Employers paying off student debt: The new 401k

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I attended college way back in 1994 and by the time I quit going to college in 1999, I had amassed over $45,000 in student debt. Due to some financial hardships right out of college, I had begun a deferment program where I was not required to make monthly payments, but still accrued interest. Now, over sixteen years later and after years of making payments nearing $600 per month, I owe nearly $55,000. Granted, some years were better than others where I would pay every month. Others years were not so great where I would go back into deferment. Given this crushing amount of seemingly never-ending debt, I cannot fathom diverting any of my paycheck for long-term retirement goals. The only real incentive to putting money away in a tax-advantaged plan is the fact that my employer matches some of what I contribute. That seems fine until you factor in how much interest I would pay over the life of the student loans and how important it is both financially and emotionally to finally be free.

One morning, recently, I heard on a radio talk show, how some companies were offering to contribute to student loan repayment instead of into 401k programs. I decided to look further into this topic by asking my HR professional at work if they had heard about this. It turns out that this is a new program being offered by companies such as PricewaterhouseCooper. “We see student loan debt as a major societal issue. The current state of student loans is troubling—$1.3 trillion of outstanding student loans, a $35,000 average loan balance for the class of 2015, and 40 million Americans with student debt—we need to start somewhere to help alleviate the burden.” (PwC, 2016)

Research suggests that employers should offer the option to match payment of student loans *or* 401Ks because employees of the ‘millennial’ generation have shifted their benefits preferences, under certain circumstances it is better to pay off higher interest debt first before investing in 401ks, many people are falling behind on paying off student debt, and millennials distrust the stability of the markets in which 401k are invested.

To begin, Millennials have shifted their benefits preferences away from more traditional offerings. Millennials, the generation of Americans born between 1980 and 2000, represent one-third of the total US Population in 2013. The total outstanding student debt was over $ 1trillion at the end of Q2 2014, making student debt the second largest category of household debt. The average amount of debt carried by each borrower is over $35,000 (CEA, 2014).

In a recent survey by IonTuition, researchers asked 1,000 participants with student loans what types of benefits they wanted from employers. Fifty-five percent of respondents said that they would rather have the money that is currently going to health care go to pay down their student loans. In the same survey, forty-nine percent of respondents indicated that they would rather have their student loans paid down as opposed to contributing to a 401k plan (IonTuition, 2015).

In another survey, eighty-five percent of participants indicated that they would accept a job and indicated a willingness to stay at a job at least thirty-six percent longer if student loan repayment was offered. Also, the average participant preferred student loan repayment nearly 2:1 over 401k contribution or health insurance and 11:1 over gym memberships. Twenty-seven percent of participants preferred student loan repayment over 401k by a margin of 18:1 and by a margin of 23:1 over health insurance (Aronson, 2015). "Pricewaterhouse Coopers (PwC), the global consulting and accounting firm, announced that starting in July 2016, some employees will become eligible for a student loan benefit. About 45% of staff between entry level to six years of tenure could receive $1,200 per year for up to six years, according to Michael Fenlon, PwC's global talent leader. 'We targeted the program toward recent college graduates, because they've told us they are feeling the weight of student debt.'" (Dishman, 2015).

Also, under certain circumstances it is better to pay off higher interest debt first before investing in 401ks. According to Dave Ramsey (Ramsey, n.d) you should pay off all debt except your mortgage using the “debt snowball method” before you invest 15% of your income in your tax advantage retirement accounts. “Millions of people try to multi-task and work towards these goals all at once. They pay on their debt, try to save a little for emergencies, and contribute a bit to their 401(k)s all from the same paycheck. Not only does that slow their progress, it also leaves them unprepared when unexpected expenses arise. “(Ramsey, n.d)

Paying off student loans is a guaranteed investment. It not only eliminates the interest, but also guarantees an increase in cash flow. “There’s another benefit that most people don’t think about. Understand that while the terms of any loan arrangement are fixed, the results of investment activity are not. Stocks can fluctuate in value, but debt doesn’t. That is to say that there is a fundamental imbalance between debt and investments. “(Mercadante, 2015)

Next, according to a Bloomberg article, “About 11.5 percent of student debt was delinquent or in default for at least 90 days in the quarter that ended in June, up from 11.1 percent in the previous three months, according to data released today by the Federal Reserve Bank of New York. Credit-card delinquencies held steady, at 8.4 percent.” (Lorin, 2015).

Also, current students do not have realistic expectations about the amount of time it will take to repay student loans. “The standard repayment plan for federal student loans puts borrowers on a 10-year track to pay off their debt, but research has shown the average bachelor's degree holder takes 21 years to pay off his or her loans. Under federal income-based repayment options, remaining debt is forgiven after 20 years.” (Bidwell, 2014)

“3.6 million borrowers—about 1 in every 6—were in default on a total $56 billion in student debt, meaning they had gone at least a year without making a payment. Another three million borrowers, owing an approximate total of $66 billion, were behind in payments by at least a month. And yet another three million, owing nearly $110 billion, were in ‘forbearance’ or ‘deferment,’ which means they had received permission to temporarily cease payments due to a financial emergency like unemployment.” (Close, 2016)

“According to the Education Department, 8.1 million people — roughly the population of New York City — had not made a payment on $128 billion in student loans for at least nine months as of June, an 8 percent increase over the same period a year earlier. Well over half of the people in default have loans from the old bank-based federal lending program, but the number of borrowers with newer loans who were falling behind on payments is high. “(Douglas-Gabriel, 2016).

And finally, millennials distrust the stability of the markets in which 401k are invested. “While the simple fact that boomers are older may explain some of the difference in behavior -- it’s hard to prioritize investing and saving for retirement when it seems you’ll be working forever — there’s more than the feeling of invincibility that’s typical of the (millennials) that’s keeping them away from the stock market. Instead, a lack of money and information are the biggest reasons why the under-30 set is skittish about stocks.” (Berman, 2015)

“The earliest millennials have already been forced to endure two stock market crashes and multiple armed conflicts (sparked by one of our nation’s most traumatic experiences in a century), and they’ve inherited a world with some of the least-trusted leaders in history, while the national debt soars to stratospheric all-time highs (when it’s said that future generations will pay for the current generation’s debts, millennials are that future generation).

Given that backdrop, it’s hardly surprising that millennials are frequently disillusioned, harbor a distrust of most large institutions, and have largely spurned many of the ‘traditional’ career paths. Furthermore, they’re deeply skeptical of the stock market. (Powers, 2015)”

In conclusion, due to the shift in benefit preferences of millennials, the fact that in some instances it is better to pay off student debt before investing in your retirement, the staggering numbers of students that have fallen behind in paying off student debt, and the general mistrust of the markets in which 401k systems are based, it should be a matter of practice for employers to offer to match student loan repayment or traditional 401k investments.

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