

The question of loans

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Incidence (2003)

Plan level

- 53% of 401(k) plans offer loans
 - >500 participants 82-92% of plans
 - 100 to 500 participants 70-77% of plans
 - <100 participants 36-63% of plans
- Major obstacle to adoption: administrative cost and complexity

Participant level

- 86% of participants are in plans with loans
- Percent of participants with a loan: 18%
- Percent of account balanced borrowed: 13%

Source: Holden and VanDerhei (2004)



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Borrowing limits

- Participants can borrow 50% of balance (max \$50K)
- Simple design: 401(k) with EE contributions and ER match
- Complex designs: 401(k) with DB or DC
 - By law participants can borrow from any type of plan—DB or DC!
 - Yet many sponsors prohibit loans from certain employer monies.
 - Bottom-line: we're not sure how much \$\$ is loan-able

PRIVATE SECTOR PLAN DESIGN		
Plan design	% plans	% EEs
401K	38%	25%
401K + DC	28%	11%
401K + DB	20%	24%
401K + DB/DC	14%	40%
	100%	100%

Source: Mitchell, Utkus, Yang (2005)

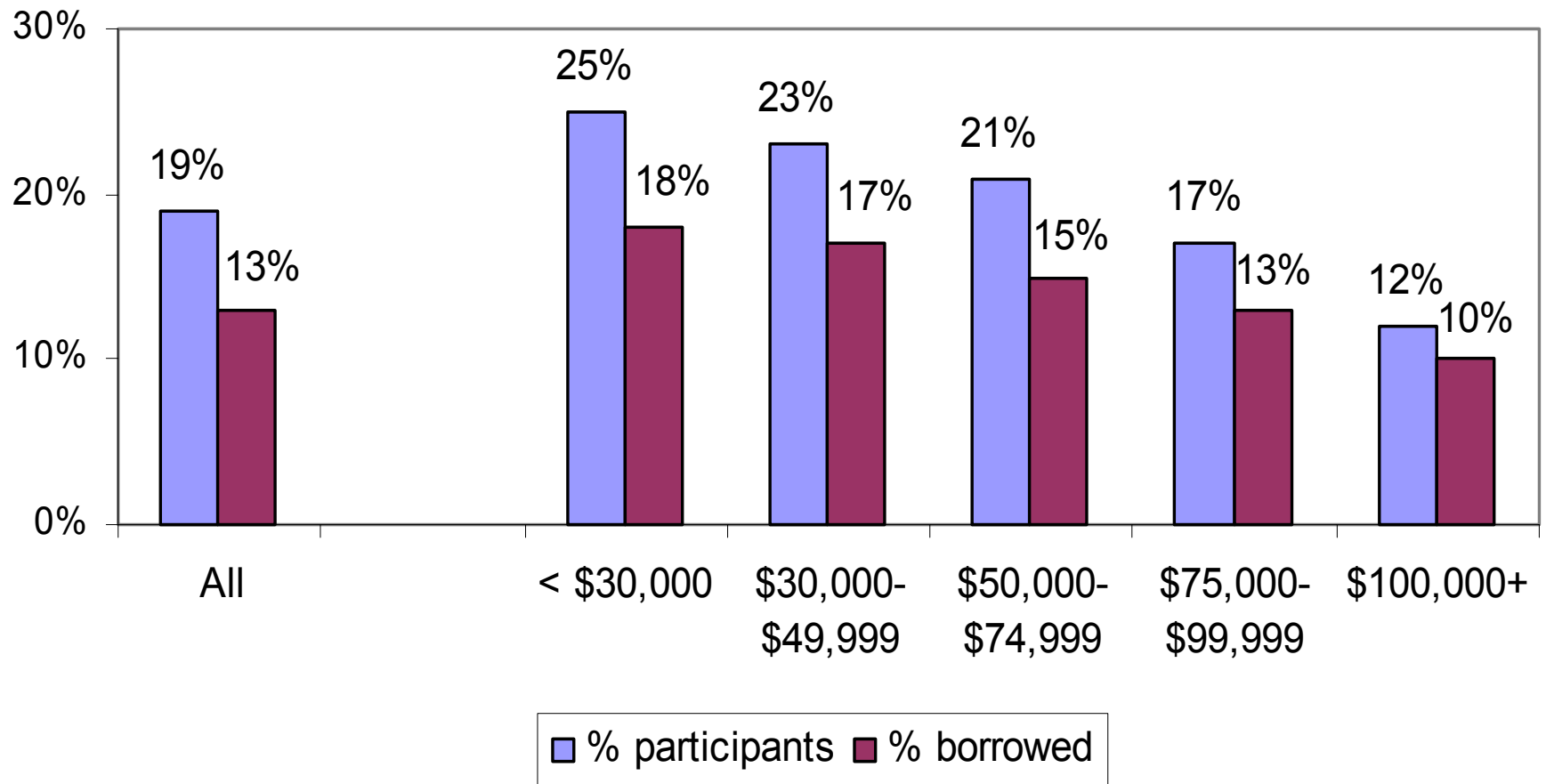


Other features

- No credit underwriting, no credit reporting
- Attractive borrowing rates
- Loan considered an asset in account
- No restrictions on loan features, but common practice is:
 - One loan only (60% of plans, Vanguard)
 - General purpose v. home mortgage
 - Loan fees for equitable allocation of costs
- Repayment by payroll deduction only
 - Can repay in full at any time
 - Job change / retirement: must repay in full *or* pay taxes & 10% penalty
- Bankruptcy: Plan assets excluded, and loans cannot be discharged



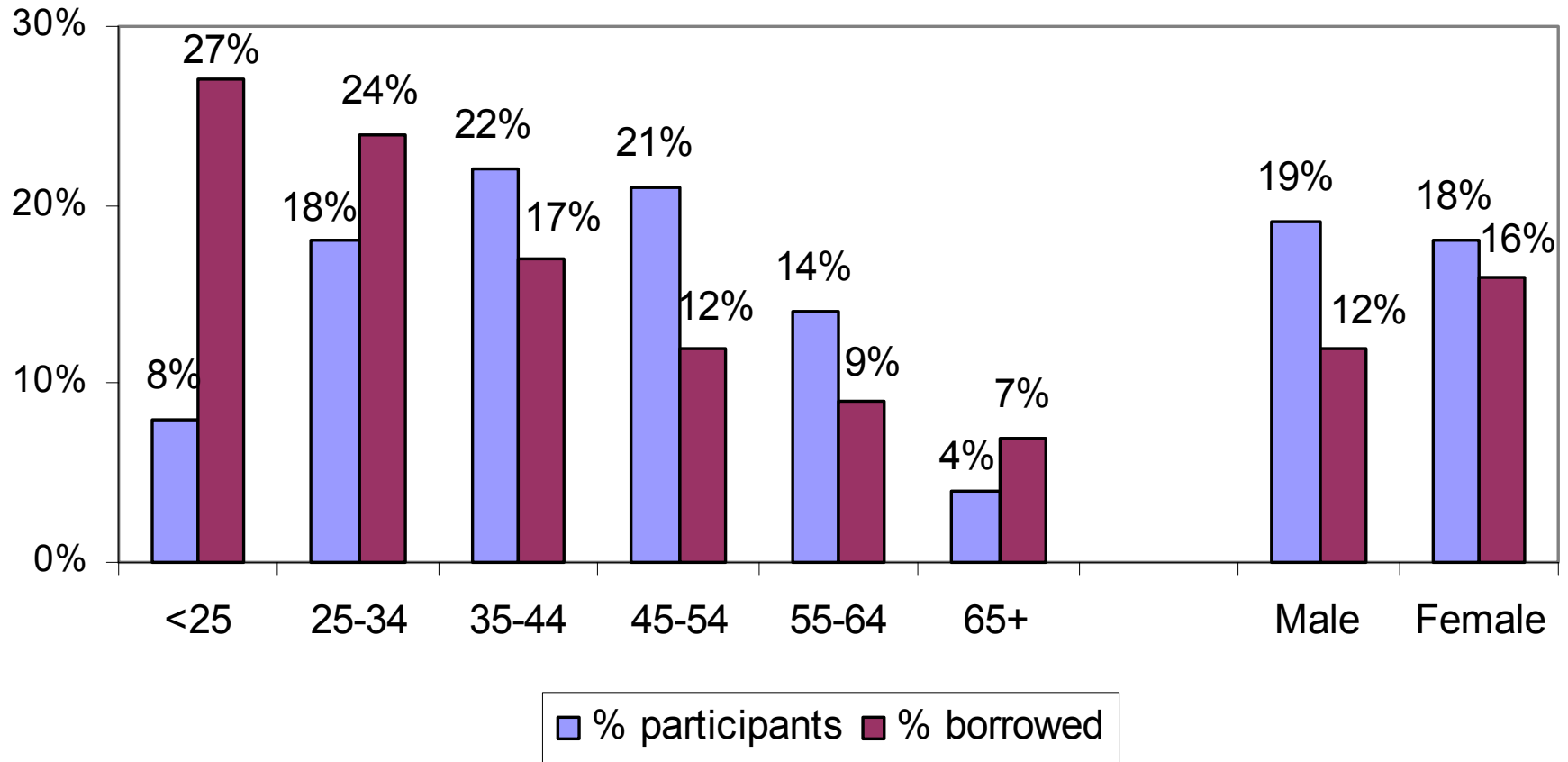
Loan usage by income (2003)



Source: Vanguard (2004)



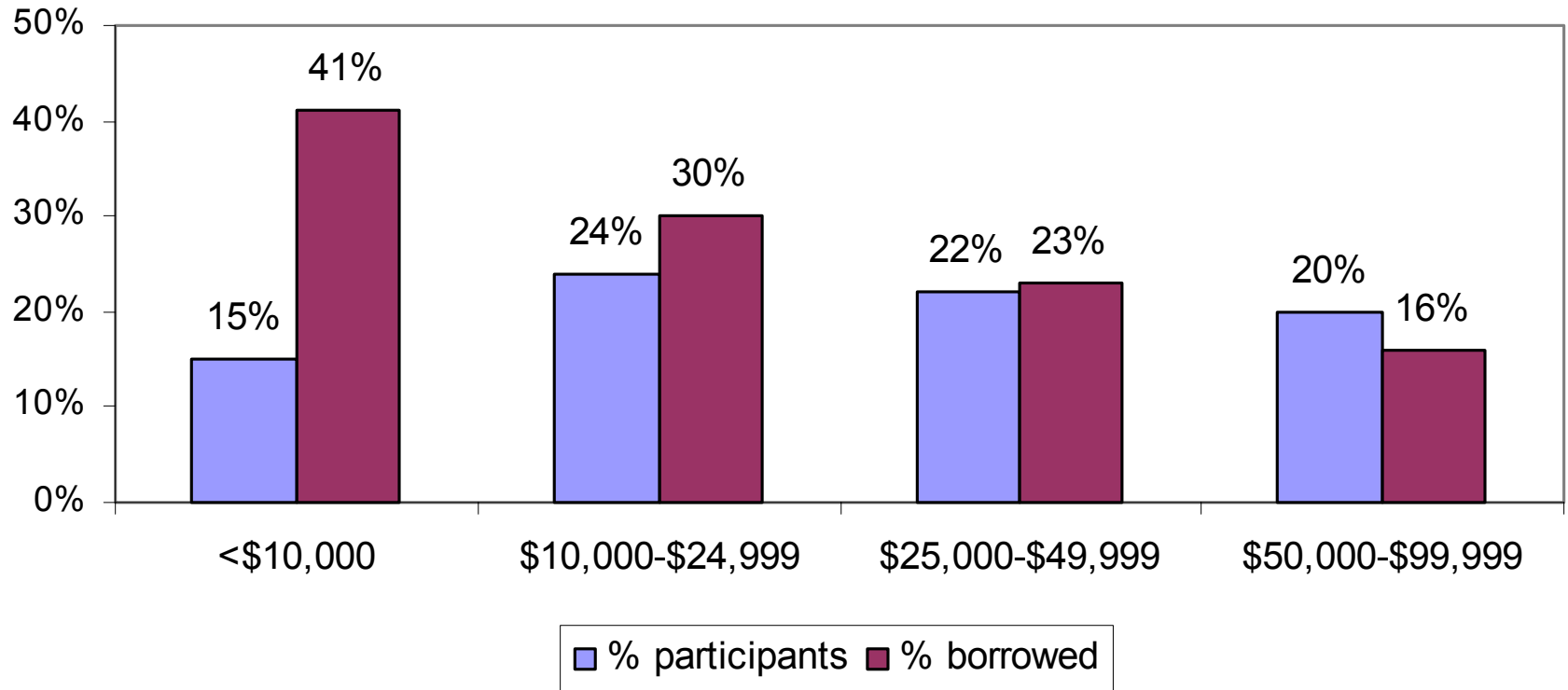
Loan usage by age and gender (2003)



Source: Vanguard (2004)



Loan usage by account balance (2003)



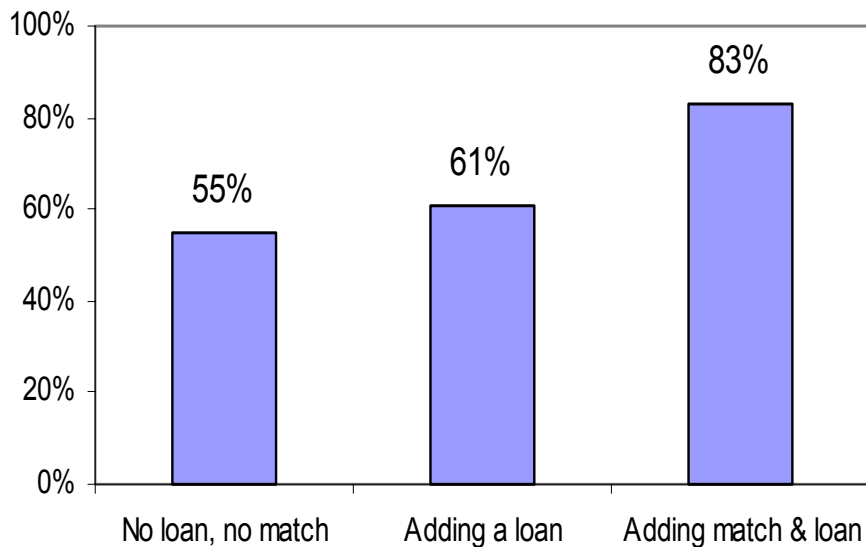
Source: Vanguard (2004)



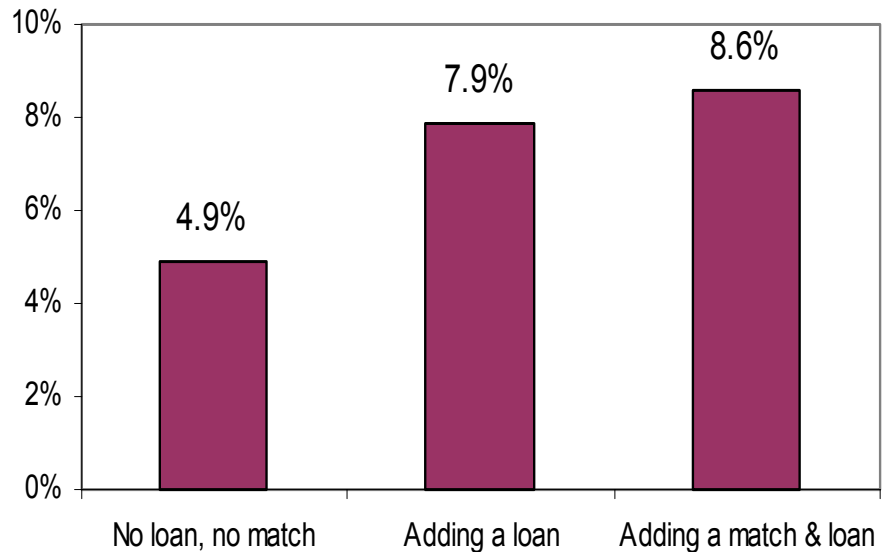
Empirical analysis of loans I (GAO, 1997)

- Loans influence contribution rates more than participation rates
- IRS 5500 data (1992), but with limited control variables

PARTICIPATION RATE



SAVINGS RATE



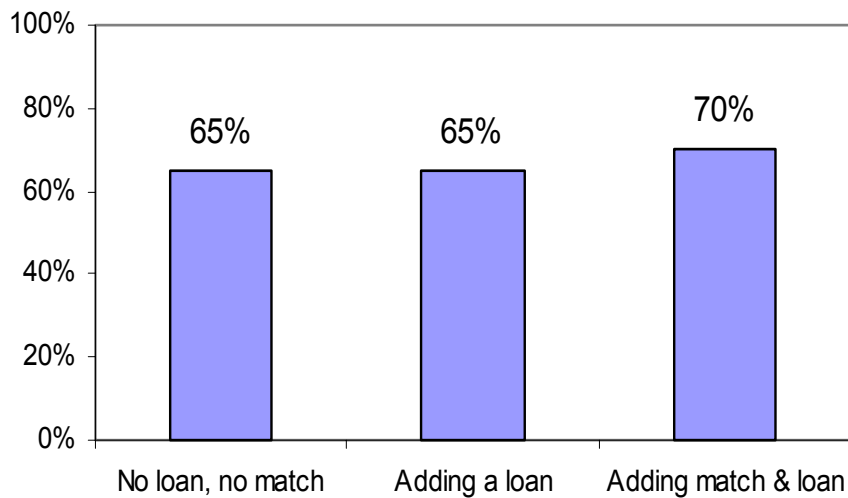
Source: GAO (1997)



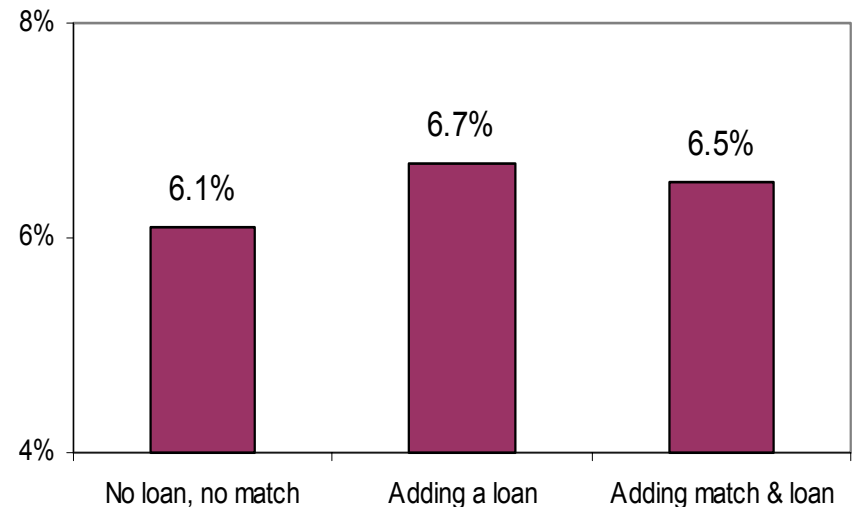
Empirical analysis of loans II (Mitchell, Utkus, Yang, 2005)

- Loans have no effect on participation and large effect on contributions
- Administrative data, 507 Vanguard plans (2001), with extensive employer and employee controls

PARTICIPATION RATE (NONHIGHLY COMP)



SAVINGS RATE (NONHIGHLY COMP)



Source: Mitchell, Utkus and Yang (2005)



Empirical analysis of loans III (new enrollees, preliminary)

- Loans raise participation rates among new enrollees
- Administrative data, 98,221 newly eligible Vanguard participants (2004), various plan and participant controls

New enrollee participation rate	33%
Loans	+8%
Company match	+4%
Lifecycle fund	+4%

Source: Mottola and Utkus (2005, preliminary)



What we don't really know about loans

- What are the patterns of use over time?
 - Does everyone eventually take a loan—or are their habitual users?
 - Do loans enhance or impair savings over a working career?
- How significant are loan defaults among job changers?
- How important are loans in psychological terms? Do participants overvalue loans in joining a plan—but in reality under-utilize them?



Summary

- Empirical research suggests loans are important design element
 - Loans raise contributions significantly
 - Loans may raise new enrollee participation
- In the US:
 - Many designs are more than 401(k), and not all assets are loan-able
 - Loans are an exceptionally flexible source of credit
 - Loan usage appears to be modest and sensible, with “the loan problem” an issue of some young workers changing jobs

References

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Holden, Sarah and Jack VanDerhei, 2004. "401(k) Plan Asset Allocation, Account Balances and Loan Activity in 2003." Employee Benefit Research Institute and Investment Company Institute, Washington, DC. <http://www.ici.org/stats/res/per10-02.pdf>. August 2004.

Mitchell, Olivia, Stephen Utkus and Tongxuan (Stella) Yang, 2005. "Better Plans for the Better Paid: Determinants and Effects of 401(k) Plan Design." Wharton Pension Research Council Working Paper 2005-5. Wharton School, University of Pennsylvania, Philadelphia, PA. <http://prc.wharton.upenn.edu/prc/prc.html>.

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