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Increasing 401(k) Balances Can Bring Increased Risk



By the second quarter of this year, the number of “401(k) millionaires” rose 2.5% from Q1, marking a record high according to Fidelity. At the same time, retirement savers overall experienced three consecutive quarters of growth — and that’s good news for many investors. However, a Vanguard analysis of its plans also shows a concerning trend: The percentage of savers who took hardship withdrawals

from retirement accounts increased twofold over a three-year period, climbing from 1.7% in 2020 to 3.6% in 2023. Moreover, new rules introduced this year make accessing those funds even easier, allowing participants to withdraw up to \$1,000 annually from a qualified retirement plan or IRA, without penalty, to cover self-defined urgent needs.

Rising 401(k) balances can lead to financial overconfidence for some participants, tempting them to view their retirement account as a quick fix during economic challenges instead of exploring alternative strategies for managing emergency cash flow. Here are ways employers can help.

Promote Goal-specific Savings and Solutions

Encourage participants to view their retirement plan as one part of a holistic financial strategy that includes building emergency savings, managing debt and setting short- and mid-term financial goals. Provide tools and resources that emphasize creating greater financial security through emergency funds, PLESAs or goal-based savings accounts.

Provide Data to Drive Decisions

Educate participants on the risks of dipping into their 401(k) for non-retirement needs. Offer clear examples and online tools that illustrate long-term impacts of loans or early withdrawals, clearly demonstrating potential risks to their retirement readiness. Empowering participants with data can encourage them to search for alternative solutions.

Offer a Human Touch

Give workers the opportunity to schedule one-on-one sessions with a financial advisor ahead of any loan or early withdrawal. Personalized advice can facilitate understanding of the long-term consequences of prematurely accessing retirement savings. Advisors can review the employee’s full



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financial picture and offer tailored solutions that might make an early 401(k) withdrawal unnecessary.

Leverage Financial Wellness Programs

Many participants dip into their 401(k) due to overwhelming financial pressures, especially high-interest debt. Offering specialized financial wellness programs that focus on debt management, consolidation strategies, nonprofit credit counseling or low-interest refinancing can give employees alternatives to raiding retirement accounts.

Carefully Consider Plan Design

As a plan sponsor, you have flexibility in determining whether your plan offers loans and hardship withdrawals and, if so, how much and under what conditions. Additionally, implementing a tiered vesting schedule can help discourage excessive borrowing while promoting steady participation.

Help Participants Reframe and Reprioritize Retirement Savings

Just as the broader economy is experiencing record highs in both stock market values and personal debt levels, participants are facing a similar dichotomy with growing 401(k) balances and rising loan and hardship withdrawal activity. While it's encouraging to see participants accumulate wealth, it's also crucial to address the potential pitfalls of borrowing against or depleting those funds. With a multi-faceted approach, you can help employees avoid sacrificing tomorrow's financial security to meet today's needs.

Sources

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