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Student loan debt and retirement savings

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As companies consider offering a student loan benefit, a common question arises: Should the benefit remain outside of the employer-sponsored retirement plan, be integrated into the plan, or should it combine both?

Americans continue to be burdened by student loan debt. Fifty-five percent of students obtaining bachelor's degrees in 2020 had student loans, with an average of $28,000 in federal and private debt, and 14% of parents with students graduating in 2019 had an average of $37,500 in federal parent PLUS loan debt.[1] Forty-four million Americans now have student loan debt, with an average balance of $40,904.[2] As student loan debt continues to rise and employers face an increasingly competitive job market, many firms are considering alternatives to help employees reduce and manage their student loan debt. A recent survey from the Employee Benefit Research Institute (EBRI) concluded that nearly one-half (48%) of large employers offered, or are planning to offer, a student loan benefit for their employees.[3]

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Legislative and regulatory efforts impacting student loans and 401(k) plans

In August 2018, the IRS released the details of a private letter ruling (PLR) pertaining to student loan repayments and 401(k) plans. The requester, Abbott Laboratories, went public with the intention of generating wider discussion within the industry. The PLR allowed Abbott Labs to treat student loan repayments as if they were elective deferrals for purposes of receiving an employer contribution.

[1] Data from Federal Reserve, College Board, and Saving for College.

[2] Investopedia, *Student Loan Debt: 2021 Statistics and Outlook*, April 9, 2022. https://www.investopedia.com/student-loan-debt-2019-statistics-and-outlook-4772007

[3] Data from *2021 EBRI Financial Wellbeing Employer Survey: Focus on COVID-19 and Diversity Goals*.

The rationale was that there were participants who could not afford to make an elective deferral to a 401(k) plan because they needed to make student loan repayments. By not making an elective deferral, and as a result not receiving an employer match, these individuals were delaying retirement savings and could be at risk of having a shortfall at retirement.

The issuance of the PLR created plan sponsor interest in the issue. However, employers acknowledged that the PLR could only be relied on by Abbott Labs. Industry groups reached out to the IRS requesting more general guidance that could be relied on by plan sponsors, as many did not want the time commitment and expense of requesting their own PLR. The IRS stated that it would consider the request and subsequently indicated there was a project in the works.

> Currently, employers can consider a few additional options beyond the benefits offered under The Consolidated Appropriations Act of 2021. For example, employers may choose to offer student loan counseling, coaching, and education services. In addition, employers can provide employees with access to student loan refinancing as well as federal loan consolidation.

Meanwhile, as interest grew in Congress, proposals began appearing in various bills[4] that would allow a 401(k) plan to treat student loan repayments as if they were elective deferrals and provide a matching contribution on such repayments. As a result, the IRS announced it was pulling back from working on new rules and would wait and see what action would be taken by Congress.

In March 2022, the House of Representatives passed The Securing a Strong Retirement Act of 2022, often referred to in the industry as “SECURE 2.0.” This bill, which passed with overwhelming bipartisan support, would permit employers to make matching contributions in a 401(k) plan with respect to student loan repayments. The Senate is in the process of developing its own “SECURE 2.0” bill, which is expected to contain similar provisions related to student loan repayments and matching contributions.

Ultimately the two bills would need to go to Committee for a final compromise bill before proceeding to the President for signature into law. It is expected that there will be a “SECURE 2.0” bill signed into law, possibly by the end of 2022 or in 2023.

[4] For example, The Securing a Strong Retirement Act of 2020 (October 2020), Congressmen Richard Neal (D-MA) and Kevin Brady (R-TX); The Retirement Security and Savings Act of 2021 (May 2021), Senator Benjamin Cardin (D-MD); Retirement Parity for Student Loans Act (April 2021) Senator Ron Wyden (D-OR).

Plan sponsor considerations

As the retirement industry anticipates that a SECURE 2.0 bill will eventually be signed into law, many employers are actively considering whether to offer a student loan benefit, and if so, what the structure should be, including whether to include the benefit in its 401(k) plan. While some employers and employees may find this option appealing as both employee attraction and retention tools, there are considerations that plan sponsors should weigh when implementing a student loan benefit feature.

Outside the retirement plan

The Consolidated Appropriations Act of 2021 (the Act) allows employers to make tax-free contributions up to $5,250 a year to their employees' student loan debt. One common solution that employers have implemented is to provide a fixed dollar amount benefit (e.g., $100/month) paid directly to the employee's student loan servicer or paid directly to the employee. These payments are made concurrent with the employee's required monthly payments. The purpose of this type of benefit is to help reduce the student loan debt balance and accelerate the payoff date.

Currently, employers can consider a few additional options beyond the benefits offered under the Act. For example, employers may choose to offer student loan counseling, coaching, and education services. In addition, employers can provide employees with access to student loan refinancing as well as federal loan consolidation.

Integrated with the retirement plan

As student loan debt continues to grow, some employers worry about the impact on retirement savings. Their concerns have merit. Most student loan debt is owed by younger workers. Given the power of compounding, if employees miss out on retirement savings early in their working career, they could significantly impact their retirement readiness, leaving them with retirement shortfalls as they approach retirement.

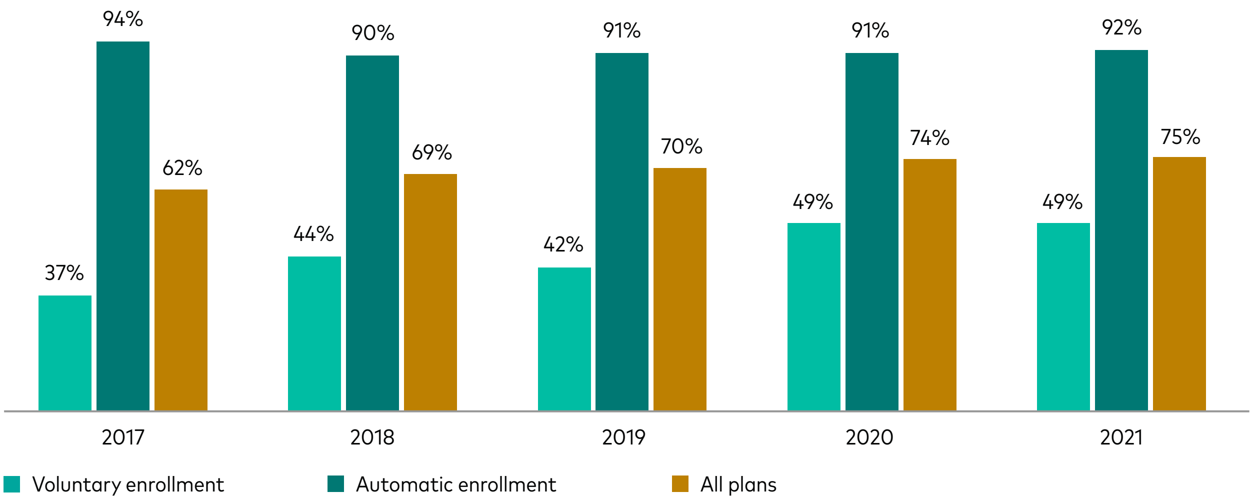
One alternative is to provide an in-plan solution. In this scenario, employers provide a matching contribution to employer-sponsored retirement plans when employees make payments to their student loan servicer, as long as an employee is not already deferring in the plan and receiving the employer match. Vanguard anticipates that the final SECURE 2.0 bill will contain provisions which will give plan sponsors the ability to provide this type of student loan benefit.

Is an in-plan option the answer? A look at our *How America Saves* data

While student loan debt impacts the financial wellness of employees of all ages, younger participants tend to have lower incomes and may be most susceptible to not participating in a retirement plan due to the burden of student loan debt.

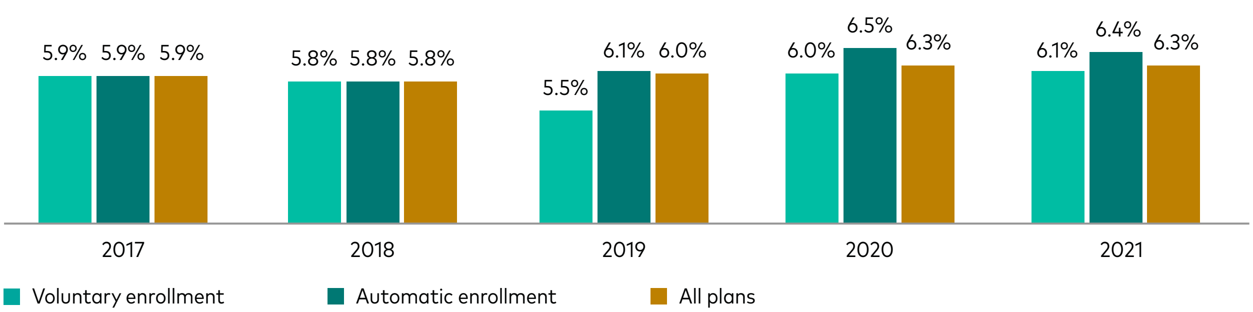
Data from Vanguard's *How America Saves 2022* shows that over the past five years, participation rates among younger employees have modestly increased. In fact, when employers automatically enroll employees into plans, only 8% of workers age 35 and younger opt to not contribute.

Participation rates: Employees younger than 35



In addition, deferral rates of younger participants have slowly increased over the past five years as well.

Deferral rates: Employees younger than 35



Source: Vanguard retirement plan data as of year-end 2021.

Note: Reenrollment, undersaver, and automatic increase sweeps can be performed with any group of employees, at any time, to help encourage strong retirement savings.

These participation and deferral rate improvements can be tied to automatic plan design solutions and the increasing adoption of automatic enrollment. Over the past 15 years, plan sponsors have increasingly implemented automatic solutions to help better prepare their employees for retirement. As of 2021, 56% of plans (and 75% of plans with at least 1,000 participants) had implemented an autoenrollment design, and adoption rates continue to increase. Furthermore, autoenrollment default rates continue to rise as plan sponsors reconsider the appropriate starting point for employee savings. Therefore, data suggests that while overall student loan debt has increased, employee retirement saving behaviors have not deteriorated but have modestly improved.

Firms that decide to offer an in-plan student loan benefit could potentially underserve their employees and unintentionally unwind the progress made by automatic enrollment. Offering an in-plan option could signal to employees that it is not necessary for them to defer into retirement plans and that the student loan employer contribution may be sufficient for retirement preparation. Furthermore, when employees eventually pay off the student loan, employer contributions will stop. Humans have a bias toward procrastination, and it may take time for them to join the plan by setting up their own payroll deferrals. Therefore, between saving at lower rates at the beginning and the potential for a delayed enrollment after payoff, the in-plan design could lead to unintended (and perhaps unnecessary) consequences by negatively impacting the retirement readiness of participants.

As of 2021, **56%** of plans (and **75%** of plans with at least 1,000 participants) had implemented an auto-enrollment design, and adoption rates continued to increase.

Plan sponsors considering in-plan student loan benefits may want to keep a few things in mind before proceeding:

- It is important to consider the current participation and deferral rates of younger employees. How have they trended over the past five years? Do these numbers suggest that employees are not making elective deferrals because they have student debt to repay, or do they suggest that elective deferrals are being made despite student loans being repaid?
- If the plan has an automatic enrollment feature, is it leading to expected participation rates? How does it compare with the benchmark? Analyzing plan data will help determine whether there is a savings deficiency.
- If an in-plan option is implemented, what will happen when the student loan debt is paid off? Will the plan consider automatically defaulting these individuals into the plan to ensure retirement contributions continue?

Conclusion

Providing a student loan reimbursement program or including a benefit within a retirement plan holds promise for employers looking to enhance their financial wellness programs. Plan sponsors may also create an integrated financial wellness experience that focuses on student loan debt, recommending solutions to lower payments through refinancing and/or prioritizing the debt among other financial imperatives. In 2022, Vanguard partnered with a third-party vendor to offer participants options to reduce student loan obligations, as a component of our holistic financial wellness programs both within and outside the 401(k) plan.

Plan sponsors should consider several factors before adopting an in-plan student loan benefit, including cost, administrative complexities, and the current saving behaviors of their participants before selecting a student loan benefit for their employees. Vanguard is ready to assist plan sponsors with industry-leading statistical analysis and benchmarking.

Improving retirement outcomes for all

Vanguard marries deep retirement expertise with technology-driven, client-centric innovation to deliver a comprehensive, world-class recordkeeping experience for plan sponsors and participants alike. As part of Vanguard's recordkeeping offer, plan sponsors have access to Vanguard Strategic Retirement Consulting, which draws upon its team of attorneys, actuaries, behavioral finance experts, and benefit plan professionals to develop innovative plan features and capabilities designed to improve participant outcomes. As part of the firm's efforts to give all investors the best chance for success, Vanguard also regularly advocates for industry practices and policy changes, such as the SECURE 2.0 legislation, that help improve Americans' chances of financial security in retirement.

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