No Retirement Account Left Behind

By Kerry Pechter *Thu, May 19, 2016*

"Auto-portability" would consolidate a plan participant's old accounts into his or her current account, automatically. Spencer Williams and Tom Johnson of Charlotte-based Retirement Clearinghouse have spent three years trying make it happen on a large scale.

Fintech, aka robo-finance, is scaring the bejeezus out of the financial industry's old guard. Barbarians from Silicon Valley, with their gleaming algorithms, have disrupted traditional business models. The mice are scaring the elephants—at least until the elephants acquire the mice outright.

But fintech doesn't always originate in California, and it doesn't always threaten the status quo. Sometimes it sprouts from within, and aids, the retirement business, especially when it's applied to one of the retirement industry's inefficiencies—like the "leakage" from 401(k) and other qualified plans, for instance.

Spencer Williams, the president and CEO of Retirement Clearinghouse (RCH), was in Washington, DC, last week to explain his company's proposed technology solution to leakage—most of which occurs when people liquidate their tax-deferred accounts in the course of changing jobs.

The solution is called "**auto-portability**." When a worker with a small retirement account quits a job at a company in the auto-portability network, RCH will try to find them at their next employer's plan and consolidate their old account with their new account. RCH and similar companies perform this "roll in" service today, but on a manual, piecemeal basis; auto-portability would robo-ize and scale it.

The technology for auto-portability involves "electronic records matching." That's the identification and verification process that facilitates the use of credit cards in retail transactions. But the success of auto-portability will need more than financial technology.

"First, you have to get all the recordkeepers onboard. That's no mean feat," Williams told about 130 professionals who gathered for the Employee Benefit Research Institute (EBRI) Policy Forum on May 12. "The other requirement for a clear path forward is assistance from the Department of Labor." [To watch a video of the presentation, cl

Auto-portability needs the DOL's blessing, because it will work only if plan participants can be auto-enrolled by default—by not actively refusing to be included in the system. RCH has asked the DOL for an Advisory Opinion confirming the legal basis for default enrollment in an auto-portability program.

RIJ has reported several times on RCH's auto-portability initiative since 2013. Since then, Williams and Tom Johnson, both of whom worked as retirement executives at MassMutual in the mid-2000s, have met with plan sponsors, recordkeepers, Washington officials and trade association reps to assemble the cross-industry cooperation that auto-portability will require.

If auto-portability takes off, RCH will run the technology, charging $59 for each account that passes through the system. (RCH charges $79 per account to do this manually today, and will continue to be in that business.) "When people look at the damage done by leakage and understand the benefits of auto-portability," Williams told *RIJ* this week, "they become engaged."

The leakage problem

If you were designing an employer-sponsored retirement savings system from scratch, you'd probably build in a method that allows people to transfer money from their previous plans to their new ones when they change jobs, so that the nest egg keeps growing and compounding tax-deferred. Indeed, it's said that rollover IRAs were created in anticipation of this need.

But merely allowing rollover IRAs didn't solve the leakage problem, in part because the system has generated so many tiny accounts. Given the high rate of job turnover in the U.S., millions of people aren't in a 401(k) plan long enough to develop large balances. When they change jobs, they tend to cash out those accounts ("leakage") or abandon them.

About 53% of job changers take the cash. Of those, “37% take the money because they need it for an emergency. The other 63% take it because it’s much simpler to say, ‘ Send me money,’ and to pay the taxes and penalties on the withdrawal,” rather than execute a do-it-yourself transfer of assets to an IRA or to their next plan, said Williams: “We take the DIY out of it, and put in a mechanism where we do it for them.”

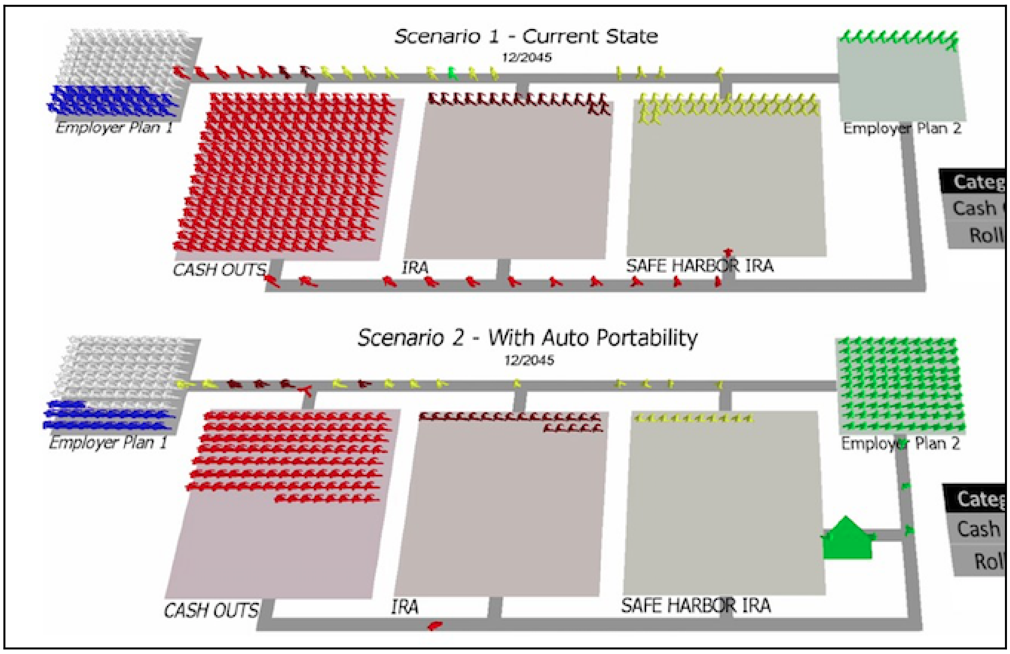
Pension law allows plan sponsors to transfer orphaned accounts that are worth less than $5,000 to safe harbor IRAs, or SHIRAs. The biggest 401(k) plan providers, like Fidelity and Vanguard, operate their own SHIRAs. Independent SHIRAs absorb the rest of the flow. SHIRAs try to find the missing owners, but the process, as noted above, is slow.

System-wide, leakage starts as tiny drips but swells into a flood of dissipated savings. According to EBRI data, 12.5 million leave DC plans each year. Of those, five million have accounts worth $5,000 or less. People with accounts of that size have a 28% job turnover rate, changing employers once every 3.5 years on average.

An estimated $8.8 billion in small account balances falls out of the DC system this way each year; the total annual leakage, according to EBRI, could be 10 times that amount. While these losses represent a tiny percentage of the multi-trillion-dollar DC industry, they compound over a 35- or 40-year career cycle into a significant sum. According to the Center for Retirement Research at Boston College, leakage reduces the aggregate DC savings of the nation’s 60-year-olds by 25%.

How auto-portability works

Williams said that his firm’s version of auto-portability works by “push” rather than “pull.” The process begins when the employee’s account gets pushed out of the old plan. This may occur long after the former participant has changed jobs. Then the system tries to match the participant with the new plan. In a “pull process,” the new plan sponsor’s recordkeeper would initiate the process after a new employee joins the plan.



Here's a step-by-step explanation of the auto-portability process:

1. A participant who has been defaulted into the auto-portability program leaves his or her job and leaves behind a DC account.
2. The plan sponsor informs the participant that he's eligible for the auto-portability roll-in process. After an initial notice and waiting period, the account goes to a safe-harbor IRA, or SHIRA. After the SHIRA account is opened, the records are sent to Retirement Clearinghouse.
3. Using the "electronic record matching" technology, Retirement Clearinghouse looks for matches between the owners of accounts in the SHIRAs and the millions of participants in plans whose recordkeepers use the auto-portability program.
4. When a match is confirmed, RCH completes the forms required for rolling the account assets into the participant's new plan account. These participants will receive a postcard notifying them of the transaction.
5. The safe-harbor IRA account is closed and the balance is rolled-in to the participant's new employer plan. The money is automatically invested according the participant's current investment elections, or in the retirement plan's default investment option. The participant receives a final notice.

'Ah-hah' moment

Williams, a US Naval Academy graduate, became more interested in auto-portability relatively recently. Back in 2007, he was headhunted away from MassMutual to help turn around Rollover Systems, a Charlotte, NC-based SHIRA owned by Robert Johnson, the founder of Black Entertainment Television, or BET.

Williams replaced Reggie Bowser, a former Lending Tree executive who started the firm in 2001 to capitalize on the provision in the first Bush tax cut (“EGTRRA”) that allowed and encouraged plan sponsors to force the small 401(k) accounts of separated employees into safe-harbor IRAs, and spawned the assisted rollover business.

In 2010, a Rollover Systems client, a 250,000-employee company that Williams declined to identify, asked Williams if Rollover Systems could, in addition to transferring the small accounts of departed employees to safe harbor IRAs, also help its new employees merge previous retirement accounts into their new plan. Williams had an epiphany.

“It was an ah-ha moment. We asked ourselves, ‘If we can do an assisted rollover for job changers, could we do an automatic roll-in?’ The answer is yes. We find that there are all kinds of circumstances for consolidation. There are plans that are terminated. There are companies that are sold. Every job change turns into a series of consolidations. Our mission is to create a new automatic path to consolidation,” he told *RIJ* in 2013.

Flash forward to 2016: “This is not just a concept,” Williams said this week. “This is in practice in our client base today, with the ERM technology already at work. We’re working with a very large employer and its recordkeeper. We find that the average account balance in the employer plan increases by about 45% when we do this. We have about 1,500 people whose old accounts we have matched up and moved into their new accounts. The account value almost doubles, proving the utility of the process.”

Not all of the issues have been resolved. One objection: A person’s new 401(k) plan may have higher fees or worse investments than their old one. Companies that solicit IRA rollovers from job changers might not like auto-portability, but rollover companies aren’t likely to care about the tiny accounts that RCH is talking about.

If they build it, will participants buy into it? Research by Warren Cormier of Boston Research Technologies, using auto-enrollment behavior as a proxy, has given RCH a glimpse of how people would respond to auto-portability, Williams said.

“As people get used to using this mechanism, as it gets into their heads that *this will be done for me*, there’ll be an ever-decreasing number of cash-outs,” he told *RIJ*. “With the status quo, we estimate there will be $320 billion in cash-outs over the next generation. If we eliminate leakage, we can cut that number in half.” He’s hoping to receive DOL’s blessing this summer.