VIEW POINT

AUTO PORTABILITY OF DC RETIREMENT ACCOUNTS

Abstract

It's hard enough for workers build a path toward a financially secure retirement, made even harder when they change jobs often – a phenomenon we're seeing more frequently, according to the U.S. Bureau of Labor Statistics[1].

When employees participating in a workplace retirement Defined Contribution (DC) plan, like a 401(K) plan, change jobs, it can be disruptive to their long term savings strategy. For those who carry a small plan account balance (<$5,000), he or she may have to cash out the balance of their plan or see that money rolled over into an Individual Retirement Account (IRA). Even for those with higher account balances, the account rollover process from the old employer to the new one is sometimes so complicated that participants are inclined to cash out the balance altogether. All of these possible outcomes could negatively impact the positive inertia of the worker's savings habits, leave their balance sitting in an account type which could earn little to no growth or interest, and disrupt their path toward a financially secure retirement.

This POV talks about a program called "Auto Portability of DC Retirement Accounts," which provide an automated option for participants to transfer retirement accounts from their previous employer's plan to the active retirement plan of their new employer. Here, we outline a program from The Retirement Clearinghouse that, if more widely embraced, could significantly reduce the negative impacts of job changes on participants.

This paper outlines details such as what the current challenges of such job change instances are, how the Auto Portability program works, the associated regulatory rules, and multiple advantage of the program. While this paper focuses on the US market, the trend is one seen globally.

Infosys®
Navigate your next

Overview

A cash out from an employer provided 401k plan after leaving a job is basically a withdrawal of all the money and a closure of that account. A cash out is not often necessary when leaving the job; the participant often has several options.

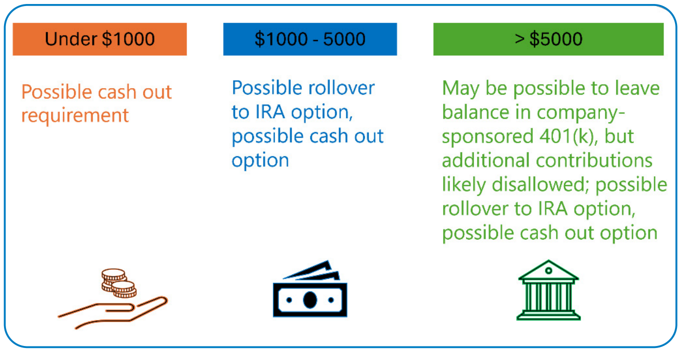

Figure 1: Hypothetical Options After Leaving Job, for Employees Participating in Workplace Retirement DC Plan

Employees tend to change multiple jobs throughout their working lifetime. Frequent cash outs or leaving the balances as-is after every job change could be detrimental to the success of a worker's long-term retirement savings strategy.

According to research by the "Savings Preservation Working Group", at least 33% of participants cash out their retirement savings after switching jobs, often within a year of job change. According to the research, this phenomenon happens most commonly among low-income workers and minorities earning only $20,000 to $30,000 per annum.

This cash out of small retirement accounts happens most frequently when employees exit the company and have a balance up to $1,000; balances between $1,000 and $5000 are often rolled into an Individual Retirement Account (IRA), which could have a very conservative asset allocation. Being out of the market, in an investment vehicle that doesn't keep pace with inflation, without maximizing tax savings opportunities, could all have a dampening effect on the worker's ability to save for a financially secure retirement. Also, keeping track of multiple, small balance accounts can be daunting. Furthermore, the costs associated with seeking professional financial advice can be a barrier for lower income workers, so they often lack a holistic view of their financial well-being.

Auto Portability of retirement accounts can address the aforementioned problems. It provides an automated option for participants to transfer their small, inactive retirement accounts from their previous employer's plan to the active retirement plan of their new employer.

Underlying Challenges and Impact

- Cash-out leakage from retirement accounts: When employees with smaller balances (<$5,000) leave their company, they typically have 30-60 days to move their plan balances from their old employer to their new one. Failing to do so could result in their balance being cashed out (< $1,000) or moved into an IRA, which could default investors into a conservative investment vehicle that could earn negligible interest or growth potential. Since this plan-to-plan transfer is very cumbersome process which requires an average of 19 hours of employees' efforts, many prefer to either cash out or leave the balances behind. According to a study, 36% of employees with balances between $100 and $500, valued their personal time over completing the plan transfer. Even with larger balances over $5000, 6% employees gave priority to personal time.

  After 35-40 years of service across multiple job changes, these small, neglected accounts could lead to potential loss of asset growth, making a considerable impact on overall savings for retirement. According to 2015 data from the Employee Benefit Research Institute (EBRI), $92 billion is cashed out of U.S. retirement plans due to job changes every year. This means that over time, trillions of dollars have been yanked away from the retirement savings vehicles they've been directed to – putting retirement savers further and further from their goals.

- Missing participant and small abandoned retirement accounts: Many participants take no action at all when they change jobs – including making updates to the mailing address on record with their old employer. In 2018, there was a joint survey conducted by Boston Research Technologies and the Retirement Clearing House (RCH) which showed that 11% of employees who were forced out of their previous plan had old addresses in their records. Furthermore, it resulted in one-fifth of these employees falling under a "missing participant" category with their former employer. According to this research, this resulted in more than three million participants falling in to this "missing" category, effectively separating them from assets that belong to them. This is one of the biggest challenges of any recordkeeper or plan sponsor. The U.S. Department of Labor (DOL) is now focusing heavily on number of missing participants.

How Does Auto Portability of DC Retirement Accounts Work?

The concept of auto portability of DC retirement accounts was first piloted by the RCH in 2017. It implemented the concept by developing critical infrastructure and multiple interfaces with the latest innovative technologies — technologies that can help plan sponsors and recordkeepers ensure the smooth flow of participant information and other relevant data between recordkeepers and the RCH in a highly secure manner.

Technology plays a critical role in reducing the amount of time, administrative work required, and costs associated with transmitting the relevant retirement account details of the participant from the previous employer to the new employer after a job switch. It helps make it more efficient than the traditional plan-to-plan transfer. There are four basic operational components of Auto Portability. Refer Figure 2.

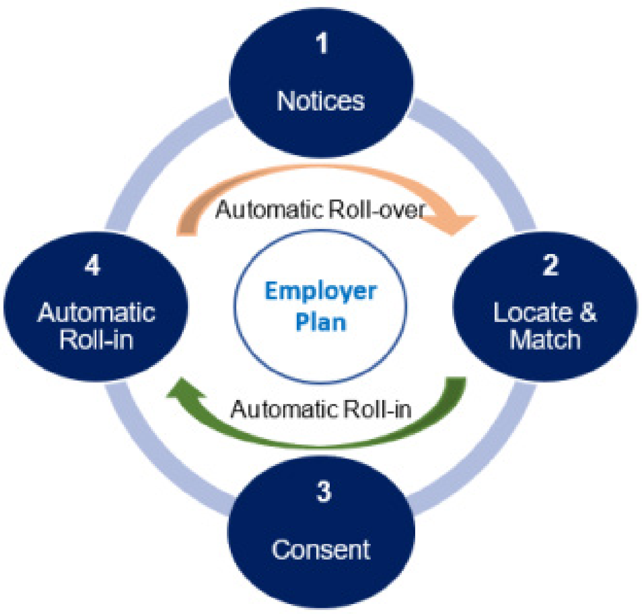

Figure 2: Operational Components of Auto Portability of DC Retirement Accounts

1. **Notices:** Once a participant's retirement account is eligible for mandatory distribution (for example, the plan balance shrinks to <$1,000), the participant could receive a notice asking for all required information to proceed legally with the next step in the Auto Portability program process.
2. **Locate and match:** These details of the participant's account are securely shared with the RCH, which in turn, securely shares it with all recordkeepers participating in this Auto Portability program. Each recordkeeper could query their system to find a match. Upon finding a successful match, a notice could be sent to the participant asking for his or her consent on the next steps.
3. **Consent:** The participant may provide his or her positive consent in multiple ways and channels, such as in written, over secure web or voice response system, or via call center. No response may be treated as negative consent in some cases, in which case a non-responder could move to the next step.
4. **Automatic roll-in:** Based on details and responses received in the above steps, the inactive account with the previous employer could be closed. The balances could be rolled over to the account in the new employer's plan, and could be invested as per the participant's investment election in new plan. In case of no elections, it could be invested in a default fund in the participant's active plan. After successful completion, the participant could be notified that the transfer has been completed.

Regulatory Support

The regulatory framework of Auto Portability of retirement accounts was published by the DOL. It outlined the important guidelines for the Auto Portability program conceived and developed by RCH.

In 2018 and 2019, DOL had issued two pieces of guidance as mentioned below which outlined the critical parameters of this program — such as the responsibilities of a fiduciary and other requirements including mandatory communications to participants, fee disclosures, and other details.

1. **Advisory Opinion 2018-01A (DOL, Nov 5, 2018):** This Auto Portability program raised multiple concerns related to fiduciary responsibilities. The DOL, for example, had in its advisory opinion stated that for rollovers from old plans to IRAs, or from IRAs to new plana, the RCH could own fiduciary responsibilities. However, old and new plan sponsors could also remain fiduciaries to decide to participate into this program as well as for their respective plans. New plan sponsor can also be responsible to ensure that incoming IRAs are compliant with the new plan requirements, and can reserve the right to allocate the incoming balances as per the new plan's investment options.

2. **Final PTE 2019-02 (DOL, July 31, 2019):** Once the balances from an old IRA have been moved to a new plan, RCH, being a fiduciary of this program, had charged a fee to the new plan sponsor. However, as per the Employee Retirement Income Security Act of 1974 (ERISA) which says that two fiduciaries cannot be engaged in self-dealing, it was determined that this could not be permitted. The result was scepticism about the feasibility of this Auto Portability program. To avoid this, the DOL has given an individual prohibited transaction exemption (PTE) with multiple conditions but only for five years, after which the RCH program can go through an audit to ensure that the program indeed benefited participants.

Advantages of Auto Portability

1. **Prevent cash-out leakage from retirement accounts:** According to the RCH, every year, approximately 15 million participants, contributing in one of the DC plans, switch jobs. About 40% of those participants withdraw their total balances. If those balances are not rolled over into another retirement savings vehicle, savers miss out on the power of compounding, and risk having their nest egg eroded by inflation.

   Taken in aggregate, this means that over time, there are trillions of dollars intended for retirement savings that are sitting on the sidelines while the modern worker falls further and further behind meeting their retirement savings goals..

   The tendency to cash out during a job switch has been seen most frequently from the 5.3 million participants with balances less than $5,000,. Out of these, 4 million - i.e., 75% of this population --leaked out in total $174 million. Again, if we do same calculation based on the current dollar rate, over a period of 40 years, this amount be aggregated to $1.5 trillion.

   EBRI and RCH, in their simulation of Auto Portability in year 2016, had demonstrated that with the help of Auto Portability, over a span of 40 years, the leakage of retirement savings can be reduced from $320 billion to $164 billion which is almost 50% reduction.

2. **Help lower the number of missing participants:** Since 2014, DOL has been very strict in their audits of recordkeepers and plan sponsors, and they are focusing heavily on missing participants and abandoned accounts. Auto Portability could help recordkeepers and plan sponsors ensure compliance with lost-account rules and avoid incurring fines and penalties.

3. **Help reduce the duplicate accounts and reduce cost:** With the feature of consolidating balances into one active account with a worker's current employer, Auto Portability could help reduce the number of duplicate accounts and hence lessen the maintenance cost as well.

4. **Better financial wellness of participants:** Smooth transfer of balances from a previous employer to a new employer could help retirement balances grow, increasing the financial wellness of participants. This is also a priority of all recordkeepers and plan sponsors.

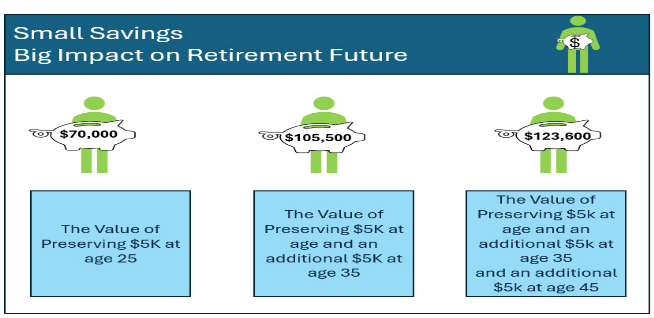

Figure 3: Retirement Nest Egg Growth Potential with Additional Savings

POV for service providers

For Auto Portability to work timely, efficiently, seamlessly and be adopted broadly in the industry, the recordkeepers and their IT service providers must work together to support the required unifying tech stack and protocols and make it available to all parties as an opensource product. Regulatory support has been in place for quite a while now and early adoption also started in 2020, but wider implementation is still lacking.

It may be due to additional cost to be borne by the recordkeepers which is holding them back, therefore Plan sponsors have huge role to play in motivating their respective administrators and providers for faster adoption, which ultimately can help their employees' financial well-being and reduce retirement savings leakage.

IT service providers need to instill confidence in the interconnection mechanisms by quickly resolving any tech roadblocks so that the experience is uniform and pleasant for users across the board.

Conclusion

The US retirement market is growing at a steady pace where employers are encouraging participants to save for their golden years. According to the "Investment Company Institute", total U.S. retirement assets were $39.9 trillion as of March 31, 2024, up by 4.3 percent from December 2023. Out of which, DC plan assets were $11.1 trillion, at the end of the first quarter, up 5.3 percent from March 31, 2023. Also, as per the RCH, there are 14.8 million DC participants switching the job yearly.

Current processes of the plan-to-plan transfer are complicated, cumbersome, and time consuming, leading many participants to either withdraw their balance or see it moved to an IRA. It also results in either duplicate or missing participant accounts. Effective Auto Portability can address these concerns and help the participants in reducing leakage from their retirement savings. It can also help the recordkeepers and plan sponsors to reduce the administrative burden of deserted and duplicate participant accounts.

Understanding the importance of Auto Portability, the RCH has developed a robust solution and the DOL has issued the associated regulations to encourage adoption by plan sponsors. In July 2020, Alight Solutions became the first institution to adopt Auto Portability for its 185 companies and 5 million participants. Vanguard also engaged the RCH in September 2021 and went live with their solution in mid-2022. Following the footprint, Fidelity Investments rolled out this option to their clients and end participants in October 2023.

Along with major recordkeepers like Fidelity, Vanguard, and Alight, the other three recordkeepers in the network—Empower, Principal Financial Group and TIAA— have joined the Portability Services Network (PSN) consortium and are scheduled to go live with this RCH service with their plan sponsors in the first quarter of 2025.

Now that big players such as Alight solutions, Vanguard and Fidelity have shown confidence in this program, DOL and other regulators appear to be planning to take further steps to promote and facilitate the adoption of Auto Portability by all plan sponsors and recordkeepers.

References

1. https://www.bls.gov/opub/mlr/2024/beyond-bls/what-factors-do-workers-consider-when-changing-jobs.htm#:~:text=They%20find%20that%20changing%20jobs,more%20likely%20to%20switch%20jobs.
2. https://cri.georgetown.edu/auto-portability-what-it-is-why-its-needed-and-how-it-will-strengthen-retirement-security/
3. https://pressroom.vanguard.com/news/Press-release-Vanguard-RCH-to-offer-Auto-Portability-Service-to-401k-Participants-092121.html
4. https://rch1.com/auto-portability/recent-developments
5. https://rch1.com/auto-portability/regulatory-information
6. https://info.rch1.com/mobileworkforce
7. https://www.benefitnews.com/advisers/opinion/why-auto-portability-can-create-more-secure-retirements
8. https://www.benefitnews.com/news/dol-guidance-gives-ok-to-retirement-savings-auto-portability-program
9. https://www.benefitnews.com/opinion/priorities-for-retirement-plan-sponsors-plugging-leakage-enabling-auto-portability
10. https://www.cnbc.com/2020/07/14/changing-jobs-now-you-can-transfer-401k-savings-automatically.html
11. https://www.ebri.org/content/the-impact-of-auto-portability-on-preserving-retirement-savings-currently-lost-to-401(k)-cashout-leakage
12. https://www.ici.org/statistical-report/ret_21_q2
13. https://www.makingsenseofcents.com/2017/04/saving-for-retirement.html
14. https://mint.intuit.com/blog/planning/what-happens-to-your-401k-when-you-quit-5802/
15. https://www.boomershineconsulting.com/content/wp-content/uploads/2018/05/BCG-Newsletter-March-2018.pdf
16. https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2016-participant-plan-transfers-and-account-consolidation-for-the-advancement-of-lifetime-plan-participation-copeland-written-statement-06-08.pdf#page=2
17. https://tsretirement.com/wp-content/uploads/2020/02/cashing-out-issue.pdf
18. https://op.bna.com/pen.nsf/r?Open=krkl-9n7sg5
19. https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/advisory-opinions/2018-01a.pdf
20. https://www.federalregister.gov/documents/2019/07/31/2019-16237/notice-of-exemption-involving-retirement-clearinghouse-llc-rch-or-the-applicant-located-in-charlotte?

Author details

Abhishek Rai

Product Manager, infosys

Abhishek Rai is a Product Manager in HILDCG Retirement Services Practice within Infosys. He has over 18 years of experience in retirement domain of USA and Australia. His area of expertise includes various defined contribution plans such as 401(k), 403(b), 457, IRA (traditional and Roth), ESOPs, non-qualified and superannuation. He also has good exposure to multiple fintech tools being offered in US retirement domain. He can be reached at abhishek.rai07@infosys.com.

Vinod Chatriki

Principal Consultant, infosys

Vinod Chatriki is a Principal Consultant in HILDCG Retirement Service practice within Infosys. He has over 20 years of experience in US Retirement, Capital Markets, Investment Banking, Custody, Treasury and Regulatory compliance domains in US, UK, Europe and Singapore regions. His area of expertise includes, Trade & Custodian Settlements, liquidity Monitoring and Regulatory reporting, Defined Contributory plans. He can be reached at vinod.chatriki@infosys.com