Change Ahead

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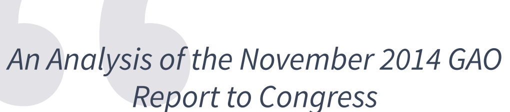
WHITE PAPER



Changes Ahead for Retirement Plan 401K Forced Transfers and Inactive Accounts

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INTRODUCTION

In November 2014, the United States Government Accountability Office (GAO) submitted a report to the Senate Committee on Health, Education, Labor and Pensions entitled “401(K) Plans: Greater Protections Needed for Forced Transfers and Inactive Accounts.” The report studied what happens when employees change jobs and leave their retirement savings in their former employers’ 401(k) plans. It also made several important recommendations to help protect the value of these assets and plan participants’ ability to collect their lost funds.

As CEO of PenChecks Trust™, one of the largest independent providers of administration and custodial services for Default/Missing Participant IRAs (and one of the firms interviewed by the GAO), I would like to present my analysis of this important document, focusing on three broad areas as covered in the report.

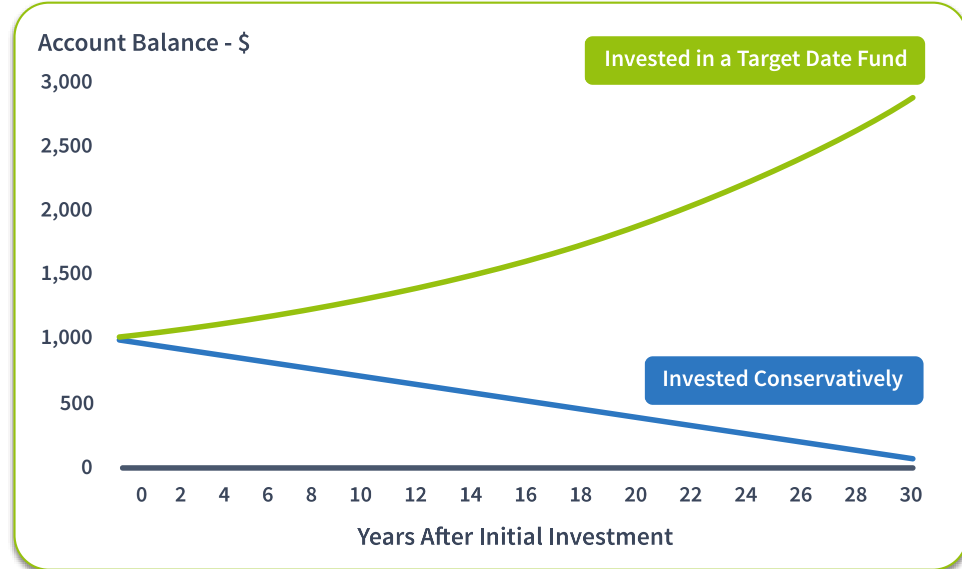
ANALYSIS

1. **What happens to the account balances of participants who are forced out of their plans and into IRAs.** Each year, millions of employees change jobs, with many leaving their retirement savings in the former employer's 401k plan. If their accounts are small enough and they do not instruct the plan to do otherwise, plans can transfer their savings into an IRA without their consent. Over time, account fees and low interest rates can seriously erode the value of these assets.

2. **The challenges plan participants face trying to keep track of retirement savings, and how other countries address similar challenges of inactive accounts.** The GAO's review included projecting forced–transfer IRA outcomes over time using current fee and return data from 10 providers, as well as interviews with stakeholders in the U.S., Australia, Belgium, Denmark, the Netherlands, Switzerland and the United Kingdom.

3. **Recommendations for Congress.** The GAO suggests current law be amended to permit alternative default destinations when transferring participant assets out of plans, and replacing a provision that allows plans to disregard rollovers when identifying balances eligible for transfer to an IRA. The GAO also recommends that the Department of Labor (DOL) convene a taskforce to explore the possibility of establishing a National Pension Registry. The DOL and Social Security Administration (SSA) each disagreed with one of GAOs recommendations. GAO concluded its report by maintaining the need for all its recommendations.

The timing of the study played an important role in many of the GAO's conclusions. For example, current Safe Harbor provisions guiding mandatory distributions ("Force-Outs"), require the funds to be invested in FDIC insured deposits, with no risk to principle. However, because the GAO study was conducted during the Great Recession, which featured the lowest interest rates in over 75 years, fees outpaced returns in most Force-Out IRAs. The GAO concluded those types of account balances tended to decrease over time, finding that 13 of the 19 balances decreased to 40% of their initial value within 50 years.



Source: GAO projection based on analysis of investment return data | GAO-15-73

A $1,000 Forced-Transfer IRA Balance Invested in a Target Date Fund Could Grow Over 30 Years but Declines When Invested Conservatively

PenChecks agrees with the GAO that the current investment limitations produce very poor results, resulting in a decline in the participant's account balance – especially for accounts with less than $15,000. It might take almost a decade for the account to disappear, in which time interest rates could significantly increase and change the outcome. But for now interest rates remain low, and it will likely be a long time before they return to pre-2007 levels.

The report also points out that individuals who accrue multiple accounts over their careers may be unable to consolidate their accounts by rolling over savings from one employer's plan into the next. Maintaining communications with multiple former employers or Auto Rollover providers can also be challenging, especially when companies merge, go out of business, or a plan terminates or merges into another plan. In addition, key information on lost accounts may be held by different plan service providers, making integration of those accounts more complex, if not impossible. As a potential solution, PenChecks believes the moment a person becomes a participant in any qualified plan for the first time, a Master IRA account should be established.

Thereafter, each time the participant changes employers, their account balance – regardless of size – would automatically be transferred to the Master IRA account. This account would remain with the participant for their whole working career and would be tied to a registry of accounts, such as the National Registry of Unclaimed Retirement Benefits (www.nrurb.com). If a plan sponsor could not locate a former participant, it could use the NRURB to locate their Master IRA and transfer the funds to it.

THE PROBLEMS WITH FORCED-OUT ACCOUNTS

According to the SSA, from 2004 to 2013 separated employees left more than 16 million accounts of $5,000 or less in workplace plans, with an aggregate value of $8.5 billion. Leaving these assets in the former employer plan makes no sense and guarantees poor performance and ultimate loss of proper use of the funds. Consolidating them into a Master IRA account would insure continuity of the investment return, effective marshaling of the assets, and hopefully sustain the value of the assets while keeping pace with inflation. Participants could not withdraw the funds until age 55, and could not borrow from the account. The Master IRA could be converted to a Roth, but only at the discretion of the participant after demonstrating he/she is the rightful owner.

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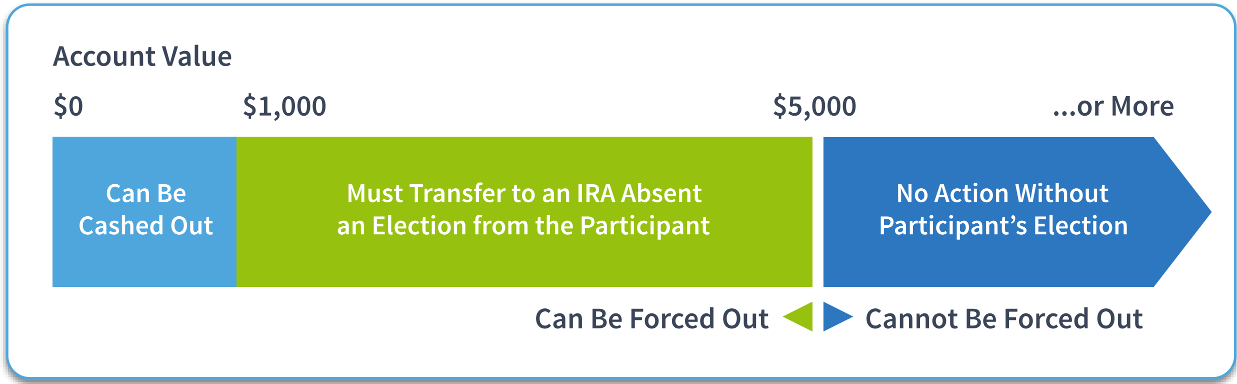

Source: GAO review of select laws and regulations | GAO-15-73

The PPA gave the PBGC the option to expand the defined benefit program to include defined contribution plans, but did not require it. Currently, defined contribution plans vastly outnumber defined benefit plans. Plus, the PBGC has no jurisdiction over defined contribution plans (with the exception of money purchase plans, which also seem to be going away).

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Currently, the reporting and filing requirements for terminating and abandoned plans occurs entirely with the DOL. Turning these over to the PBGC would result in a large data gap that would be difficult and expensive to close. At minimum, it would likely require significant IT resources to allow two disparate systems to share data. A more likely scenario would involve entirely new systems for both the DOL and PBGC – an investment requiring millions of dollars. Once built, the costs of maintaining these massive databases and searching for participants could make it difficult to perform this work at a competitive/reasonable price.

Keep in mind that the Pension Benefit Guaranty Corp.'s deficit hit a record $61.7 billion in fiscal 2014. Moreover, the PBGC is not funded by general tax revenues. Instead, its funds come from four sources: insurance premiums paid by sponsors of defined benefit pension plans; assets held by the pension plans it takes over; recoveries of unfunded pension liabilities from plan sponsors' bankruptcy estates, and investment income.

Given these headwinds, PBGC's comment that it hopes to open its program to terminating defined contribution plans in 2016 (see footnote 38 in the report) would seem hopeful indeed. Furthermore, such a move into the defined contribution space would seem to put the federal government in competition with the private sector.

Another glaring issue is that in the course of a working career a participant could end up with multiple forced-out IRAs – with each charged a separate fee rather than being consolidated. The GAO points out that most providers will not merge multiple IRAs for the same person into one, although there are exceptions. This further supports the value of a Master IRA for each participant in a qualified plan that will automatically collect funds for the same person.

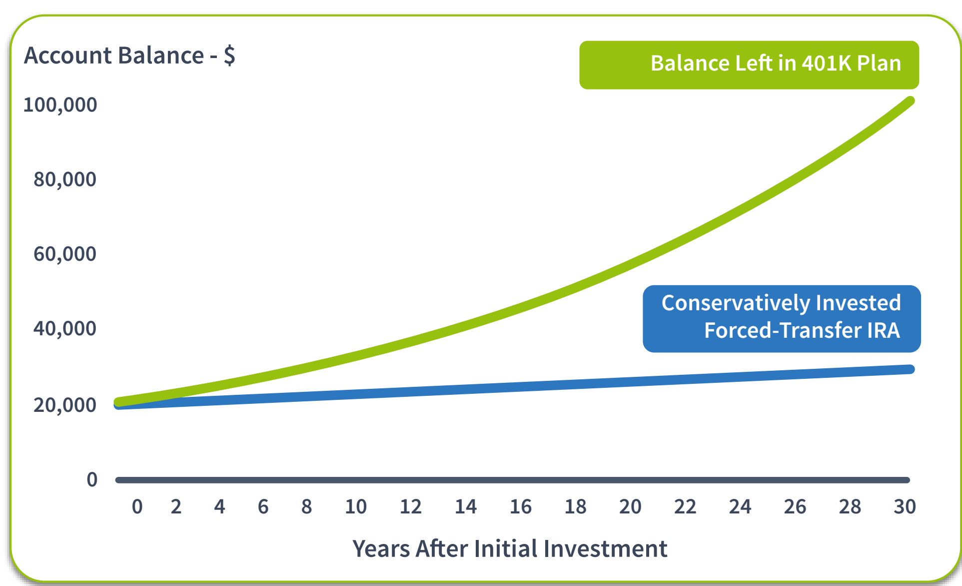
The use of appropriate Target Date Funds may provide a workable solution.

The GAO makes an excellent case that unless the law is changed by Congress to provide an alternative destination for forced-out account balances, both the DOL's and IRS's hands are tied. Former plan participant's savings will continue to be placed in investments unlikely to be preserved or grow over the long term. The use of appropriate Target Date Funds may provide a workable solution.

When analyzing the size of those rollovers, the GAO made a clear distinction between forced-out account balances without rollover funds and those with rollover funds from a former employer. The average account size with a rollover is approximately $5,810, with a median rollover balance of $4,260. The average without a rollover was $1,551.

The GAO then developed a scenario involving a forced-out vested account balance of $5,000 plus an accumulated rollover amount of $14,500, allowing the plan to force the entire fund balance to a Forced-IRA. They projected that had these funds been left in a 401(k) plan and reinvested in a target date fund earning 6.3%, the account would have gained more than $80,000 over a 30-year period.

Options for Forcing Out a Separated Participant Depend on the Participant's Vested Balance



Source: GAO projection based on analysis of forced-transfer IRA and 401K Industry data | GAO-15-73

The GAO also noted that the amount of time required to become eligible to participate in the plan, along with a lengthy vesting schedule, can make it hard for low-wage workers to build up a vested balance that exceeds $5,000. In fact, about 40% of the plans studied used a service requirement that resulted in smaller balances being accumulated. Current law allows graded vesting to stretch out as long as six years, while cliff vesting can stretch out for three years. These vesting schedules could have a significant impact on account balances. For this and other reasons, I am a strong proponent of 90-day eligibility periods and immediate 100% vesting.

Current vesting schedules could have a significant impact on account balances

The report went on to say that today's highly mobile workforce increases the likelihood that employees will participate in multiple plans. During the past 10 years, 25 million participants in workplace plans separated from their employer and left at least one account behind.

The GAO concluded there is no standard way for participants to consolidate their accounts within the 401(k) plan environment. It also pointed out that the promotion and use of Automatic Enrollment contributes to participants having multiple accounts, thus increasing the number of accounts being forced out and resulting in accounts with smaller balances, which participants my be less likely to pay attention to. Lack of an easy path for plan-to-plan rollovers increases the number of accounts, making it more difficult to keep track of one's retirement funds.

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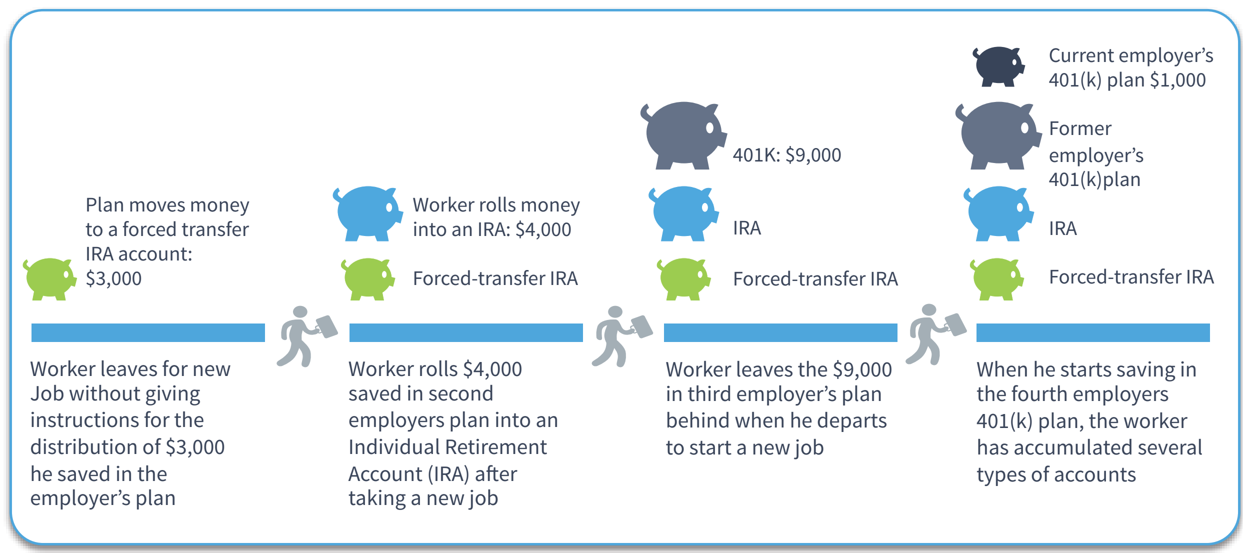
Accordingly, the GAO recommended that the DOL and IRS work on eliminating the barriers prohibiting plan-to-plan rollovers.

A Worker's Accumulation of Multiple Accounts for Retirement Savings



Source: GAO review of select laws and regulations | GAO-15-73

A simpler process would involve creating a Master IRA, with each deposit being reported to the Social Security Administration – as we are currently required to do with terminated participants with vested account balances that have been gone for a year. (This information is communicated to the SSA on form 8955-SSA.) Let's assume such a Master IRA account did exist, and that it came time for the participant to begin receiving their social security benefit. Once they applied for their benefit, the SSA would have the necessary information to advise the participant that they have a Master IRA account and where to apply for those benefits.

One of the obvious challenges for plan sponsors and record-keepers is developing an automatic way to keep current information on a former participant. The GAO suggested that the guidance on searches is unclear and insufficient. For example, they suggested it is unclear how to satisfy disclosure requirements, such as privacy issues and fees charged against the plan, when a participant's address on file is known to be incorrect. However, at PenChecks we have found many ways to validate information and conduct ongoing searches, including public search engines and even private investigators for accounts with large balances. The report did include information on various federal agencies or entities that can help former participants locate 401(k) Accounts. These include the DOL's "Office of Outreach, Education, and Assistance" (OEA), Pension Benefit Guarantee Corporation (PBGC), and the Health and Human Services Administration on Aging. Page 29 of the report gives an excellent description of each agency's support services.

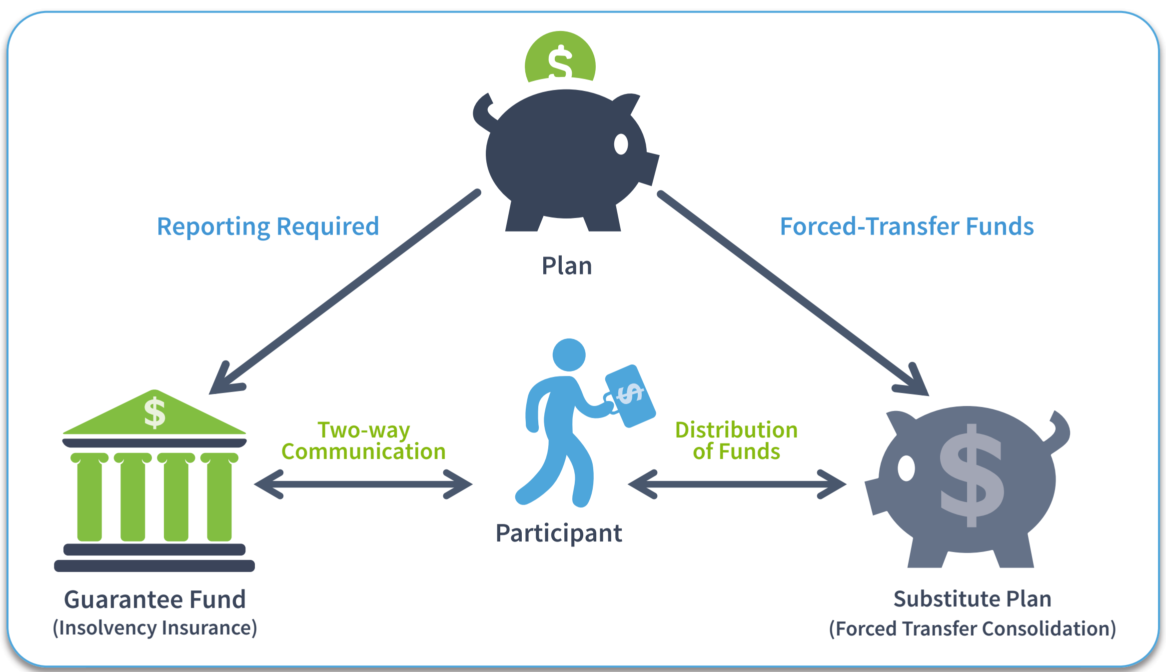
The GAO also pointed out how the Social Security Administration provides assistance that can help participants locate retirement savings left with a former employer. Plan participants can request a copy of the "Notice of Potential Private Retirement Benefit Information" from the SSA, and if the plan sponsor filed form 8955-SSA, the SSA will have the information. Surprisingly, although the SSA claims they have records of potential benefits for more than 33 million people, only 760 people requested this information in 2013.

APPROACHES IN OTHER COUNTRIES

Some countries have legislation that provides for the consolidation of transferred accounts, either in a participant's new plan or with other forced-out transferred accounts. **This enables these accounts to grow, either at a rate comparable to participants' current retirement accounts, or at least keeping pace with inflation.**

However, on pages 35-45 the report discusses in some detail how these countries (United Kingdom, Switzerland, Australia, Denmark, Belgium and the Netherlands) attempt to deal with protecting forced transfers and tracking accounts. Their approaches reinforce the concept of a Master IRA as a potential solution in protecting and tracking force-outs.

Options for Forcing Out a Separated Participant Depend on the Participant's Vested Balance



Source: GAO analysis of documents describing Swiss transfer policy and statements from Swiss officials | GAO-15-73

The European Union is examining the use of a registry for former participants to use and search for prior benefits. Currently, the U.S. lacks a pension registry that can provide those opportunities for participants. However, we do have the National Registry of Unclaimed Retirement Benefits (NRURB). Sponsored and supported by PenChecks Trust, this service is available at no cost to anyone, including plan sponsors and government entities.

PenChecks created NRURB as a public service company to help reunite plan participants with their money. However, besides PenChecks and a few other employers, it hasn't seen widespread use within the industry. We believe that using this service adds another layer of fiduciary protection that companies have done everything to locate a former employee.

GAO RECOMMENDATIONS

The GAO set forth the following recommendations in their report:

1. To ensure that 401(k) plan participants have timely and adequate information to keep track of all their workplace retirement accounts, we recommend that the Social Security Administration's acting commissioner make information on potential vested plan benefits more accessible to individuals before retirement. For example, the agency could consolidate information on potential vested benefits, current sent in the Potential Private Retirement Benefit information notice, with information provided in the Social Security earnings and benefits statement.

2. To prevent forced-transfer IRA balances from decreasing due to the low returns of the investment options currently permitted under the Department of Labor's safe harbor regulation, we recommend that the Secretary of Labor expand the investment alternatives available. For example, the forced-transfer IRA Safe Harbor regulations could be revised to include investment options currently under the qualified default investment alternatives regulation applicable to automatic enrollment, and permit forced-transfer IRA providers to change the investments for IRAs already established.

3. To ensure that individuals have access to consolidated online information about their multiple 401(k) plan accounts, we recommend that the Secretary of Labor convene a taskforce to consider establishing a national pension registry. The taskforce could include industry professionals, plan sponsor representatives, consumer representatives, and relevant federal government stakeholders, such as representatives from SSA, PBGC, and IRS, who could identify areas to be addressed through the regulatory process, as well as those that may require legislative action.

Three Possible Ways Workplace Retirement Accounts Can Follow Job-Changing Participant

Source: GAO interviews with relevant officials and account transfer policy documents | GAO 15-73

For DOL and SSA responses to the GAO recommendations, please see pages 50-53 of the report.

CONCLUSION

Before concluding my review, I would like to point out the following:

- As of 2013, the 10 major IRA providers (of which PenChecks is one) had opened more than 1.8 million forced-transfer IRA accounts with a total of $3.4 billion in retirement savings. One provider has projected that more than 600,000 new forced-transfer IRAs could be created each year. Assuming each account averages $2,500, a total of $15 billion would be transferred into these accounts each year.

- According to the SSA, from 2004 to 2013 separated participants left more than 16 million accounts of $5,000 or less in workplace retirement plans, with an aggregate value of $8.5 billion (this reflects both defined contribution and defined benefit plans).

- According to a Profit Sharing Council of America (PSCA) survey of 401(k) plans, about 40% of plans do not currently force out participants with balances of $1,000 to $5,000. However, this survey only reports on 401(k) plans and does not include data on balance-forward plans.

- In the GAO research, several IRA providers stated that forced-transfer from terminating plans represent a small part of the forced-transfer IRA business. One provider indicated that 9% of forced-out plans comes from terminated plans, with many of the providers not offering this service to terminating plans. This suggests that participants in terminating plans are more likely to have an opportunity to select a distribution destination other than a forced-transfer IRA. We agree, based on the stricter demands placed on the administrators handling and communicating with participants in a terminated plan.

In closing, it is rare that one reads a report published by a governmental agency that is thorough in all of its aspects, filled with relevant information, and provides recommendations that are both practical and relevant. I encourage those that operate in the Qualified Plan space to take the time to read it.

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With 20 years in business, PenChecks Trust is an expert and industry-leading provider of unique and comprehensive solutions for a myriad of trust resolution issues. Services include automated and branded solutions for benefit payment processing, uncashed/stale dated checks, Abandoned Plan/QTA services and Taxable Savings Accounts. Customers include financial institutions, third party administrators, plan advisors, and plan sponsors.

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