

# Why Student Loan Debt Is a Threat to Your Retirement Plan



## RETIREMENT SERVICES

Student loan debt ranks as the second-highest form of consumer debt in the United States, behind only home mortgages. With over \$1.2 trillion outstanding, default rates are climbing. Employers have noticed the crisis among their employees, and the marketplace has begun the race to provide solutions, but caution is advised.

### How Bad Is Student Loan Debt?

An average student with a four-year degree will graduate with nearly \$30,000 in debt and spend the next 20-plus years paying it off. A recent PricewaterhouseCoopers study found that 42 percent of millennials have student loan debt which, for 79 percent, limits their ability to achieve financial goals. The problem is not isolated to millennials. In the same study, nearly 80 percent of parents paying their children's student loans said they also struggled to achieve their own financial goals.

The impact of this burden is being felt at work. In the same study, 37 percent of millennials say that their financial troubles distract from work and 46 percent say that they spend at least three hours a week dealing with financial problems while on the job. For parents, the burden means staying in the workforce far longer than they would like in order to afford retirement, which directly impacts employer labor and health insurance costs.

### Retirement Plan Impact

Many believe that pre-paying loans to avoid interest outweighs retirement investment earnings potential. But a recent study by Morningstar and HelloWallet found that, in most cases, this is not the case, particularly if a worker receives an employer match on retirement savings. Consider a hypothetical worker at age 25, making \$50,000, paying off a \$20,000 loan, and receiving a 5 percent match on his or her retirement savings. This person can accumulate 15 percent more for retirement by focusing on saving rather than dedicating all of his or her discretionary dollars toward paying off his or her loans ahead of schedule. Saving for retirement compounds faster because contributions in a 401(k) are tax-deferred and earnings enjoy tax-deferred growth. Meanwhile, for many employees, only the interest on loans is tax-deductible.

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*Every dollar of student debt decreases retirement savings between \$0.17 and \$0.35.*

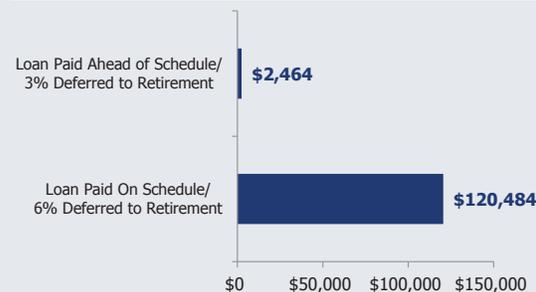
—Morningstar and HelloWallet Study, 2016

#### HYPOTHETICAL SCENARIO



<b>Student Loan Amount:</b>	\$20,000
<b>Interest Rate:</b>	5%
<b>Investment Return:</b>	7%
<b>Match Rate:</b>	5% on 6% Deferral
<b>Salary:</b>	\$50,000

#### NET WEALTH AT LOAN END



Source: "Two's a Crowd: Are Retirement Savings Being Crowded Out by Student Loans?" Morningstar and HelloWallet, 2016

## Solutions

The competition for talent is fierce. Many employers look for new solutions to attract and retain candidates, and some go a step further, seeking ways to encourage employees to participate in their 401(k) plans when they might otherwise feel they could not. When it comes to student loan solutions, four approaches emerge:

- 1. The Education Approach**—Providing simple, straightforward educational employee counseling, both in person and online. These services are relatively low cost and easy to implement but require engaged employees.
- 2. The Attraction Approach**—Offering sign-on bonuses in the form of student loan payoffs. Employers using solely this approach may miss opportunities with tenured employees.
- 3. The Retention Approach**—Rather than a sign-on bonus, offering periodic student loan payments for employees who complete service requirements. Payments extend years after hire, creating a retention incentive.
- 4. The 401(k) Approach**—Some vendors' programs work in conjunction with employer 401(k) plans. Employees make student loan payments via payroll deductions which are "matched" by their employer in the form of pretax plan contributions. This strategy may be problematic from a compliance perspective.

## Proceed With Caution

Being the first to offer a benefit isn't always positive. Take, for example, "matching" an employee's student loan payroll deduction payments with an employer pretax contribution to the 401(k) plan. Employers would need to amend existing plan documents to describe this contribution and its formula. It is very possible that this type of amendment may not be supported under a prototype plan, requiring employers to adopt individually drafted plans. Currently, the

IRS does not provide qualified determinations on individually designed plans, creating even higher risk. Also, a contribution provided to only a select group may require testing requirements that the plan otherwise could avoid. Lastly, serious questions arise as to whether current IRS rules relating to contingent benefits would even allow employers to do this. Under the IRS' Contingent Benefit Rule, offering any incentives for employees to defer or not to defer into a 401(k) plan is prohibited. A plan sponsor would want to carefully discuss this strategy with its own ERISA counsel before proceeding.

## Government Help?

Bipartisan legislation has been proposed to encourage employers to do more. The Employer Participation in Repayment Act, introduced in the Senate, and the Employer Participation in Student Loan Assistance Act, introduced in the House, would amend tax laws to allow up to \$5,250 per year in employer contributions toward student debt to be considered as nontaxable income. These bills have been referred to the Senate Finance Committee and the House Ways and Means Committee, respectively, but due to the current Washington political climate, they are not expected to be seriously considered this year.

## Next Steps for Employers?

Student loan debt is not just an employee problem. The impact on employees' personal well-being, their performance on the job, and their retirement readiness is significant, and it is all felt by their employers.

As employers expand benefits to include different recruiting and retention programs, Lockton will continue to examine solutions that promote employer goals without imposing undue cost or administrative burden. If you have questions, please contact your Lockton Retirement Services Team.

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