HARDSHIP WITHDRAWALS
Improving the well-being of those who take them
Hardship withdrawals from defined contribution (DC) plans were designed to provide relief to participants who have financial emergencies.

At Fidelity Investments, we understand that people who take hardship withdrawals are often experiencing significant financial stress. Our research shows this stress also has a far-reaching impact on their health, work, and life. Since the passing of the Bipartisan Budget Act ("BBA") of 2018, which eliminated the requirement to take all available plan loans before obtaining a hardship withdrawal, we have seen a shift in participant behavior. While the percentage of participants taking loans and hardships overall hasn't increased, of those withdrawing money from the plan, fewer are taking loans and more are taking hardships.

While we believe that taking money from one’s retirement savings should be a last resort, we recognize that participants in financial distress may have no other option but to tap into their DC plan. Taking a loan will have less of an impact on participants’ long-term savings and is generally a better option than taking a hardship. Although the BBA no longer requires plan loans before taking a hardship, plan sponsors can still consider requiring a loan before requesting a hardship. However, we know that for some participants, taking a hardship may be their only option and may be a “lifesaver.” To understand how we can help those who are in financial distress, we looked at the changes to hardship withdrawal rules, recent participant behavior, and the well-being of those taking hardships.
Bipartisan Budget Act (BBA) of 2018

The BBA made several changes to the hardship withdrawal rules that became effective on the first day of the plan year that began in 2019. The legislation:

- Permits hardship withdrawals without requiring participants to first obtain available plan loans.
- Removes the required six-month suspension of participant contributions after taking a hardship withdrawal. This change will be mandatory for all hardships requested after December 31, 2019.
- Allows qualified nonelective contributions (QNECs),* qualified matching contributions (QMACs),* and earnings on QNECs and QMACs to be available for hardships along with elective deferral contributions.
- The proposed IRS-issued BBA regulations permit hardship withdrawals for natural disaster–related casualty loss when declared by FEMA.

* QNECs and QMACs are employer contributions made to a 401(k) plan to help it pass the actual deferral contribution percentage and/or the actual contribution percentage test.

Pre-BBA
- Loans had to be exhausted prior to accessing hardships
- Hardships were a last resort

Post-BBA
- Hardships can now be a first resort
- More sources can be accessed
- Additional flexibility on safe harbor reasons

Shifting participant behavior: Loans and hardship withdrawals

Historical Loan and Hardship Withdrawal Trends

While the percentage of participants taking loans and hardship withdrawals has remained relatively consistent, there has been a slight decrease in the percentage of participants taking loans and a slight increase in the percentage of participants taking hardships since the passage of the BBA.

Source: Fidelity recordkept data, analysis of 33.4k plans with 23M participants as of 06/30/2019.
The good news:

Since the BBA, plan sponsors are no longer required to suspend participant contributions to the plan after a hardship withdrawal. As a result, only 3% of participants taking hardship withdrawals have actively lowered or stopped their deferrals by choice.\(^2\)

For the 96% of participants who took a hardship and continue to save,\(^2\) it could mean an extra one-third of an average hardship withdrawer’s annual salary in retirement. In the hypothetical example below, we calculated what the ending balance in retirement would be for a 45-year-old participant with an annual income of $68,500 and a total savings rate of 7%, who took two separate hardship withdrawals one year after another.

In one scenario, the participant chose to continue saving in the plan and received the company match, and in the other scenario the participant stopped saving for six months after each hardship request. This example illustrates the importance of continuing to save, as it could mean an additional $20,500 for this participant at retirement.

Assumptions based on participant’s annual income of $68,500, 1.5% annual income increase, 4.50% personal rate of return, 4% participant deferral rate and 3% employer match. Starting balance $22,000, two separate hardship withdrawals taken one year after another totaling $15,000 (plus taxes and penalties, which are equal for each hardship) starting at age 45, deferral suspension for six months after each hardship withdrawal (equaling one full year of deferral suspension), and retirement age of 67.

Earnings and pretax contributions are subject to taxes when withdrawn. Distributions before age 59 1/2 may also be subject to a 10% penalty. Contribution amounts are subject to IRS and Plan limits. Systematic investing does not ensure a profit or guarantee against a loss in a declining market. This example is for illustrative purposes only and does not represent the performance of any security. Consider your current and anticipated investment horizon when making an investment decision, as the illustration may not reflect this. The assumed rate of return used in this example is not guaranteed. Investments that have potential for 4.50% annual rate of return also come with risk of loss.
Over the last 10 years, preventing eviction or foreclosure is the #1 reason participants take hardships.

Although the overall rate of hardship withdrawals remains low historically, of those who do take them, 73% are taken for two primary reasons: the first is to prevent eviction or foreclosure, and the second is to pay uninsured and unreimbursed medical expenses. For both hardship reasons, the average amount is $2,900 and the average number of withdrawals taken per participant is 1.5 per year.

Avoiding a past-due medical bill is a legitimate concern, as our well-being research found that unpaid medical bills place a heavy burden on overall well-being and connect health and wealth in a downward spiral:

- Roughly one in eight participants report having unpaid medical bills
- Eighty-four percent of the participants with unpaid medical bills are financially unwell, and virtually none have excellent financial wellness*
- No other forms of debt are linked as strongly to so many dimensions of well-being, not even student debt or credit card debt

* Excellent financial wellness is defined as having 24% expense to income ratio, 7% debt to income ratio, 18% retirement savings rate, and planning ahead 10+ years financially. All data are medians.

Those with unpaid medical bills also report a multitude of associated problems:

- Two times as likely to feel highly stressed about their finances
- Two out of three don’t get enough sleep
- Miss three more days of work, and two out of the three are due to health

Hardship Withdrawal Reasons

source: Fidelity Investments record kept data as of 06/30/2019, eCertified participant web entries.
Impact of stress on the brain, body, and behavior

Stress has toxic effects on the brain, body, and behavior—and that has consequences for employers as well as employees.

Potential impacts on employers
- People who have a lot of stress at work are 10X as likely to be dissatisfied with their job than those who have just a little stress.
- They are half as likely to recommend their employer as a great place to work, compared with those who have a little stress.

The brain
- More likely to have difficulty thinking clearly
- More likely to suffer depression

The body
- More likely to get sick
- More likely to gain weight

Behaviors
- Less likely to get enough exercise
- Less likely to take vacation

Stress not only keeps employees up at night, but its toxic effects can hurt your company’s bottom line as well.

Read this charticle to understand the underlying causes of employee stress.
Feeling the most financial stress

Our well-being study highlights that participants who take hardship withdrawals from their plans have more stress than other DC participants across the board and could benefit from help in many areas, such as maintaining a budget, managing debt, and saving for short-term emergencies and for the future.

The heat map below illustrates the intensity of stress across age groups and stress types of those participants who take hardship withdrawals. Darker red indicates higher levels of stress and darker green indicates lower levels of stress. When looking at participants who take a hardship withdrawal, the top four stressors are all financial, with the number one being their overall financial situation. Compared to DC participants overall, whose top stressor is their job, these participants are feeling financial stress much more intensely.

Sources of Stress by Age
401(k) Hardship Withdrawals

Source: Fidelity Investments, 2017 Total Well-Being Research online survey.
Financial stress tends to spill over into other aspects of life. For example, our well-being study shows that those who are the most financially stressed also have higher absenteeism at work and take more sick days.

**Of those who are the most financially stressed:**

- **Job burnout:** Approximately 2X as likely to be burned out and stressed out about their job.
- **Absenteeism:** Nearly 1.5X more likely to take sick time.
- **Health Behaviors:** Almost 2X less likely to do half of the eight recommended health behaviors*
- **Net Promoter Score (NPS):** Nearly 2X more likely to be detractors (have a negative view and/or negatively promote the employer) compared to participants who are not financially stressed, and it’s not simply a matter of dissatisfaction with one’s pay—financial stress predicts lower NPS scores across all income levels.

* Getting enough sleep, exercising regularly, getting a flu shot, visiting doctor regularly, visiting a dentist regularly, healthy diet choices, having healthy BMI, and avoiding tobacco use.¹
Three ways to help reduce stress and improve the well-being of participants in financial hardship

Now more than ever there are many steps sponsors can take to help participants understand their paycheck, and how to budget for current expenses while saving for short-term emergencies and long-term goals. Consider the following to reduce stress and improve the well-being of participants:

1. **Offer a Financial Wellness program:**
   
   Ensure a financial wellness program is part of your benefits offering and is designed to help all participants, focusing on those who are financially stressed. The most important place to start is helping to encourage emergency savings.

   - **Encourage an emergency savings account to help reduce stress:**
     
     One way to help decrease the likelihood that a participant would tap into his or her DC plan when experiencing a financial hardship is to help them understand the importance of having an emergency savings account. Our research illustrates of the nearly 50% who had a financial emergency within the past two years and did not have an emergency savings account in place, 42% took a loan or withdrawal from their DC plan and 38% used a credit card to cover the expense.7

     We recommend aiming to have the equivalent of three to six months of income in an emergency fund, for big emergencies like job loss or a health crisis. Participants can start to build this fund by taking simple steps:

     - Automate savings (either from payroll or via EFT from checking account)
     - Use a separate savings account (from other types of savings or checking accounts)
     - Start today even if it is a small amount each pay period

80% of participants without emergency savings are highly stressed about their finances1

Did you know?

When an emergency savings cash management account option is available to participants, it gets funded 69% of the time.8 Encourage participants to learn more by visiting the emergency savings page on NetBenefits®.

Not just those who tap into their plan need help:

One-third of financially established participants do not have a sufficient emergency savings in place.9 Share the Financial Wellness Assessment with participants to help them see where they stand today and what they can do to meet their goals tomorrow.
Provide debt management resources:
Help participants manage their debt as they try to balance competing financial priorities, including saving for retirement.

Provide help with day-to-day budgeting:
Help participants understand spending habits and stick to a budget to improve their current financial situation.

Review your DC plan to help reduce stress for those in a financial crisis:
To help participants who are in an expected or unexpected financial crisis, plan sponsors should consider hardship withdrawal processes that allow for quick and streamlined access to assets. Many DC plans today require manual approval, which delays processing time, and it can take an average of four to nine calendar days for participants to get their money. To help participants who are in a financial hardship situation get their money quickly, a preapproved digital experience can reduce the processing and delivery time frames by 20%–25% (depending on various delivery methods available). For participants experiencing heightened financial stress, every day counts.

One or two days could mean the loss of a home.
To help preempt these urgent situations, it’s even more critical to encourage saving in an emergency savings account.

MANUAL PROCESS
“Making it so difficult to withdraw money during a difficult time just adds more stress.”
Female participant
Age 55
Income $74,000
Savings $63,000

PREAPPROVED DIGITAL PROCESS
“...saved me from being homeless.”
Female participant
Age 30
Income $57,000
Savings $16,000
3 Take time to analyze hardship withdrawal trends in your plan:

If hardship withdrawals within your plan have increased and loans have declined since the BBA, talk to your Fidelity relationship manager to discuss different plan design options, such as limiting the number of hardships allowed.

- Leverage communication resources:
  Send targeted and relevant messages to participants who are withdrawing money from their plan to ensure they get the education and resources they need. For example, communicating to those who stop saving during a hardship or to those who should consider a loan before a hardship.

Talk to a Fidelity relationship manager:
Start the conversation today and work together to assess what makes sense for your plan and the needs of plan participants today and in the future.
ENDNOTES

1 Fidelity Investments Total Well-Being Research online survey of 9,315 active Fidelity 401(k) and 403(b) participants from across the United States. The survey was conducted by Greenwald and Associates, an independent third-party research firm, on behalf of Fidelity in September 2017.

2 Data and insights are based on Fidelity analysis of recordkept data of 33.4K plans with 23M participants as of 06/30/2019.


6 Fidelity Investments 2019 Hardship Withdrawal Journey CEI survey.

7 Fidelity Investments 2016 Participant Panel Survey.

8 Fidelity Investments MyMoney Checkup Survey data as of 6/30/2018.


Hardship distributions are taxed as ordinary income and may be subject to a penalty when you file your income taxes.

Keep in mind that investing involves risk. The value of your investment will fluctuate over time, and you may gain or lose money.

For plan sponsor and investment professional use only.

Approved for use in Advisor and 401(k) markets. Firm review may apply.

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