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DOL ADVISORY COUNCIL TESTIMONY
ON
AUTO PORTABILITY

My name is Stephen Saxon. I am an attorney at Groom Law Group. I am currently chairman of the firm. Groom was recently recognized as the top employee benefits firm in the United States.

It is a privilege to be here today. I have been asked to discuss legal issues involving the concept of "auto portability." I will do this in two parts. First, I will attempt to briefly describe auto portability and the basic retirement policies it involves. Second, I will discuss a few of the key legal issues we have encountered in the last few years as we have worked on auto portability matters.

Auto Portability

In the United States, approximately 75 million americans participate in 401(k) and other defined contribution plans. The total assets of these plans is approximately $6.9 trillion. At the same time, 46 million american households maintain individual retirement accounts (IRAs). Many Americans maintain multiple IRAs, frequently maintaining one for each job they have had and from which their retirement plan accounts have been rolled over into. IRAs are now the largest retirement program within the U.S. retirement system with $7.1 trillion in savings. The single largest source of the assets held in IRAs – according to research as much as 90% of the $7.1 trillion, came from employer sponsored defined contribution plans. The most common reason for these savings to move from employer sponsored plans into IRAs is that the individual participant changes jobs. In fact, an estimated 10 million plan participants change jobs each year, making them eligible for a rollover.

Within the job changer population, there are an estimated 3.2 million participants per year that have less than $5,000 in their qualified plan at the time of their job change. Most often these participants are lower income, younger, and often minorities, and 50%-60% of these participants are cashing out every year – between 1.6 million and 1.9 million participants every year. Furthermore, the balance of these participants – more than 1 million per year – are forced out of their plan into a safe harbor IRA. The incidence of cash outs and small balance IRAs for these job changers is a very significant problem.

One way to reduce the rate of cashing out and help these small balance IRA holders to incubate their savings is to consolidate their multiple IRA accounts into the 401(k) or other defined contribution plan maintained with their new employer.

For employees who are terminated from employment and are being "forced out" of their plans into a safe harbor IRA, technology has been developed to enable plan recordkeepers to "roll in" IRA account balances to the employees' new plan on a fairly seamless basis. We call this “auto portability” and it results in two important outcomes: it keeps savings invested in retirment and it “recycles” those savings into a participant’s new employer plan. This is how it works.

First, an employer as sponsor of the plan from which a participant/employee is being terminated selects the safe harbor IRA to which the participant’s account balance will be defaulted in the event the participant does not cash out or does not select his or her own IRA provider. For the defaulted IRA, the plan sponsor selects the investment option to be offered.

For the participant, an initial decision must be made as to whether to cash out or roll over his or her account balance to an IRA. As noted, if no decision is made, the participant’s plan account balance will be transferred to an IRA selected by the plan sponsor.

Importantly, if the participant is defaulted into an IRA, the participant will be asked whether he or she consents to the “roll in” of their IRA account balance to his or her new employer’s plan. Most participants will authorize the roll in of his or her IRA to the new plan based on communications given to the participant upon termination of employment and <u>again</u> upon the establishment of his or her IRA. In the event the participant IRA holder does not object to the roll in of the IRA to his or her new plan, the roll in will take place within a reasonable period after the date the second communication is made.

This is a key element of “auto portability.” If a participant does nothing after he or she is forced out of the old retirement plan, his or her account balance will automatically be rolled over to a safe harbor IRA and then rolled into the IRA holder’s new plan. The transfer to the new employer plan will occur when the recordkeeper for the new plan electronically identifies the IRA holder as a participant in the new plan.

Third, the plan sponsor of the new plan, in working with its recordkeeper, must approve roll ins of IRA assets. A key component of the plan sponsor’s approval is confirmation that the IRA holds “qualified plan” assets. The plan sponsor will not approve each participant’s roll in to the plan.

<u>Legal Issues</u>

I will now discuss the key legal issues we believe need to be addressed. I will keep these fairly generic.

There are 3 major areas I will focus on. First, the fiduciary status of the key players impacting auto portability. Second, plan sponsor concern over accepting qualified plan assets from the IRA into the new plan. Third, confidentiality or privacy issues regarding the possible sharing of participant/IRA information.

<u>Fiduciary Status</u>

Let’s assume for purposes of this discussion that the sponsors of the IRA holder’s former plan and new plan are named fiduciaries under ERISA.

And we can safely assume that the former plan sponsor’s selection of an IRA provider and IRA investments under the default IRA are fiduciary decisions, meaning that they need to be prudent and in the best interest of plan participants going through the termination/distribution process. But, importantly, the former plan sponsor does not exercise fiduciary control with respect to the decision to roll in assets to the IRA holder's new plan.

At the other end of the roll in transaction, the new plan sponsor will authorize the effecting of roll in transactions. This is done by authorizing the plan's recordkeeper to accept the transfer of IRA assets from current plan participants if, among other things, it can be demonstrated that the assets coming into the plan constitute "qualified plan" assets. The new plan sponsor will not make the decision to roll in any particular IRA.

Aside from the plan sponsors, there are a number of administrative service providers involved in auto portability. Recordkeepers must implement the technology needed to effect the locate & match functionality, as well as roll in transactions in a seamless, efficient manner. Recordkeepers are generally not deemed to be fiduciaries in carrying out administrative services. In this case, we think it is safe to assume the recordkeepers are acting upon direction and are not exercising independent judgment in effecting auto portability. The same is true for the technology provider. And while an IRA provider may be a fiduciary for some purposes, such as investment management, the IRA provider will not participate in or control the decision to roll in assets to a new plan. That decision is made by the IRA holder alone.

The decision to effect a roll in transaction is made by the IRA holder based on information that fully describes the proposed roll in transaction. To be effective, it must be made on a "negative conent" basis where the IRA holder is granted the opportunity to object to the roll in transfer of his or her IRA assets into the new plan. If the IRA holder objects, the assets will stay in the IRA.

This is the key fiduciary decision. It is made by the IRA holder based on communications provided to the IRA holder in advance.

Qualified Plan Assets

As depicted in the GAO report on IRAs, the major reason cited by plan sponsors regarding their uneasiness with accepting IRA assets into their plan was concern about the qualified status of the assets entering the plan. Many plan sponsors wanted absolute assurances as to qualified status of the assets and without it, they were reluctant to authorize the effecting of roll in transactions.

With the issuance of Revenue Ruling 2014-09, the IRS has made it easier to obtain a satisfactory level of comfort that the assets entering the plan are qualified. Under the revenue ruling, where a plan administrator files a Form 5500 and makes certain representation in the 5500 regarding the plan's qualified status under Section 401 of the Code, the IRS opined that it would be reasonable for the plan administrator of the participant's new plan to rely on that representation. Essentially, the revenue ruling permits plan administrators to rely on the representation in a plan's Form 5500 as to the qualified status of the plan from which the assets originate.

I think it is safe to assume that this IRS ruling will enhance the acceptability of auto portability within the plan sponsor community.

Privacy

Both recordkeepers and plan sponsors are concerned about the sharing of personal identifying information used in the auto portability technology. Personal information is used electronically to ensure that the IRA holder, whose account is about to be rolled into the IRA holder's new plan, is in fact the actual participant in the new plan. Even if the IRA holder has a common name (e.g., Joe Smith), the auto portability technology has the ability to sift through millions of plan participants with U.S. recordkeeping systems to find the correct participant. Personal identifying information is used electronically to sift through the relevant data and locate the correct plan and participant.

While I am not an expert on applicable privacy rules, we believe that obtaining the consent of the IRA holder to use his or her personal identifying information is the way to satisfy applicable privacy rules. Generally speaking, compliance under the federal privacy laws requires that "financial institutions" or businesses "significantly engaged" in financial activities that hold nonpublic personal identifying information obtain the consent of participants before sharing that information with third parties. That being said, auto portability obtains such consent on a "negative consent" basis where the IRA holder is granted the opportunity to object to the roll in transfer or his or her assets into the new plan. In the event the participant does not object to the roll in of the IRA to his or her new plan, the roll in will take place a reasonable time after the date the communication is made.

We believe this negative consent option should not conflict with federal privacy laws as it is consistent with financial institutions' current practice of sending participants an "opt out notice" with an applicable subsequent waiting period prior to the sharing of customer or consumer nonpublic personal information. Such "opt out notices" that meet particular criteria and provide reasonable waiting periods of 30 to 60 days have already been sanctioned by laws such as the Gramm Leach Bliley Act. What is more, we have found no authority that conflicts with or calls into question the legality of this negative consent or "opt-out" notification feature.

One final note. Over the past year, the basic concepts of auto portability that I have described today have been reviewed by hundreds of industry experts, including recordkeepers, plan sponsors, plan advisors and consultants. One of the most common reactions has been that the same principles that underlie auto portability could be applied to other participant populations, i.e. not limited to mandatory distributions. This is true and we are confident that as the use of auto portability grows and the industry recognizes its prinicipal benefit – keeping participant savings in qualified employer plans – it may come to be a standard feature of our retirment system, and facilitate lifetime participation in employer qualified plans.