

# Advisory Council on Employee Welfare and Pension Benefit Plans

Report to the Honorable Thomas E. Perez,  
United States Secretary of Labor

## **Issues and Considerations Surrounding Facilitating Lifetime Plan Participation**

November 2014

## **NOTICE**

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the "Council"). The Council was established under Section 512 of ERISA to advise the Secretary of Labor on matters related to Welfare and Pension Benefit Plans. This report examines Issues and Considerations Around Facilitating Lifetime Plan Participation. The contents of this report do not represent the position of the Department of Labor (DOL).

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## **ABSTRACT**

The 2014 ERISA Advisory Council examined recent movement of participant assets out of Defined Contribution (DC) and Defined Benefit (DB) Plans, and into retirement accounts not covered by ERISA, such as IRAs or other savings accounts, or as plan distributions. Based upon testimony received during two days of hearings, this report provides ideas for plan administrators and plan participants, including communications strategies and plan design options to facilitate lifetime retirement plan participation. The Council recommends DOL develop educational materials for Participants and Sponsors on the value of lifetime plan participation and educate Plan Sponsors on various plan features that may encourage such participation. The Council also makes recommendations with respect to plan loans and development of sample forms to simplify plan rollovers and facilitate consolidation of retirement assets within a plan.

## ACKNOWLEDGEMENTS

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## **I. EXECUTIVE SUMMARY**

Since enactment of the Employee Retirement Income Security Act of 1974, as amended (ERISA), there has been a significant increase in the number of defined contribution (DC) plans and a corresponding decrease in defined benefit (DB) plans. ERISA also created individual retirement accounts (IRAs) for the purpose of providing workers who did not have access to workplace retirement plans a vehicle to save for retirement. If the worker did have access to a workplace retirement plan, but wanted to and could transfer assets out of the plan, the IRA was a vehicle that could be used to hold retirement plan assets.

As of December 31, 2013, Americans had \$22.8 trillion in assets earmarked for retirement. IRAs have grown to be the largest single component of the U.S. retirement system with \$6.5 trillion, followed by private sector 401(k) plans with \$4.2 trillion. State and local government plans had \$3.7 trillion and private sector DB plans had \$3.0 trillion.

American workers are highly mobile and likely to participate in more than one retirement plan over the course of their careers. Whereas the DC system has become extremely effective in facilitating payroll deductions into defined contribution plans, it remains highly ineffective when it comes to moving assets between accounts.

Some employers are reluctant to take on fiduciary obligations on behalf of former employees. Other employers (often large employers) recognize the benefit of former employees staying in the plan so that the plans have more plan assets and consequently lower fees.

The Council also heard extensive testimony regarding the movement of assets within the retirement system and the reasons participants make the decisions they do. Testimony was also received from plan sponsors concerning their attitudes in this area. The Council also considered the impact of loans and withdrawals, as well as the benefits of certain plan design options that encourage lifetime retirement plan participation.

Based on the testimony, the Council made recommendations to DOL in the areas of:

- 1) DOL Outreach and Participant Communications
- 2) Plan Design Features
- 3) Lifetime Income
- 4) Post- Employment Loans
- 5) Technology and Infrastructure

## II. RECOMMENDATIONS

Based upon the testimony and research received:

- A. The Council recommends that DOL:
  1. Provide education and outreach to participants and plan sponsors on the considerations and benefits to participants of retaining assets within the employer-sponsored system, including providing sample educational materials that can be used by plan sponsors at all points of participation in the plan.
  2. Develop model, plain language communications that can be provided to participants at all points of their participation in the plan, including prior to enrollment and throughout employment to help them decide what to do with retirement assets, particularly at job change and retirement, or other distribution events.
- B. The Council recommends that DOL provide educational outreach and materials to plan sponsors relating to plan features that encourage lifetime participation.
- C. The Council recommends that DOL:
  1. Provide additional guidance to encourage plan sponsors to offer lifetime income options, including an updated defined contribution plan annuity selection safe harbor.
  2. Look for additional ways to make useful tools available, including the DOL's Lifetime Income Calculator ([www.dol.gov/ebsa/regs/lifetimeincomecalculator.html](http://www.dol.gov/ebsa/regs/lifetimeincomecalculator.html)), and integrate existing tools such as those in My Social Security (<http://www.ssa.gov/myaccount/>).
- D. The Council recommends that, for plan sponsors who make loans available to participants, DOL should provide information to them about allowing continuation of loan repayments after separation from employment. DOL also should point out the advantages of loan initiation post-separation in order to prevent leakage.
- E. The Council recommends that DOL should:
  1. Create uniform sample forms for facilitating plan to plan transfers. In cooperation with other agencies, industry groups, and other interested groups, foster technology standards which simplify the electronic transfer and consolidation of accounts, reduce costs associated with such transfers, and improve the privacy and security of participant data. Encourage a future Council to consider the issues related to standardized technology solutions for automatic account aggregation for job changers.

### III. BACKGROUND

There has been a recent trend towards movement of participant assets out of defined contribution (DC) and defined benefit (DB) Plans, and into retirement accounts not covered by ERISA. These retirement accounts include IRAs or other retirement or savings vehicles. Additionally, participant assets are also lost from DC plans, and less frequently from DB plans, through plan distributions. This dynamic occurs in the DC plan context when the participant leaves an employment relationship and elects to withdraw DC plan assets but not transfer them to the DC plan of another employer. Retirement assets are also lost when a participant requests a withdrawal of plan assets under a hardship exception or does not pay off a plan loan for reasons related to another significant life event. In the DB plan context, retirement assets are lost when the participant elects to take a lump-sum distribution of pension benefits. In some cases such disbursements can occur when the DB plan is terminated.

The Council examined some of the factors leading participants to leave their assets in or move them out of retirement plans. Such factors may include fees, the number and quality of investment options, current needs for funds, considerations of personal control versus third party expertise, legal considerations such as fiduciary duty, ERISA creditor protections and spousal protections, inertia in the face of default provisions, the difficulty of rolling the DC plan assets into the DC plan of a new employer, and other factors that may depend on specific personal circumstances. For DB plans, these factors may include the level of interest rates for determining lump sums and also other benefits, rights, and features in the plan. The Council focused on evaluating differences between the employer and non-employer based system, understanding plan sponsor attitudes around keeping participants within their plan or the employer based system overall, and discussing whether there are positive steps that can be taken to further encourage individuals to stay in the system, assuming it makes sense for them to stay in the plan environment.

The Council examined the types of communications participants are receiving from their employer when they leave employment and whether the quality of the participants' decision-making can and should be enhanced by communication or other plan design features. The Council examined the interest of plan sponsors and any hesitance they may have in encouraging participants to keep their assets in the Plan

The Council focused on the following areas.

- 1) Compare and contrast considerations for participants in deciding whether or not to leave money within the employer based system.
- 2) Gain a better understanding of asset movements out of the employer based system. The aim is to answer questions such as:
  - a. The frequency of withdrawals
  - b. The volume of assets leaving the system
  - c. Where the money is going
  - d. Why participants are making decisions to move money
  - e. The challenges participants face in making decisions, including the challenges to consolidate assets into a new employer's plan



- 3) Understand the plan sponsors' perspectives and attitudes towards retaining assets within their plan including:
  - a. What are the pros and cons?
  - b. Are there useful and informative communications the plan sponsor can engage in that do not implicate fiduciary liability?
  - c. Is there guidance that the DOL can offer that would address such concerns?
  - d. Are there plan features, investment options and other aspects of plan design that the plan sponsor may consider which can facilitate long-term plan participation?
  - e. How do certain plan design features impact participants' decisions around what to do with their assets at the time employment ends?
- 4) Examine what information is currently available to participants from DOL and other government sources concerning the pros and cons of rollovers to IRAs, whether the DOL's providing such information on its website would make sense and whether suggesting to DC plans that they might wish to provide a link(s) to such information would be helpful.
- 5) With respect to hardship and other withdrawals and loans from the DC plan, examine whether there are educational programs or reasonable plan mechanisms which can serve a positive role in discouraging pre-retirement withdrawals and facilitating return of assets to the fund.

The 2013 Council considered various aspects of DB plan lump-sum distributions in its study of "Private Sector Pension De-risking and Participant Protections." The 2012 Council considered aspects of DC plan hardship withdrawals in its study of "Managing Disability Risks in an Environment of Individual Responsibility." This Council did not revisit those areas in this study.

Participants who are leaving employment may receive outside communications regarding the potential rollover of their account balances into IRAs. It is not our intent to examine these communications as this is an area DOL is actively focused on through its proposed conflict of interest rules.

## **IV. SUMMARY OF TESTIMONY AND COUNCIL DISCUSSION**

### **A. Introduction**

Craig Copeland of EBRI examined the level of participation in employment based pension and retirement plans based on data from the U.S. Census Bureau's Current Population Survey (CPS). In 2012, there were 156.5 million working Americans, of whom 76 million or 48.6% worked for an employer or belonged to a labor union which sponsored a retirement plan. Of the 76 million workers, 61.6 million, or 39.4%, participated in a retirement plan. Data from the National Compensation Survey conducted by the U.S. Department of Labor's Bureau of Labor Statistics conducted in March 2013 found that 49% of private-sector workers participated in employment based retirement plans. In the private sector, excluding self-employed individuals, 39.1% of full-time, full-year wage and salary workers ages 21 – 64 participated in an employer-based retirement plan.

Mr. Copeland noted that retirement plan participation increases substantially with age, education and income. For private sector employees ages 21 – 24, 14.8% participated in a retirement plan in 2012, compared to 47% for workers ages 45 – 64. Only 15% of workers without a high school diploma participated, versus 58% for those holding graduate or professional degrees. 12.7% of workers with income between \$10,000 and \$19,999 participated compared to 66.3% for those with income over \$75,000.

The size of the employer also played a role in plan participation. For employers with fewer than 10 employees, retirement plan participation was 13.5%. Participation rates steadily increased with the size of the employer, reaching 54.8% for employers with 1,000 or more employees. Industry also played a role, with service workers participating at the lowest rates while workers in the manufacturing, transportation, utilities, information and financial industries had the highest participating rates.

Retirement plan participation has remained relatively stable from 1987 to 2012. Participation levels for workers ages 21 – 64 have gone from 39.8% in 1987 to 39.1% in 2012. The only significant exception has been the closing of the participation gap between men and women.

Since the enactment of ERISA forty years ago, there has been a significant growth in DC plan participation relative to the DB plan. The DOL's Employee Benefits Security Administration's Private Pension Plan Bulletin Historical Tables and Graphs (2013) indicates that the number of active participants covered by a private-sector DB plan decreased from 27.2 million in 1975 to 16.5 million in 2011, a 39% decrease. During the same time period, the number of active participants covered by a private-sector DC plan has increased from 11.2 million to 73.7 million, a more than six-fold increase.

While the level of participation in private employer based retirement plans has remained stable, the significant shift from DB to DC plans means that workers' choices can have a significant impact on their financial well-being in retirement. The availability of cash withdrawals and lump sum distributions for both DB and DC plans is leading to substantial leakage of retirement funds leaving workers with limited retirement income.

Based on testimony from Sarah Holden and Elena Barone Chism of ICI, at the end of 2013, \$22.8 trillion in assets were earmarked for retirement. IRAs with \$6.5 trillion represent the single largest component, followed by private-sector 401(k) plans with \$4.2 trillion, state and local government DB and DC plans at \$3.7 trillion, private DB plans at \$3 trillion, federal DB at \$1.4 billion, Federal Thrift Savings Plan (TSP) with \$0.4 trillion and the remaining in annuities held outside retirement accounts (\$2 trillion), 403(b) plans with \$0.9 trillion, and other DC plans with \$0.7 trillion.

First created under ERISA, the IRA market has grown to be the largest single component of the U.S. retirement system. IRAs were designated as both contributory retirement plans for those who did not have access to employer based plans, and as rollover vehicles for assets accumulated under an employer-sponsored retirement plan. Today, IRAs represent 29% of U.S. retirement assets and 10% of all U.S. household financial assets. Although contributions played

a part in this rapid growth in IRAs, most recent growth has come from rollovers from employer sponsored retirement plans. IRS data show that rollovers to IRAs in 2010 totaled \$288 billion.

Based on ICI data, 46.1 million Americans or 38% of U.S. households held IRAs in 2013. 32% of U.S. households had both IRAs and employee sponsored retirement plans (DB or DC), 29 % had only an employer-sponsored retirement plan, with a total of 67% of all U.S. households holding some type of tax favored retirement savings in 2013.

Of the \$5.6 trillion assets held in IRAs in 2012, 44% or \$2.5 trillion was invested in mutual funds. Because IRAs are invested through many institutions – financial services companies, banks, savings institutions (credit unions), ETFs, bonds, stocks, treasury securities and insurance companies - the total cost of owning an IRA is difficult to determine and varies greatly.

In 2012, 51% of IRA assets invested in mutual funds were in equity funds. According to ICI, IRA owners in general concentrate their assets in lower-cost equity funds, with an average expense ratio of 0.78% of assets versus 0.63% for 401(k) investors.

## **B. Movement out of plans**

American workers are highly mobile, changing jobs as many as 10 times during a 40 year career. As employees change jobs, they have to decide whether to leave funds in the employer plan, cash out in a lump sum, roll over to a new employer if it accepts rollovers, or roll over into an IRA. DC plans are typically flexible and funds can be rolled over or cashed out as a lump sum. Some DB plans also offer cash-out options in the form of a rollover or lump sum distribution.

According to Aon Hewitt, in 2013, 43% of terminated employees took cash distributions from their 401(k) plans, 31% left money in the plan and 26% rolled funds to another qualified vehicle. Warren Cormier of Boston Research Technologies, in his statement to the Council, stated that cash outs remove \$1.0 trillion from future retirement income streams. Stein also expressed concern over the prevalence of cash outs. Younger employees ages 20 – 29 were more likely to take cash distributions, according to AON Hewitt research. 56% took cash distributions compared to 33% of workers ages 50 – 59.

Research has shown that rates of cashing out of retirement plans are higher for employees with low income. Sudipto Banerjee of EBRI cited research that showed that 30.5% of workers with incomes under \$25,000 cashed out their accounts, compared to 9.8% of those with wages over \$75,000. 18% of workers with income under \$25,000 rolled over into IRAs compared to 29.7% of workers with income over \$75,000. The rates for employees who left their funds in their employer plan were very close, at 27.1%, for those with income below \$75,000 and 20.6% for those with income over \$75,000. Sponsors concerned about the flow of assets out of the plan at termination may wish to consider educating younger and lower wage employees on the value of preparing early for retirement.

Data cited by ICI showed that U.S. households transferred nearly \$300 billion from employer-sponsored retirement plans to IRAs in 2010, with \$288 billion going into the traditional IRAs and \$8 billion going into Roth IRAs. Of the households that transferred their funds into IRAs,

85% transferred the entire retirement plan account. Of those who had IRAs, half indicated that their account held employer-sponsored rollover funds, while 56% had also made contributions to the traditional IRA.

**C. Factors of interest to the participants in making decision to keep funds in plans or place them in an IRA**

The Council heard considerable testimony, particularly from John Turner, Marla Kreindler and Norman Stein, on the various factors which terminating employees might consider in evaluating whether to keep assets in the employer 401(k), take a cash distribution, or roll assets over to an IRA. The participant's actual decision may well depend on factors specific to him or her or to the characteristics and features of the particular DC Plan or IRA. Some of the factors that the participant may wish to consider include the following:

1. The plan's fees versus the fees of the IRA
2. Investment vehicles offered
3. Availability of loans
4. Tax considerations
5. IRA not subject to ERISA
6. Protection against creditors
7. The need for immediate cash
8. The health of the participant

These and other factors may be particularly important to the individual participant.

**D. Actual reasons participants take assets out of plans and put them into an IRA**

In its testimony, ICI provided the results of a survey of households that recently rolled over funds from DC plans to IRAs.<sup>1</sup> The five most frequently cited reasons in order were:

1. Wanted to preserve tax treatment of savings
2. Did not want to leave assets with former employer
3. Wanted more investment options
4. Wanted to use a different financial services provider
5. Wanted to consolidate assets

Each of these reasons was cited by at least half of the survey participants. Nearly two-thirds of the participants cited reason 2, 3 or 5 as their primary reason. Plan sponsors wishing to increase retention in their plans should focus on these reasons.

Jack Towarnicky, testifying on behalf of Willis North America, emphasized that the Willis North America Plan was successful in retention in part due to the fact that it stressed the theme that the

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<sup>1</sup> See Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2013," ICI Research Perspective 19, no. 11 (November 2013), available at [www.ici.org/pdf/per19-11.pdf](http://www.ici.org/pdf/per19-11.pdf).

plan was the participant's, not the sponsor's, thereby countering the traditional mindset that, as the U.S. Treasury Deputy Assistant Secretary for Retirement and Health Policy Mark Iwry put it, "you leave the employer, you leave the 401(k), you take your money out."

### **E. Plan sponsor considerations**

The Council heard testimony from a number of plan sponsors who expressed their views on the issue of facilitating lifetime plan participation. Among them was Robert Hunkeler, Vice President of Investments at International Paper and a former chair of the Committee on Investment of Employee Benefit Assets ("CIEBA"). CIEBA represents more than 100 of the country's largest corporate pension funds. Its members manage almost \$2 trillion of DB and DC plan assets on behalf of 17 million plan participants and beneficiaries.

While Mr. Hunkeler specifically represented the official views of CIEBA on facilitating lifetime plan participation, much of this viewpoint was echoed in the testimony of several other witnesses.

Mr. Hunkeler cited the results of two surveys conducted by CIEBA in July of 2013 and May of 2014. From the 2014 survey, Hunkeler indicated that 90% of CIEBA members surveyed (who primarily represent the investment functions at plan sponsors) indicated that keeping participants in ERISA-covered DC plans after termination of employment is a good idea because it will result in lower participant costs and provide ERISA fiduciary protections. On the other hand, only slightly over 60% of the surveyed participants felt that their company wanted to keep participants in the plan, and less than a quarter of the sponsors had a program in place to encourage retention. He attributed this difference more to the newness of the concept than to opposition, as less than 10% of those surveyed felt their organization would be opposed to the concept of employee retention. He said the primary reasons for not having a retention program were that "it was a low corporate priority and that there were concerns about fiduciary liability and cost."

From the 2013 survey, he pointed out that rollovers to IRAs constitute a strong majority of distributions from CIEBA member plans, with the plans' record keepers receiving about 40% of all participant rollover dollars. CIEBA members overwhelmingly believe that the primary reason terminating participants take their assets out of their plans is due to strong third-party marketing efforts, and that such parties "are likely targeting the largest, most cost effective accounts in our plans." Plan sponsors who wish to promote the benefits of continuing plan participation after employment are at a distinct disadvantage.

Rob Austin from Aon Hewitt quoted a survey that his firm conducted, primarily of HR functions at plan sponsors. He stated in his testimony that "Aon Hewitt's survey data of over 400 large employers shows that 27 percent of plan sponsors prefer to have terminated employees remain in the plan, up from 20 percent when we last surveyed in 2013. Only 11 percent of plan sponsors prefer that terminated participants remove their money from the plan, down from 17 percent the previous year." This indicates that there are still over 60% of respondents that do not feel strongly either way.

Mr. Hunkeler, on behalf of CIEBA and its members, specifically recommended that DOL

"... work towards creating an environment that encourages terminating participants to leave their DC assets in the ERISA-covered plan system. The [DOL] could do this through a

participant outreach program that emphasizes the benefits of keeping assets in the ERISA system.”

He went on to recommend that DOL

“...create an environment that supports plan sponsors efforts to encourage terminating participants to leave their assets in their plans. The [DOL] could do this by providing best practices guidance that emphasizes the plan design features that encourage terminating participants to leave assets in the plan, and reassure sponsors that their efforts to keep terminating participants in their plans will be considered participant education, not investment advice. The [DOL] could also provide guidance that would help sponsors provide lifetime income options in their plans – a design feature that would encourage terminating participants to leave their assets in the ERISA-covered plan system.”

Mr. Hunkeler explained that some plan sponsors are very active in their efforts to encourage participants to stay in the employer sponsored plan, but that it is an area of fiduciary and other liability concern for many others. CIEBA provided two hypothetical examples of communications that plan sponsors might use to facilitate lifetime plan participation. They are in the form of charts that identify various options available to plan participants and highlight a number of pros and cons of each option. (See Appendix 1.) CIEBA suggested that such communications could be sent separately and/or combined with the tax notice required under Section 402(f) of the Internal Revenue Code (“IRC”) prior to a participant taking a distribution from the former employer’s plan. CIEBA explained that its examples borrowed heavily from actual communication materials used by some of their members.

Additionally, some sponsors have pursued the development of more personalized communications which include estimates of: 1) account values, and 2) the potential tax consequences and penalties associated with the early withdrawal of assets from qualified retirement plans. In response to questions from Council members with respect to fees and expenses, Mr. Hunkeler explained that retail pricing applicable to the investments available through the vast majority of individual retirement account arrangements in the U.S. cannot match the average fees for participants in CIEBA member sponsored plans, which run at approximately 26 basis points (a basis point is 1/100 of 1.00%) for accounts with average balances of \$115,000.00. However, he acknowledged communicating this significant fee advantage to plan participants and helping them ask financial advisors to form comparisons is not a core competency of employers, who instead prefer to focus on streamlined and clear communications.

## **F. Information available from sponsors and the government**

### **1. Notices required at distribution**

The Section 402(f) tax notice. IRC Section 402(f) requires that plan administrators of tax qualified plans notify participants receiving a distribution under their plan of the income tax consequences of the distribution. IRS has developed a model notice that may be used for this purpose at [www.irs.gov/pub/irs-drop/n-09-68.pdf](http://www.irs.gov/pub/irs-drop/n-09-68.pdf). That notice is lengthy and complicated. Also, it does not address the option of keeping assets in the plan.

The notice of right to defer distribution. IRC Section 411(a)(11)(A) requires consent of the participant before a benefit payment in excess of \$5,000 can be distributed by a qualified plan. (Similar language is contained in Section 203(e) of ERISA.) Section 411(a)(11)(c)(2)(i) provides that a participant must be informed of the right, if any, to defer receipt of the distribution. Section 1102(b)(1) of the Pension Protection Act of 2006 instructs the Secretary of the Treasury to modify the Regulations under Section 411(a)(11) to provide a description of the participant's right to defer receipt and describe the consequences of failing to defer. The IRS proposed Regulations in October 2008 (Federal Register Vol. 73, Number 197 (pages 59575-59579)). For DC plans, the proposed regulations require a description of the tax implications of failing to defer, a statement that some currently available options in the plan may not be generally available on similar terms, a statement that fees and expenses may be different and an explanation of any provisions of the plan that could reasonably be expected to materially affect the participant's decision. No final regulation has been promulgated.

The GAO's comment on the impact of the change in the law and the proposed Regulations is of relevance here:

However, there was no requirement that plans explicitly disclose that IRAs may have higher fees than investments in a plan. Given recent research showing participants' lack of knowledge about their plans' fees, participants may also not understand that plans often offer investments at lower cost than the typical retail fees charged by IRAs. Additionally, in light of the marketing efforts of IRA providers—which our website review found can include claims that IRAs are “free”—as well as the recent spotlight on 401(k) plan fees, highlighted by Labor's new fee disclosure requirements, simply stating that fees and expenses could be “different” may not be sufficient. Such statements may not clearly convey to participants that they could pay more for investments outside of a plan or the long-term effect of higher fees on their retirement plan savings.

Moreover, IRS regulations do not require plans to provide the requisite distribution information when a participant is separating from employment with the plan sponsor; rather, the information is required within a specified window of time prior to receipt of a distribution. We identified no current legislative or regulatory requirements ensuring that participants receive timely information on their distribution options before they have made a decision to take a distribution. There are also no requirements for plans to give participants comprehensive or balanced information comparing their options at the time of job separation. In lieu of regulations from IRS or Labor, experts told us that plans and their providers determine when participants receive such information. Although some service providers we interviewed said that they typically send separation packets as soon as participants separate from employment, since there is no requirement to provide a detailed packet at separation, participants cannot rely on getting the information they need in time to make a distribution decision. In fact, several service providers we spoke to said they do not provide information until the participant requests a distribution. (GAO 13-30, pages 42-43)

On the IRA side, according to Elena Chism of ICI, there do not appear to be any required disclosures that are specific to plan distribution. There are disclosures, however, which are tied to the creation of the IRA. These include a disclosure statement that explains the requirements of IRC Section 408:

“the income tax consequences of establishing the account including the deductibility of contributions and tax treatment of distributions, the circumstances under which the account can

be revoked, and certain statement regarding the consequences of engaging in a prohibited transaction, borrowing money from the account, taking early distributions, not taking required minimum distributions, making excess contributions, and other matters.”

There are also required disclosures related to the acquisition of specific financial instruments such as the need to provide a Prospectus and annual reports to buyers.

## 2. Information available from official websites

The Financial Industry Regulatory Authority (FINRA), a non-governmental regulator for all securities firms doing business with the U.S. public, has posted useful information entitled: “The IRA Rollover: 10 Tips to Making a Sound Decision” at [www.finra.org/Investors/ProtectYourself/InvestorAlerts/RetirementAccounts/P436001](http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/RetirementAccounts/P436001). This guidance clearly sets forth the options, indicates the tax consequences of a rollover, and includes paragraphs such as “Compare Investment Options and Other Services,” and “Understand Fees and Expenses.”

It is also important to note that there are very useful lifetime income calculators on the Social Security Administration and DOL websites. [www.ssa.gov/myaccount/](http://www.ssa.gov/myaccount/) and [www.dol.gov/ebsa/regs/lifetimeincomecalculator.html](http://www.dol.gov/ebsa/regs/lifetimeincomecalculator.html).

### **G. Communication steps for plan sponsors to consider to encourage participants to stay in the plan and for DOL to consider in educating and encouraging plan sponsors and participants**

Rob Austin of Aon Hewitt testified that the communications which sponsors provide vary widely. Some sponsor communications provide the minimal amount of information required; others are much more proactive. While keeping participants in the plan when they leave their sponsor’s employment is a relatively new area of plan sponsor concern, the Council received considerable input from plan sponsors and others relating to communication steps that they can take to encourage participants to keep their monies in the plan when they leave the sponsor’s employment. That input focused on “when, how and what” plan sponsors should communicate.

#### When

A number of witnesses stressed the importance of communicating with participants from the beginning of their participation in the plan. Georgette Gestely from the NYC Benefits Program noted that, immediately upon their being employed, new participants were introduced to the concept of remaining in the New York City DC plan throughout their lives. Lew Minsky from DCIIA indicated that promoting the benefits of the plan to new employees could be coupled with a suggestion that they consider rolling over their plan assets from their previous employment. Rob Austin indicated that it was important to provide participants with the right information in a timely manner, not just at retirement or termination of employment.

Mr. Minsky stated that perhaps because of cost, extensive communications programs were less likely to exist with DC plans of small employers, where the bare minimum of required communication was more likely.



## How

The normal method of communication from sponsor to participant is by written material. Mr. Austin testified that some plans utilize multiple channels of communication. Ms. Gestely stated that the City of New York offers seminars for its participants.

Greg Long, Executive Director of the the Federal Retirement Thrift Investment Board, which administers the Thrift Savings Plan (TSP), testified that the TSP has been experimenting with phone centers whose representatives initiate “collaborative conversations” with participants who had requested transfer of monies out of the plan. Mr. Long reported that 82% agreed to talk and at the end of the conversations 59% agreed to leave their money in. Mr. Long indicated that they had learned that these calls require a meaningfully different skill set for the call center staff.

In addition to the manner of communication itself, the dynamics of the communication are important as well. Some witnesses indicated that they did not include the withdrawal forms with the initial communication to terminating employees. They are, of course, supplied upon request. The initial communication also may indicate that if participants wish to leave their monies in the plan, they did not need to take any action.

## What

A number of witnesses indicated that it was important that the sponsor let participants know that they are welcome and encouraged to keep their assets in the plan after they retire or terminate.

Greg Long testified that TSP emphasizes to its participants from the outset of employment the fact that their assets may remain in the plan, that they can roll monies in from their former employer’s plan and that TSP is encouraging them to consolidate their monies in the plan. Jack Towarnicky observed that his plan’s communication with its employees does not use the phrase “employer sponsored”, but instead emphasizes that the participants “own” the money they have in the plan.

Of course, one of the terminating employee’s alternatives to leaving the monies in the plan is to take a withdrawal. Mr. Cormier of Boston Research Technologies noted that 45% of terminating employees cash out their accounts. Those cashing out on average have disproportionately lower balances. In its written statement submitted to the Council, AARP indicated that “millions of Americans are jeopardizing their future retirement income security by spending retirement savings distributions or otherwise failing to maintain retirement assets.” Cynthia Mallet from Met Life, testifying on behalf of ACLI, indicated that education about the drawbacks of cashing out is essential. Mr. Austin stated that plan sponsors can play a role in educating participants from the beginning on the value of keeping their money in the retirement system by, as some plan sponsors are doing, sharing information on life expectancy and how long a specific amount of money will last. Plan sponsors can also stress the tax consequences of withdrawals, including the 10% early withdrawal penalty for those under age 59 ½.

Cynthia Mallet suggested that for those participants contemplating taking their DC plan assets and transferring them to an IRA, the plan sponsor may wish to point out the level of its plan’s fees (which may be lower than the IRA) and the availability of stable value options and other investment classes not found in IRAs. The participant will be helped in making his or her decision by having access to comprehensive, objective information. The plan sponsor is in a

position to provide that information. Some plan sponsors do, in fact, provide that type of information to its participants. See, for example, materials provided by CIEBA in Appendix 1.

Some witnesses testified that some plan sponsors are reluctant to provide participants with guidance on the pros and cons of their DC plan versus an IRA because of a concern that such communications may be considered investment advice rather than investment education under Interpretive Bulletin 96-1, and therefore subject to fiduciary duties under ERISA. AARP expressed the strong opinion that investment advice should be subject to fiduciary rules. In his testimony, Joe Canary of EBSA indicated that there are not *per se* limitations on what the plan sponsor can communicate. The issue is determining when those communications give rise to fiduciary duties. Mr. Canary also indicated that active regulatory projects may have an impact in this area. Because of this, the Council has not sought to explore this area, but notes that plan sponsors testified that clarification on these issues would be useful.

The GAO in its March 2013 Report recommended that DOL “[d]evelop a concise written summary explaining a participant’s four distribution options and listing key factors a participant should consider when comparing possible investments, and require sponsors to provide that summary to a participant upon separation from an employer.”

Currently, the only required communication to the participant at termination is the legalistic and complicated IRC 402(f) tax notice described in Part IV-F above. As previously stated, this notice does not discuss the favorable tax consequences of keeping the money in the plan. Cynthia Mallett of ACLI appended to her Council statement a sample notice which ACLI developed that could be provided to plan participants upon their termination under a plan. While the ACLI notice is useful, it does not appear to go as far as the GAO Report has suggested. Specifically, it does not list “key factors a participant should consider when comparing possible investments.”

Sarah Holden, on behalf of ICI, recommends that DOL develop additional educational materials which are prominent and accessible to participants. Robert Hunkeler, on behalf of CIEBA, suggests a “participant out-reach program that emphasizes the benefits of keeping assets in the ERISA system.” Rob Austin for Aon Hewitt recommends that DOL educate plan sponsors “on the benefits and advantages of retaining assets within the employer-sponsored system.”

### Recommendations

Based on the testimony and statements presented, it is the Council’s view that participants need more information and advice to make informed decisions about how to handle potential plan distributions and that DOL can play a role in providing this information directly through its educational programs and indirectly by encouraging plan sponsors to provide educational materials to participants at various stages during their employment relationship and beyond after employment has ended.

The Council recommends that DOL develop a notice along the lines that GAO has suggested. In developing such a notice, the Sample ACLI Notice and the comparison information provided by CIEBA would be a useful starting point, as would the information posted by FINRA discussed in IV-F above. Even if DOL were to conclude that it does not have the regulatory authority to

require plan sponsors to provide such a notice, it is clear from the testimony that many plan sponsors would welcome and utilize such a notice.

## **H. List of structural changes and procedures for sponsors to consider to encourage participants to stay in the plan and for DOL to consider in educating and encouraging sponsors**

### 1. Plan design -- making the plan more attractive

Witnesses provided the Council with examples of and recommendations in relation to a range of plan features that may encourage terminating participants to leave their assets in their plans. However, the Council understands that to date few plan sponsors have implemented these features and have made them available to all plan participants regardless of employment status.

While not exhaustive, the following list could serve as the topics for a series of FAQs or illustrations which would provide ideas for plan sponsors who are considering making the enhancements to their plans.

- a. Adopting lifetime income options
- b. Establishing and offering access to deemed (“side car”) IRAs
- c. Providing brokerage or mutual fund windows
- d. Automating the process for terminating participants to consolidate accounts
- e. Allowing all participants to transfer qualified assets into the sponsor’s DC plan (see further discussion in the next section).
- f. Allowing all participants to rollover DB plan lump sums into the sponsor’s DC plan
- g. Providing access to stable value fund options
- h. Providing for partial or systematic withdrawals at retirement
- i. Providing access to financial advice or assistance

The 2012 Council’s report on “Examining Income Replacement During Retirement Years In a Defined Contribution Plan System” made recommendations regarding the adoption and implementation of lifetime income options in DC plans. Because of that report, the Council has not considered these issues. Also, DOL has issued a current RFI on Brokerage Windows. Because of the RFI, the Council has similarly not considered these issues.

Another feature that would potentially benefit from a broader understanding of DOL’s view is the establishment and utilization of deemed or “side car” individual retirement accounts which were established under the EGTRRA 2001, but to date has not been widely used. An example of the use of this innovative structure exists in the New York City Deferred Compensation Plan. Although this plan is not subject to ERISA, according to the testimony received, this plan has been designed and governed under strict fiduciary standards. In addition to its IRC Section 457 and 401(k) plans, New York City offers the Traditional IRA, the Roth IRA, the Spousal Traditional IRA and the Spousal Roth IRA. This forward thinking public plan may serve as a model for broader adoption of deemed IRAs and their many variations across both the public and private sectors. The existence of an IRA option, which is essentially bolted on to qualified plans through the incorporation of a master trust structure, together with access to the potentially more

affordable investment options available through many qualified plans, may be a significant feature to encourage participants to remain in the plan.

## 2. Roll-ins (plan to plan transfers) and roll-overs

As witnesses testified, recent IRS Regulations now make it easier for a recipient DC plan to complete its due diligence on a rollover request by accessing the transferring DC plan's 5500 form on the EFAST website and determining that monies which are sought to be transferred into the receiving plan are in fact tax qualified.

Many employer-sponsored plans in the U.S. explicitly permit plan participants to transfer assets from the qualified plans of former employers into the qualified plans of their current employer. Some, like the TSP, permit terminated participants to continue to participate in the plan of their former employer, including allowing terminated participants to transfer assets from the qualified plans of other former employers into that plan. By so doing, such plans address the desire of participants to consolidate their retirement plan assets.

## 3. Relationship with recordkeeper

A special circumstance exists when the recordkeeper retained by the sponsor to provide services to the plan advises the participant who is terminating employment that the recordkeeper's services are available to act as IRA custodian. Mr. Hunkeler indicated that a CIEBA survey of its members indicated that the plans' recordkeepers were receiving 40% of all rollover dollars.

Because of the possibility of overlap with ongoing regulatory actions, the Council has not addressed the question of whether conflict of interest or fiduciary issues may be involved in such circumstances. We do note, however, that the relationship between the plan sponsor and the recordkeeper is a contractual one and the recordkeeper's role can be addressed in the agreement between the parties. Mr. Hunkeler indicated that some CIEBA members do not allow their recordkeepers to solicit any business from their participants, and a few even prohibit their recordkeepers from acquiring IRA assets through rollover business from the plan's participants. On the other hand, he indicated that he has heard of some recordkeepers that would not serve in that capacity unless they were permitted to solicit rollover IRA business.

As part of the contractual negotiating process, Rob Austin suggested that plan sponsors ask providers questions about what marketing messages they send. Professor Stein suggested that the contract could include a provision that the recordkeeper could not initiate rollover discussions with a participant unless the participant had requested it in writing. Alternately, he suggested that the contract could require that the recordkeeper accept fiduciary status as a precondition to soliciting rollover business.

## **I. Withdrawals and loans**

The Council's scope document specifically requested that testimony address (a) loans and hardship withdrawals and (b) ways to discourage pre-retirement withdrawals and facilitate the return of assets to the trust fund. The Council received a great deal of useful testimony on this subject which is highlighted below.

Jack VanDerhei of EBRI testified on the impact of leakages on 401(k) accumulations at retirement, including the leakages due to loans and hardship withdrawals. In his Retirement Security Projection Model (RSPM), he projects the percentage of households (by income quartile) that could be at-risk (i.e., unable to retire at age 65 with an adequate income - defined as 80% of pre-retirement income).

To determine the impact of leakage, he analyzed a stylized worker<sup>2</sup> with and without the three types of leakages (cash-outs, loans, and withdrawals), and projected whether they would have adequate incomes at age 65 (set at 80% of pre-retirement income for this purpose). For people in the lowest income quartile, he found that eliminating the three types of leakages would have reduced the percentage of workers with inadequate retirement incomes by 27%. The corresponding percentage for individuals in the highest income quartile is 15%, because they are less likely to leak. Using a lower threshold (60% of pre-retirement income) to define an adequate retirement income, decreases the number of inadequate incomes, which is the denominator of our percentage. Because of this smaller denominator, the above percentages increase to 42% and 30% respectively. Thus, finding ways to reduce leakage can significantly reduce the numbers of people with inadequate incomes in retirement.

When each of the three types of leakages is studied individually, cash-out at job change was found to have the greatest impact, as 10% to 20% of people with inadequate incomes at retirement would have adequate incomes if this problem was solved. Eliminating hardship withdrawals (including 6-month suspensions of contributions) would help an additional 3% to 8% have adequate incomes; solving the problem of loan defaults would help another 3% to 4%.

In a 2001 paper, Dr. VanDerhei noted that eliminating loans and hardship withdrawals under a plan would not improve things, because plans that allow loans have higher contribution rates than plans without loans. Thus, he suggested that mandates eliminating or restricting loans and withdrawals might backfire and that flexible rules might have better outcomes.

Sarah Holden of ICI suggested that sponsors not provide hardship withdrawals until all loan options have been exhausted, and restrict the payout of the employer match as much as possible until retirement. She also suggested that sponsors allow old loans to continue at termination of employment and that new loans be available. She suggested that post termination loans are less problematic if the sponsor requires repayment by automatic bank debit

Greg Long of the TSP testified that the plan had 116,408 hardship withdrawals in 2012, and almost half of the participants have not resumed contributions by the end of 2013. The TSP wants participants to understand that when taking a hardship withdrawal, both their contribution and matching contributions stop for 6 months. The goal is to ensure that participants look to hardship withdrawals as a last resort. The TSP also plans to automatically reenroll participants at

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<sup>2</sup> The stylized worker is age 27, works for 30 years at multiple companies with auto-enrollment plans with an initial 3% of pay contribution and automatic 1% annual escalation (with some opting out), and retires at age 65 with an inflation-indexed annuity of an amount equal to at least 80% of pre-retirement income. See Figure 3 of Jack VanDerhei's testimony. The no-leakage calculations for the stylized person assume there are no behavioral changes, even if the only way to accomplish that is to prohibit them (which would possibly decrease participation and contribution rates).

the end of the 6-month hardship period, and the participants must take affirmative action if they do not want to re-enroll. In addition, the TSP has reduced the number of loans that participants can take at any one time to one general purpose loan and one residential loan and imposes a 60-day waiting period after a participant pays off a loan before becoming eligible to take another loan of the same type. He did note however, that if they restrict loans, then the number of hardship withdrawals increases. Finally, he noted that they reduced loan defaults by allowing participants to make individual payments directly to the TSP and to amortize their loans. But Mr. Long did note that the TSP does not allow loan continuation after termination, because of the expense.

Mr. Hunkeler suggested a number of plan design features that may encourage terminating participants to leave assets in their DC plans. The features included giving terminating participants access to initiate new post-employment loans or continuation of pre-existing loans.

Marla Kreindler, of Morgan Lewis & Bockius, testified that it can be difficult for terminating employees to pay back loans when they quit their jobs. She also noted the complexity for plan sponsors to roll over accounts with loan balances to the next employer. She suggested that model transfer forms, processes, and loan documents be created for all plans to use, so that plan sponsors receiving rollovers and loans from multiple places would find it much easier to handle them. She stated that if all sponsors used model forms, there would probably be fewer cash outs, because the common model forms would eliminate some of the complexities with rolling over accounts with loans.

Joe Canary, from EBSA, discussed the legal issues for plan loans, and in response to a question noted that a loan to a former employee does not constitute a prohibited transaction under ERISA. As a result, such a loan does not have to comply with the terms of the loan regulations or the statutory exemption for that transaction to proceed. He also noted that there is nothing in ERISA that requires or prohibits the availability of loans in a pension plan, although he noted that there could be discrimination issues under the IRC or ADEA. Loans to terminated employees could be handled differently than loans to active employees, for example by requiring different fees (Field Assistance Bulletin 2003-03), security, or interest charges, but the loans would still have to comply with ERISA's fiduciary rules, including the setting of a reasonable interest rate on the loan.

Jack Towarnicky testified about his 21st Century loan program. Participants can have two loans while working and they can initiate loans post-separation with electronic repayments. However, the program does not allow hardship withdrawals and other in-service distributions. Mr. Towarnicky testified that allowing loans encourages employees to save more.

Professor Stein, corroborating Dr. VanDerhei's testimony, testified that 35% of terminating employees cash out their retirement plan. He considers it the biggest leakage problem. He also noted that 3% of employees take hardship withdrawals each year, so it is an important area of focus. Professor Stein noted that it is very difficult to encourage individuals to save for retirement, and that retirement is so different from other areas where savings are needed, he felt it was important to discourage loans and withdrawals (although he did appreciate the need to make assets available in emergencies). He also noted that withdrawals can be preferable to "pay-

day” loans that have very high interest rates. He suggested that employers could make it more difficult to get a loan from the plan. He was concerned that some employers have made it too easy to get loans.

**Current rules for loans and hardship withdrawals:** IRC Section 72(p) allows 401(k) participants to borrow up to half of their account balance or \$10,000 if larger (but not more than \$50,000). A plan sponsor can prohibit loans in its 401(k) or restrict them to smaller amounts or only certain kinds of loans, such as loans (1) to pay education expenses for the participant, spouse or child; (2) to prevent eviction from the participant’s home; (3) to pay un-reimbursed medical expenses; or (4) to buy a first-time residence. The plan loans must be reasonably available to all participants, without discrimination in favor of highly compensated individuals. Loans must be repaid over 5 years (or longer for a principal residence) in substantially level amounts, and paid at least quarterly. In addition, IRC Section 401(k)(2)(B) allows withdrawals in case of hardships, if they are necessary to satisfy an immediate and heavy financial need. (IRS Regulation §1.401(k)-1(d)(2))

Below are some of the recommendations that the Council received for both sponsors and the DOL.

### **For Sponsors**

1. **Sponsors could discourage or disallow hardship withdrawals until all loan options have been exhausted.** Since loans are generally repaid (except when there are outstanding balances at termination of employment), they are less likely to harm retirement incomes. Thus, they are preferred over hardship withdrawals, which permanently reduce retirement income and the tax advantages of retirement savings.
2. **Sponsors could ensure that participants understand** that when taking a hardship withdrawal, both their contribution and matching contributions stop for six months, and by losing the match they are foregoing these matching dollars. Sponsors could ensure that participants use hardship withdrawals as a last resort.
3. **Sponsors could automatically reenroll participants** at the end of the six month hardship period, and require the participant to take affirmative action if they do not want to re-enroll. This could address the inertia problem just as automatic enrollment has greatly increased participation in 401(k) plans.
4. **Sponsors could restrict the leakage of the employer match.** For example, sponsors could disallow the employer match as a source for loans or withdrawals until retirement, even if the employee terminates employment. Mark Iwry of the U.S. Treasury Department specifically suggested this alternative for sponsor consideration.
5. **Sponsors could allow loans to continue after termination of employment and allow the initiation of new loans after termination.** Allowing loan initiations after termination of employment would encourage terminating employees to keep their money in the plan. It would also allow terminating employees with cash needs to keep their money in the plan rather than cash out and incur potential tax penalties. The Council encourages this only for plans that already provide loans. The Council is not suggesting mandating this alternative because loans continued or initiated after

termination are more difficult and expensive to administer and the paperwork on them is more difficult. Also, it is difficult to stay in touch with former employees, find them, and remedy the problem when payments stop. The use of an automatic debit capability with the terminated employee's bank or credit card can greatly reduce these problems

6. **Sponsors could reduce the number of loans** that participants can take at any one time, for example, to one general purpose loan and one residential loan, or one of the four types of loans mentioned at the beginning of this section.
7. **Sponsors could impose a waiting period** after a participant pays off a loan before becoming eligible to take another loan.
8. **Sponsors could charge a lower fee to the accounts of terminated** employees without loans, since they are less work for the sponsor (if they are not making new contributions or have a loan). This could not only encourage employees to keep their money in the plan, but also encourage them to pay off their loans.

#### **For DOL.**

1. **DOL could educate plan sponsors about the above alternatives.** With education, employers will be more likely to use these alternatives, particularly if the education is provided by DOL. Employers may believe that they are less vulnerable to litigation if the DOL provided the education.
2. **DOL could create model transfer forms, model loan forms and processes** for all plans to use to make it easier for plan sponsors to facilitate these transactions. Use of common model forms would likely increase the number of rollovers between plans and lessen the number of cash outs, because the model forms would eliminate some of the problems with administering loan rollovers.
3. **DOL could encourage sponsors with plan loans to consider loan initiation and continuation after separation.** As noted above, communication with terminated employees is difficult and expensive. DOL could encourage and facilitate these communications by creating model forms and processes using the internet, and encouraging all employers to use them. DOL could provide a service to assist sponsors in finding their terminated employees who discontinue making their payments. DOL could also propose easier ways of collecting loan repayments by automatic debits against bank or credit card accounts.

#### **J. Facilitating plan to plan transfers by, for example, creating simplified forms, encouraging technology development and automatic account consolidation**

The most pivotal role of DOL in facilitating lifetime plan participation may be in fostering the development of improved and widely adopted information technology standards which are designed to modernize the structural framework of DC plans. Many of the foundational elements underpinning our current system were developed in support of the supplementary, "opt



in” approach to DC plans, which existed for most of the first 40 years under ERISA. However, it is clear that much of this framework is outdated and serves as a barrier to further enhancements to the system. In order to facilitate consistent, uninterrupted employer-sponsored plan participation over an entire lifetime, a coordinated effort is needed to develop technology standards which efficiently and safely move retirement assets within the employer based system. Even today, qualified plan to plan transfers are routinely conducted through a series of telephone calls, fax transmissions, unintelligible jargon (e.g. “Plan Determination Letter”) and paperwork that is often inexplicably misplaced or lost altogether. One of the expert witnesses who testified before the Council indicated that the process is so complicated that he has given up on consolidating his various DC plans.

DOL should consider encouraging the retirement services and information technology industries to collaborate on the development of technology standards that could improve the security and integrity of the system, enhance the privacy protections that the current method of data provision lacks, and significantly lower the cost related to the collection, transmission and provision of data to facilitate continuous lifetime plan participation. The Council heard testimony regarding the initiatives in this area undertaken by other countries. For example, a primary aspect of Australia’s retirement reforms (the “Stronger Super” initiative) is the introduction of ecommerce and data standards to help simplify the process of data transmission and facilitate consolidation of accounts. Australia has also taken steps to require the consolidation of low account balances. The Australian pension reform’s initiatives known as the “Stronger Super package” may serve as a model for how to address these issues in the U.S.. (See section 3 “SuperStream” and “Securing Super” of the Australian Superannuation Reforms Stronger Super Information Pack for a description.<sup>3</sup>) In adopting these reforms, the Australian Treasury Department established and temporarily chaired an advisory group to act as a structured forum for industry stakeholders to advise them on issues relating to the implementation and maintenance of the protocols and data and service standards. The creation of a common and open technology standard for the U.S. retirement industry could modernize the current awkward and antiquated system that exists in the U.S. in much the same way.

DOL may also look to the experiences of other federal agencies in developing new protocols that utilize modern data transmission technologies to facilitate continuous lifetime plan participation. For example, the Securities and Exchange Commission assisted with the development and application of XBRL data standards, followed by its issuance of rulings requiring their use for financial filings and data transmission. XBRL, or “interactive data” as the SEC often refers to it, is an open information format standard that enables automated, global sharing of business information as contained in company ledgers, income statements, cash flow, balance sheets, mutual fund risk and returns, as well as textual information included within footnotes and other requirements of business reporting.

XBRL does not change the accounting standards or methods used for financial and business reporting, but it puts reported information into an instantly reusable computer- readable format. Computer applications will automatically find comprehensive, granular data the instant it is posted online and flow it into analytical models for deep, automated analysis. XBRL is predicted

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<sup>3</sup> This information may currently be found at [http://strongersuper.treasury.gov.au/content/publications/information\\_pack/downloads/information\\_pack.pdf](http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf).

to have a profound impact on any person or organization that creates or uses business information.<sup>4</sup>

Another domestic example of similar action, albeit at the behest of Congress, lies in the legislation and technical implementation of HIPAA, which included Administrative Simplification provisions that required the Department of Health and Human Services to adopt national standards for electronic health care transactions and code sets, unique health identifiers, and security, and at the same time, incorporated provisions that mandated the adoption of Federal privacy protections for individually identifiable health information. While similar action may not be required for retirement services, a clear precedent exists for the role of government in fostering an environment where competing interests can work together in a collaborative manner for a common goal.

While the specific application of such standards may facilitate a number of the initiatives discussed herein, it is likely that many others which have yet to be discussed (or even imagined) will undoubtedly develop over time. However, one such area which bears immediate additional exploration is that of automatic account consolidation. We believe that there are significant potential benefits in fostering and adopting such a standard. We recommend that a future Council explore the area of automatic account consolidation, both as a matter of public policy and financial security. In doing so, we would commend to them the testimony of Mark Fortier, who is intimately familiar with the limitations of current retirement system technology and that of Steve Saxon of the Groom Law Group, whose ideas on auto portability and facilitation of account consolidation are thought provoking.

## **V. RATIONALE FOR RECOMMENDATIONS**

### **A. DOL outreach and participant communications**

The Council heard extensive testimony concerning the issue of lifetime plan participation. It is clear from the testimony that there are numerous considerations that participants should weigh when deciding what action to take with their accumulated retirement savings upon termination of employment, at job change or retirement. In making their decisions, participants certainly would benefit from objective, timely information. At the same time, the Council heard from many witnesses that plan sponsors are equally uncertain about their fiduciary obligations and restrictions related to what they can or should communicate to their participants who are confronted with this challenging decision.

The Council believes that the DOL can assume an important role in communicating clear, concise and objective information on this topic that will assist participants and plan sponsors. For example, the Council was presented with several well thought out considerations documented in this report that individuals should weigh when making this important decision.

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<sup>4</sup> XBRL Around the World - A look beyond U. S. shores to put the SEC's interactive data initiative in a global context, <http://www.journalofaccountancy.com>.

Further, DOL could help address plan sponsors' uncertainty about what information they can provide to participants by developing sample educational materials.

The Council recommends that this outreach by the DOL can also include a model, plain language notice that can be provided to participants prior to enrollment and throughout employment to help them decide what to do with retirement assets, particularly at job change and retirement, or other distribution events. While the Council recognized that there are legally required notices, the testimony of witnesses and the Council's own review confirms that many of these notices are not particularly useful in helping participants weigh some of these difficult decisions.

Finally, the Council believes that DOL should consider doing more to clarify for plan sponsors considerations that they should consider in attempting to keep participants in the plan once they leave employment. This outreach can include more specific clarification of the ERISA fiduciary obligations and considerations.

### **B. Plan design features**

The Council also heard some interesting and innovative ideas from witnesses on plan design features that can encourage lifetime plan participation. It is evident from the testimony that certain plan features may have an impact on a participant's decision related to staying or leaving the plan upon termination. Many of these examples are documented in the report. They include offering features that are not available in the retail market, such as stable value funds or loans. They also include features that are explicitly geared towards encouraging lifetime plan participation, such as retirement income (see C below), deemed IRAs and allowing for rollovers into the plan.

Individual Council members expressed differing opinions on the efficacy and relative value of these various features. While the Council is not specifically endorsing or advocating any particular feature, we believe that providing greater awareness of such features to sponsors who may not be familiar with them would be beneficial. DOL can play an important role by communicating the existence of these features.

### **C. Lifetime income**

If employer sponsored plans are to be more prominent in the delivery of lifetime plan participation, they will naturally need to include more products and services geared towards retirees in the decumulation phase. In particular, lifetime income options, such as annuities, will likely play a more prominent role in the future. The Council is aware of several DOL initiatives around lifetime income, including the Council's review of this topic in 2012. Witnesses this year confirmed that the issues and recommendations from 2012 remain as relevant. In particular, the Council believes additional guidance to sponsors on this topic, including an updated DC plan annuity safe harbor, would result in reducing some of the biggest barriers to inclusion of such options in plans today.

A focus on lifetime plan participation also means a need to communicate and offer tools to participants to better understand their retirement income projections, not just their accumulated balances. We encourage DOL to continue its efforts in this respect. These efforts include looking for ways to further make available current tools, such as the agencies' Lifetime Income Calculator, and seeking to integrate it with other tools such as My Social Security.

#### **D. Post employment loans**

There are different views and perceptions regarding the role of loans in fostering plan participation or eroding it. The testimony suggests that while retirement readiness would likely be improved if participants did not withdraw retirement assets through loans which they repay rather than adding new contributions to plans, loans may actually be a benefit relative to other forms of leakage. Witnesses testified that the inclusion of a loan feature in a plan may actually encourage participation from participants who otherwise would not save for retirement.

The greatest concern as it relates to participant loans is their non-repayment, particularly for loans outstanding at termination of employment. In fact, testimony from EBRI indicated that, while most loans do get paid back, the problem occurs upon job termination. While not required by law, many sponsors will force repayment of the loan within 60 days of termination. In the absence of repayment within that time, the loans will be defaulted and taxed (including the 10% tax penalty, if applicable). The payment of a large loan, particular when an individual has lost or is switching jobs, may be too great a burden for many. Testimony suggests that sponsors are not defaulting loans because of a lack of sympathy for the terminated employee. Rather, administering loans for a former employee who is not on the company's payroll system can be expensive and cumbersome. Further, there is little guidance or ability for a terminated employee to roll the loan to a new company plan. This also contributes to retirement savings leaking out of the system.

For the same reasons noted above, terminated participants are restricted from initiating a new loan from the plan, even though it is legally permissible. An individual who has a pressing financial burden may have no other option except to take an early withdrawal from the plan with adverse tax consequences. If a loan were available, an individual would have another option that is not as detrimental to retirement savings, as long as it is paid back.

The Council is sympathetic to plan sponsors' concerns around the cost and the complexity to administer such programs. Yet, we have been made aware of plan sponsors who do make this available, in some cases using electronic fund transfer and automatic bank debit arrangements. The Council recommends that DOL provide education and information relative to this feature.

#### **E. Technology and infrastructure**

The Council heard interesting testimony on reasons that lifetime participation is lower than some may expect. Many pointed to the fact that corporate America has been moving from a DB to a DC system. Yet, the DC system structure was initially conceived as more of a supplementary system and much of the technology and infrastructure to build it was based on that premise. In many ways, the DC system is a patchwork system of different providers and technologies that

work well for the individual who is actively employed and contributing to his or her current employer sponsored plan, but becomes more cumbersome at the time of job change. Systems do not “talk” well to each other, and often present barriers to effective lifetime plan participation.

One example that the Council heard several times is the difficulty that individuals have in consolidating assets from one employer plan to another. Much of this is due to the fact that providers and plan sponsors have different forms and requirements. The Council believes DOL can help reduce this barrier by creating sample forms for plan-to-plan transfers.

Further, encouraging the industry to adopt leading edge technology standards would greatly support the ability for electronic transfer and secure transmission of data that is important for the initiatives discussed in this report. The Council acknowledges this is a complex issue but believes that DOL could propel movement towards this goal by fostering industry cooperation.

The Council also heard interesting testimony on automatic account aggregation and suggests that a future Council further investigate this area.

## **VI. CONCLUDING OBSERVATIONS**

The Council recognizes the importance of facilitating lifetime plan participation. However, at the same time, we understand the voluntary nature of the private sector retirement system in the U.S. The Council heard testimony regarding plan sponsors who have voluntarily elected to offer a plan but have expressed concerns about additional fiduciary burdens and costs that may be imposed upon them. We also heard testimony that some participants make very personal decisions regarding their retirement balances as they move through employer sponsored plans throughout their career. Many of these participants have well informed reasons for leaving the system.

The Council recognizes that there are many different initiatives already being undertaken by DOL related to this topic, including rules around the provision of advice for those making these decisions. The Council attempted to focus on proactive steps that plan sponsors could take to further encourage participants to remain in the employer system.

Today, incorrect or incomplete information, a lack of fiduciary clarity in some areas, and infrastructure issues are some of the identified roadblocks for some plan sponsors who wish to take these positive steps. The Council’s recommendations reflect our findings that there are initiatives that DOL could take to support these efforts.

## VII. APPENDIX

### CIEBA Table -- Hypothetical Participant Communication at Point of Separation from Service

	Company 401(k) Plan	Individual Retirement Account (IRA)
<b>Retirement Choices</b>	+ Lifetime Income Strategy with institutional pricing and professional asset management	- Generally higher expenses (retail pricing); Additional fees may apply.
<b>Investment Options</b>	+ Currently 10 Primary Funds and ~12k mutual funds available through the Mutual Fund Window. + Stable Value Fund – only available in the Plan.	+ Potentially a broader choice of investment options (varies by IRA provider).
<b>Annuities</b>	+ Institutionally priced annuities	- Retail priced annuities with potentially higher embedded sales commissions/fees.
<b>Fund Fees/ Expenses</b>	+ Extremely low expenses due to institutional pricing. + Access to lower fee mutual fund share classes.	- Generally higher expenses (retail pricing); Additional fees may apply. + Low-expense funds may also be available.
<b>Access to Funds</b>	+ Custom funds are closed to the general public. + No advisor required to purchase any fund.	- No access to custom funds. - Some funds only available through an advisor.
<b>Account Management</b>	+ Active and former employees can roll other retirement accounts into the Plan.	+ You can consolidate your retirement accounts and other investments with a single investment firm.
<b>Contributions</b>	- Only active employees can contribute.	+ You can contribute after leaving the company.
<b>RMDs</b>	+ RMDs are not required until you retire. - Entire balance, including Roth, subject to RMDs.	- You must take RMDs even if you are still working. + RMDs not required from Roth IRAs.
<b>Distributions</b>	+ No federal penalty tax if you leave employment in the year you reach age 55 or later.	- You generally must be over age 59½ to avoid the 10% federal tax penalty on early withdrawals.
<b>Rules for beneficiaries</b>	- Spouses assume ownership of account, unless a valid spousal waiver is on file. RMDs generally based on original owner's date of birth. - Nonspouses may be required to withdraw or roll over balance.	+ Spouses have the option to assume ownership of the IRA and base RMDs on their own date of birth. + Nonspouses must begin distributions by year after original owner's death. Distributions based on beneficiary's life expectancy.
<b>Company Stock Fund</b>	+ Possible favorable tax treatment on investment gains on company stock funds.	- No favorable tax treatment. Gains rolled over into an IRA are treated as regular income when withdrawn.
<b>Creditor protection</b>	+ Protected from all forms of creditor judgments, including bankruptcy.	- Creditor protection varies by state and may not be as strong as in a 401(k).

Option	Pros	Cons
<b>1. Leave your money in the Company 401k Plan</b>	<ul style="list-style-type: none"> <li>• Savings keep growing tax-deferred; avoids early distribution penalties (if applicable)</li> <li>• Broad range of investment choices, including custom institutional-quality funds</li> <li>• Generally lower fees on the Plan's main fund lineup than on funds offered outside the 401(k) Plan, with no sales loads or transaction fees</li> <li>• Flexible payouts, including loans</li> <li>• Access to professional investment advice at no additional cost</li> <li>• Allows you to consolidate all your 401(k) and/or IRA plan balances in one account</li> </ul>	<ul style="list-style-type: none"> <li>• Accounts below \$5,000 are rolled over or paid out if you leave before retirement eligibility</li> <li>• Brokerage window transaction fees are generally higher than discount brokers' transaction fees</li> </ul>
<b>2. Roll your money over to a new employer's plan</b>	<ul style="list-style-type: none"> <li>• Savings keep growing tax-deferred; avoids early distribution penalties (if applicable)</li> <li>• Allows you to consolidate all your 401(k) plan balances in one plan</li> </ul>	<ul style="list-style-type: none"> <li>• New employer's plan may have limited range of investment choices</li> <li>• New employer's plan may have limited payout options or no loan availability</li> <li>• Current custom investment funds are not available</li> </ul>
<b>3. Roll your money over to an IRA</b>	<ul style="list-style-type: none"> <li>• Savings keep growing tax-deferred; avoids early distribution penalties (if applicable)</li> <li>• Broad range of investment choices</li> <li>• Availability of certain features, like options trading, that aren't available through the 401k Plan</li> </ul>	<ul style="list-style-type: none"> <li>• Generally higher fees than employer 401(k) plans, often with sales loads and transaction fees</li> <li>• Current custom investment funds are not available</li> <li>• Stable value funds are not available</li> <li>• Loans are not available</li> </ul>
<b>4. Take the cash</b>	<ul style="list-style-type: none"> <li>• Puts cash in your hands today</li> </ul>	<ul style="list-style-type: none"> <li>• Savings no longer grow tax-deferred</li> <li>• Immediate 20% federal tax withholding, with balance due at tax time; state and local taxes also due (if applicable)</li> <li>• Additional 10% early withdrawal penalty may apply unless you're at least age 59½</li> </ul>