments to the Internal

Revenue Code enacted in 1992 require employers to withhold for income tax 20% of lump sums paid directly to plan participants and to establish means by which such distributions can be transferred directly to an IRA or another employer's plan. **The indicator variable for distributions received after 1992 had a positive and statistically significant relationship to the probability that a lump-sum distribution was rolled over into another retirement plan.** Other things being equal, lump sums received in 1993 were 35% more likely to be rolled over than those received between 1987 and 1992. This result offers some encouragement about the effectiveness of these amendments on savings behavior. More recent data on pension coverage and retirement savings were collected as part of the SIPP in 1998, but are not yet available for analysis. These newer data will be especially useful in studying the disposition of lump-sum distributions that occurred after the 1992 amendments took effect.

Table 7. Disposition of Lump-Sum Distributions Received since 1975
(*logistic regression results*)

Response Variable: Full distribution was rolled over into an IRA or other retirement account

Analysis variable	Weighted mean	Parameter estimate	Standard error	Odds ratio
Intercept	—-	-3.3581 ***	0.2516	—-
Race (1 = white)	0.9104	0.7330 ***	0.1847	2.081
Children in family (1 = yes)	0.3993	-0.1979 *	0.1066	0.820
Own home (1 = yes)	0.7645	0.5279 ***	0.1193	1.695
Age = 35 to 44	0.2759	0.2892 **	0.1152	1.335
Age = 45 to 54	0.1417	0.3863 **	0.1538	1.471
Age = 55 or older	0.1602	-0.0373	0.1707	0.963
Education: some college	0.2365	-0.0105	0.1258	0.990
Education: 4+ years college	0.3895	0.3848 ***	0.1115	1.469
Monthly earn: $1,500-$2,999	0.2960	0.0819	0.1185	1.085
Monthly earnings: $3,000+	0.2377	0.7017 ***	0.1269	2.017
Lump sum: $3,500 - $9,999	0.2594	0.4626 ***	0.1210	1.588
Lump sum: $10,000-$19,999	0.1466	1.1279 ***	0.1378	3.089
Lump sum: $20,000 or more	0.1909	1.0750 ***	0.1355	2.930
Received after 1986 (1= yes)	0.6666	0.8724 ***	0.1056	2.393

Source: CRS analysis of the Survey of Income and Program Participation.
Notes: Lump-sum distributions have been adjusted to 1995 dollars.
Earnings are annualized average monthly earnings in 1995.
The "odds ratio" is a measure of how much more (or less) likely it is for a specific outcome to be observed when a particular independent variable is "true" (*x = 1*) than it is when that independent variable is "false"(*x = 0*).

n = 2,482 records
* significant at >= .10
** significant at >= .05
*** significant at >= .01

Association of Predicted Probabilities and Observed Responses

Concordant = 71.5%, Discordant = 28.0%, Tied = 0.5%

Table 8. Disposition of Lump-Sum Distributions Received since 1987

(*logistic regression results*)

Response Variable: Full distribution was rolled over into an IRA or other retirement account

Analysis Variable	Weighted Mean	Parameter Estimate	Standard Error	Odds Ratio
Intercept	—-	-2.6380 ***	0.2749	—-
Race (1 = white)	0.9052	0.7658 ***	0.2120	2.151
Children in family (1 = yes)	0.4311	-0.2347 *	0.1266	0.791
Own home (1 = yes)	0.7346	0.6474 ***	0.1370	1.911
Age = 35 to 44	0.2816	0.3205 **	0.1374	1.378
Age = 45 to 54	0.1381	0.3124 *	0.1861	1.367
Age = 55 or older	0.1729	-0.1308	0.2006	0.877
Education: some college	0.2454	-0.0583	0.1479	0.943
Education: 4+ years college	0.3753	0.5419 ***	0.1342	1.719
Monthly earn: $1,500-$2,999	0.3150	-0.1250	0.1393	0.882
Monthly earnings: $3,000+	0.2338	0.4283 ***	0.1542	1.535
Lump sum: $3,500 - $9,999	0.2312	0.6514 ***	0.1451	1.918
Lump sum: $10,000-$19,999	0.1521	1.2541 ***	0.1650	3.505
Lump sum: $20,000 or more	0.1968	1.2007 ***	0.1646	3.322
Received after 1992 (1= yes)	0.1588	0.2980 **	0.1511	1.347

Source: CRS analysis of the Survey of Income and Program Participation.

Notes: Lump-sum distributions have been adjusted to 1995 dollars.
Earnings are annualized average monthly earnings in 1995.
The "odds ratio" is a measure of how much more (or less) likely it is for a specific outcome to be observed when a particular independent variable is "true" (*x = 1*) than it is when that independent variable is "false"(*x = 0*).

n = 1,643 records
* significant at >= .10
** significant at >= .05
*** significant at >= .01

Association of Predicted Probabilities and Observed Responses

Concordant = 71.1%, Discordant = 28.3%, Tied = 0.6%

Implications for Public Policy Toward Lump-Sum Distributions

The results of this analysis are consistent in most respects with the findings of previous research into the disposition of pre-retirement lump-sum distributions. There is both good news and bad news in these results for the retirement income security of current workers. While fewer than half of lump-sum distributions are rolled over into IRAs or other retirement plans, more than half of the dollars distributed since 1990 as pre-retirement lump sums have been rolled over. There has been an encouraging trend in recent years of an increasing proportion of recipients rolling over their entire lump-sum distribution into another retirement plan. Increases in the proportion of distributions that are rolled over followed both the imposition of an excise tax on non-rollovers by the *Tax Reform Act of 1986* and the tax withholding and institutional rollover mechanisms mandated by the *Unemployment Compensation Amendments of 1992*.[26]

Responses to the Survey of Income and Program Participation indicate that many of the recipients of lump-sums who *did not* roll over their distributions into an IRA or other retirement plan saved at least some of the money in another way. Although only one-third of recipients rolled over the entire amount, another one-third used at least part of their lump-sum to purchase a home or business, invest in stocks or bonds, or to make a deposit to a savings account. Thus, two-thirds of all recipients saved at least *part* of their lump-sum distribution. Furthermore, this finding is not unique to the data analyzed for this report. Examining data from the 1993 CPS pension supplement, Burman, Coe, and Gale (1999) found that, while only 23% of recipients under age 60 reported that they rolled over their entire distribution or used it to purchase an annuity, another 48% reported that they used the money to purchase a home or business, invested it in some other way, or used it to pay off debts.[27] Likewise, Engelhardt (1999) analyzing data from the Health and Retirement Study (which included only people who were over age 50 at the time of the survey) found that only 29% of recipients rolled over their lump-sum distributions, but another 24% either invested the money in other ways or used it to reduce debt.

Both the growing proportion of recipients who roll over their lump-sum distributions into other retirement accounts and the already large percentage of dollars being rolled over are encouraging signs that many workers realize the importance of preserving these assets until retirement. Nevertheless, it appears that through the mid-1990s a majority of recipients were not rolling over their lump-sum distributions into other retirement plans. While the lump-sum distributions that were not rolled over tended to be relatively small – with a median value of $4,200 in 1995 dollars, compared to a median value of $10,200 for lump-sums that were rolled over – most were received by workers who were more than 20 years away from retirement. Consequently, many of these distributions could have grown to substantial amounts

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[26] Further investigation into the effects of the 1992 amendments will be possible when SIPP data on pension coverage collected in 1998 are made available by the Census Bureau.

[27] Note that the 20% of recipients who reported a full rollover in the CPS does not include those who left the distribution in their previous employer's retirement plan. In the SIPP, money left with the previous employer's plan is counted as having been rolled over (i.e., preserved for retirement), provided that it remains in a tax-deferred retirement plan.

had they been preserved in IRAs or other retirement plans. Among the sample examined in this report, those who did not roll over their most recent lump sum distributions gave up retirement wealth with an estimated mean value at age 65 of $81,000 if invested in stocks, or $41,000 if invested in bonds. The estimated value at age 65 of the median distribution if invested in stocks was $32,000, and the estimated value of the median distribution if invested in bonds was $16,000.

The tax policies that Congress has adopted toward early distributions from pensions and retirement savings plans represent a compromise among several competing objectives, including:

- encouraging participation among employers and employees in these plans,
- promoting the preservation of retirement assets,
- allowing participants to have access to their retirement savings when they would otherwise face substantial economic hardship, and
- assuring that the tax preferences granted to pensions and retirement plans are not used for purposes other than to fund workers' future financial security.

If any one of these objectives were paramount, devising the most effective policy would be a relatively straightforward undertaking. If preserving retirement assets were the only important consideration, Congress could require *all* distributions from pension plans to be rolled over into another account and held there until the individual reaches retirement age. Stricter limits on access to retirement funds before retirement, however, could inhibit employee participation in retirement savings plans. This, in turn, could result in more people being unprepared for retirement than currently results from some pre-retirement distributions being spent rather than saved. Likewise, allowing easier access to retirement savings could help people meet other important expenses, like buying a home or paying for their children's education, but at the expense of less financial security in retirement.

Given the competing demands that Congress faces in devising tax policy for pre-retirement distributions from pensions and retirement savings plans, the most likely outcome is that these policies will continue to represent a compromise among competing objectives. Policy analysts who have studied the effects of federal tax laws on the disposition of lump-sum distributions have suggested several options for consideration, including: changing the tax rate or the withholding rate on lump-sum distributions that are not rolled over; having the tax rate vary with the age of the recipient or with the size of the distribution; requiring at least part of the distribution to be rolled over directly into another retirement plan; and encouraging plan sponsors to educate recipients about the importance of preserving these distributions so that the funds will be available to provide for their financial security during retirement.

Appendix: Sources of Data on Lump-Sum Distributions

Tax forms submitted to the Internal Revenue Service (IRS) are probably the most reliable source of data on the number and dollar value of lump-sum distributions each year. Sabelhaus and Weiner (1999) conducted an analysis of lump-sum distributions based on an examination of IRS Forms 1040 and 1099 submitted for 1995.[28] The authors noted that even tax data are subject to some error as a result of noncompliance and inaccurate reporting. In some cases, for example, data reported on the two forms were inconsistent. Moreover, some categories of transaction reported on these forms may or may not represent lump-sum distributions from pension plans. Classifying such transactions depends on the judgment of the individual analyst.

Even if there were full compliance and accurate reporting, however, tax data on lump-sum distributions would have some limitations. First, the data are limited to people who *received* lump-sum distributions. They provide no information about people who were *eligible* for such distributions but did not receive them. Second, information available from tax forms is limited to the recipient's age, filings status, and income. Most geographic information is suppressed for confidentiality reasons. Lack of detailed demographic data limits the possibilities for analyzing the personal characteristics that may influence a recipient's decision to save or spend a lump-sum distribution. Third, data reported on tax forms do not show the ultimate disposition of all distributions. They indicate whether a lump-sum distribution was rolled over into another retirement plan or was paid out directly to the participant. For amounts paid out directly to recipients, they can reveal whether the distribution was subsequently deposited into another retirement account (based on whether the distribution was reported as taxable income.) Tax data, however, cannot tell us whether a lump-sum distribution paid directly to a recipient was saved or invested after taxes were paid on it, nor do they reveal how distributions that were not saved were spent. Furthermore, unlike some household surveys, the information reported to the IRS does not include the reason for the distribution.

Trends in lump-sum distributions also can be studied with proprietary data compiled by firms that provide benefits administration or management consulting services. The Employee Benefits Research Institute, for example, has periodically published reports based on data collected by Hewitt Associates from its clients, which are predominantly medium and large firms and are concentrated in particular industries.[29] For researchers, data collected by consulting firms in the course of their business present three difficulties. First, the firms' clients may not be a representative sample of employers. Proprietary data represent neither the entire universe of distributions, as tax returns do, nor a random sample of distributions, such as one would obtain from a nationally representative sample of businesses or households.

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[28] Form 1099R must be completed by the plan sponsor whenever a participant receives a distribution from a pension, annuity, profit-sharing plan, insurance contract, or IRA.

[29] See, for example, EBRI Issue Brief Number 188 (August 1997), *Large Plan Lump-sums: Rollovers and Cashouts*, by Paul Yakaboski.

Consequently, the conclusions that one might draw from analyzing these data may not be applicable to other employers. Second, the data collected by consulting firms from their clients are proprietary. Such data often are not publicly available to other researchers, as are the tax data published by the Treasury Department in the Statistics of Income and the public-use files of government-sponsored household surveys. Third, while previous research has established that certain characteristics of plan participants are strongly associated with the likelihood that a lump-sum distribution will be saved rather than spent, demographic information in these kinds of data sets is sometimes sparse. This limits their usefulness for policy analysis.

A third source of data for analyzing lump-sum distributions comes from surveys of nationally representative samples of U.S. households conducted by or on behalf of government agencies. Two such surveys – the *Current Population Survey* (CPS) and the *Health and Retirement Study* (HRS) – have been the basis for several recent studies of lump-sum distributions from pension plans. This CRS report adds to the findings of previous research by analyzing information collected in the Census Bureau's *Survey of Income and Program Participation* (SIPP).[30] These three surveys are especially useful for public policy analysis because they contain a wealth of economic and demographic data. Information on individual and family characteristics can be used to construct econometric models that can identify the factors that have strong statistical relationships to particular economic events – such as the disposition of a lump-sum distribution from a pension plan. Even a carefully designed survey questionnaire, however, can address only some of the variables that may influence the decision to save or spend a lump-sum distribution. Nevertheless, when processed through the appropriate statistical model, these data represent a potentially powerful means of identifying policy options that will promote retirement saving and preservation of retirement assets.

Data collected through surveys like the CPS, HRS, and SIPP have some shortcomings, most notably that questions about income and assets are susceptible to recall errors and misreporting by survey participants. For example, the 1993 benefits supplement to the CPS indicated that there were approximately 1.5 million lump-sum distributions in 1992 with an average value of $13,900. This yields an estimated total of about $21 billion in lump-sum distributions. According to information reported in the 1993 panel of the SIPP, there were 1.67 million lump-sum distributions in 1992 with an average value of $12,000. This yields an estimated total of about $20 billion in distributions. While the survey data are generally consistent with one another – allowing for differences in both sampling error and non-sampling error – they differ sharply with the information reported on tax returns. Data reported to the IRS for 1995 show a far greater number of lump-sum distributions from pension plans (about 10 million), although the average value of these distributions ($13,100) closely approximates the average value of the distributions reported on the CPS and the SIPP.

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[30] The SIPP is conducted by the U.S. Bureau of the Census to collect economic and demographic information about the U.S. population. It differs from the Current Population Survey (CPS) in that SIPP is a longitudinal survey in which the participants are interviewed at intervals over a long period (2½ years). This allows analysts to study things such as changes in income and employment over time.

Why is there such a large discrepancy between the survey data and the information reported to the IRS? The difference in years – 1992 for the survey data and 1995 for the tax data – would, of course, have some effect, but probably not very much. Tax data for years since the late1980s show more than10 million lump-sum distributions in each year. Part of the difference may be due to differences in how people construe the meaning of the term "lump-sum distribution" in the context of a survey as opposed to when they are reporting income to the IRS. As much previous research has shown, *all* sources of income have historically been under-reported in the CPS, SIPP, HRS and other surveys. Another, less significant, reason why the total value of distributions is under-represented on the CPS and SIPP is due to "top-coding" of the data. While the full value of a lump-sum distribution would be reported to the IRS (assuming full compliance with the law), surveys usually adopt a specific maximum (typically $100,000), and all income and assets above that amount are recorded at this value. Tax returns for 1995, however, show that only 2.4% of all lump-sum distributions that year were greater than $100,000. Two-thirds of all lump-sum distributions in 1995 were in amounts less than $5,000. Top-coding can therefore explain only a small part of the difference between the survey data and the information reported on tax returns.

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