Testimony on Lifetime Plan Participation Before ERISA Advisory Council

Presented by:

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August 19, 2015

Introduction

My name is Jennifer Flodin, and I am the DC Practice Leader and Senior Consultant at Plan Sponsor Advisors, a division of Pavilion Advisory Group Inc.[1] Pavilion Advisory Group has a leading defined contribution consultancy serving plan sponsors throughout the country. We currently provide ongoing service to approximately $30 billion in DC assets, across 19 different record keeping platforms. Our clients range in plan assets from $10 million to over $5 billion.

My testimony will focus on three key areas: what is being delivered to participants today post-employment; what is working and what is not; and recommendations on how the process and messaging could be improved.

Background

Fidelity, the record keeper with the highest number of defined contribution participants at 20 million, cites that one in three employees cashes out his/her defined contribution balance post-employment and prior to age 59 ½. Almost a quarter of those cashing out are under the age of 30, a growing segment of the population that is expected to experience multiple job changes over their careers. Boston Research Group reports 45% of 401(k) participants who leave their job take a distribution of their balance. Asset leakage from defined contribution plans and the retirement security of Americans is a growing issue, and one I believe can be addressed by improved, simple, concise communications to participants outlining their options post-employment.

As we all know, plan sponsors utilize a variety of plan designs, investment menus and fee structures. So it should come as no surprise that they also put emphasis, to varying degrees, on the importance of participant communication post-employment. In my experience, most plan sponsors simply default to sending what their record keeper distributes to participants, as opposed to having something more customized and targeted towards their population. There is a smaller percentage of plan sponsors that is more proactive than others in communicating to terminated participants the benefits of retaining their balances within the plan. Typically, these are the more paternalistic sponsors who have demonstrated a passion for improving participant outcomes and have been concerned with the overall retirement readiness throughout an employee's tenure with the organization, not just when the employee terminates employment. Some of the features that plan sponsors, who are concerned about their employees' retirement readiness, offer to their employees include rich match or profit sharing contributions, auto-features, and education about income needs in retirement.

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[1] *the remarks I'm about to make are my own, and do not necessarily reflect the views of Pavilion Advisory Group Inc. nor any of its employees, officers or directors nor any company affiliated with Pavilion Advisory Group Inc. or their employees, officers or directors.*

Plan Sponsor Philosophy…Or Lack Thereof

From my experience, most plan sponsors have not engaged in an internal, proactive discussion on their desire (or not) to retain terminated employees' assets within the plan. Unless sponsors have this discussion and make a determination, the most common communication to terminated participants becomes the default communication produced by their record keeper. This is a philosophical decision for plan sponsors, on whether they should try and educate their employees about the importance of preserving retirement assets throughout their career, at the point of termination, or not at all. On one hand, plan sponsors may want to have their terminated employees' balances remain in their plan to increase the overall asset level, thereby increasing the ability to access lower-cost investment options. On the other hand, some sponsors talk about not wanting balances within the plan for fear they increase the fiduciary liability. These sponsors ask, "Why should the Investment Committee and the company, at large, be fiduciaries to someone that no longer is employed with the company?" While there is no "right" answer to this quandary, it is an area I believe sponsors will need to discuss so that they are able to communicate a more appropriate message to all parties.

Current Communications Sent Post-employment

In preparation for my testimony, I reviewed many "standard" and a few "custom" communications currently sent to terminated participants by a variety of record keepers. By and large, they include the same overall message, they indicate the various options and tax considerations, and urge the individual to contact the record keeper's call center or make an appointment with one of the counselors for individual advice.

Below is a summary of some of high level observations on the notices sent to terminated employees.

- Communication length ranges from a simple one pager to a 14 page brochure. Simpler, shorter is better.
- The phraseology of how the communications refer to the participant no longer working at the company is interesting. It ranges from "you are no longer an active participant" to "a job transition can be overwhelming", to "now that you are eligible for a full distribution".
- The ordering and positioning of the options available to the participant also vary somewhat, although most often the first option listed is either to leave the money in the plan or to roll money out of the plan.
- Some of the notices offer sample calculations demonstrating the impact of taxes and penalties for those under age 59 ½ that are taking a distribution.
- Very few of the communications have any sense of personalization. Most simply delineate by those that have balances above or below the plan's cash-out threshold of $1,000 or $5,000.
- One provider shows a calculation, for someone under 59 ½ years old, of a hypothetical cash-out distribution of $50,000 and the net amount after taxes and penalties.

For the reference to leaving money in the plan or transferring it to another employer plan, none of the communications referenced either potential benefit of ongoing fiduciary oversight to monitor investments and fees or the potential for reduced investment expenses.

What's Working...And Not Working

There is a difference in the messaging between those firms that market their IRA rollover services versus those that have no such intention. Those firms which seek action from the participant, to assist him or her through this seemingly complicated decision process, prominently display their call center numbers. Those who do not offer IRAs seem to provide the notice more as an obligation on behalf of the plan sponsor, with less color and graphics, resulting in a "form letter" look. Depending on the business lines of the sender, in my opinion the current message hits (in the case of a firm with IRA rollover services) and misses (in the case of those who do not offer IRAs) the goal of effective use of behavioral finance.

I like the tone of the communications that recognize there is lack of information on why the participant has left the company. Referring to the situation as an "employment change", or stating "a job transition can be overwhelming" are both neutral and unassuming. Messaging such as "our records indicate that you are no longer an active participant" is very sterile and impersonal, as if the participant is interacting with a computer. The introduction on the notice is key to engaging the participant. The use of examples is very effective, and an illustration of the money that will be deducted from a distribution if a participant cashes-out may cause the participant to rethink a cash-out decision, such as the hypothetical cash-out distribution example I referred to earlier.

Considerations for Better Participant Decision Making

Depending on the plan sponsor's appetite for helping participants with these decisions upon their exit from the company, I have some suggestions on how to improve the processes and communications that many plans follow.

Change the messaging to attempt to make a connection and solicit positive behavior.

1. Simplify the messaging; make it short, so the decision seems less daunting.
2. Personalize the message; make it specific to the participant's generation and account balance. Participants from different generations need to be addressed differently so the message is relevant to them. For example, a participant in their 20's might react more favorably to a message that is delivered via text message and talks more about savings in general, than a participant in their 50's who may prefer print communication that specifically addresses retirement savings. Statistics, such as those from an Aon Hewitt study a few years ago, indicate that younger participants tend to cash-out more often, 60% of those ages 20-29 take cash distributions.

They tend to have smaller balances, so perhaps cashing out seems to have less impact on their overall retirement savings. To try and address this, show the participant, using their specific account balance, the impact their decision to cash-out may have due to taxes and early withdrawal penalties versus keeping the money invested until retirement. Something similar to the chart below.

Impact of Taking Your Money Out Now…	
Your Account Balance as of July 24, 2015	$12,345
Federal Income Tax (mandatory withholding of 20%)	($2,469)
Additional Federal Income Tax (potentially an additional 5% due when you file taxes)	($617)
Additional State and Local Income Tax (potentially an additional 0-10% due when you file taxes)	($1,234)
10% Early Withdrawal Penalty (since you are not at least age 59 ½)	($1,234)
Potential Cash Distribution (what you may actually keep from taking your money out now)	$6,791
Versus Keeping Your Money Invested…	
Your Projected Account Balance at Age 65 (if you keep your money invested for retirement in a plan or with an IRA)	$86,000

3. Offer help that is easily accessible, such as a tear-off card in the termination letter with a checkbox that the participants can use to indicate they want an independent specialist to contact them directly and talk through the options.
4. Perhaps including the current record keeping and administrative fees as well as the average, or weighted, investment expense would be helpful for a participant trying to weigh their options of which option is in their best interest. While this information changes over time, this could be something the record keeper updates annually at the same time they issue their 408(b)(2) notice on an annual basis.
5. Simplify, personalize, and then repeat. A single communication piece may not solicit immediate action. Since it takes work to roll over an account balance (filling out forms and coordinating between vendors), a participant who may have good intentions of rolling over an account balance will put it off, eventually forgetting about it. A reminder message, perhaps via email or text, could trigger follow-up action.

Conclusion

There is no question that the current communications that many plan sponsors are distributing, provides little support for keeping participant balances within the retirement framework as the money was initially intended. And it is even clearer that participants need substantially different tools and messaging in order to retain their money for retirement. I believe that participants should be able to make their own decisions regarding the future of their retirement accounts, but I also think they need an improved system of messaging and tools in order to be fully educated to make those decisions.