Testimony

on Behalf of Aon Hewitt

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Before

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"Participant Plan Transfers and Account Consolidation for the Advancement of Lifetime Plan Participation"

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Mr. Chairman, Rennie Worsfold, Issue Chair, and Members of the ERISA Advisory Council, thank you for the opportunity to submit this statement for the record.

Aon plc (NYSE: AON) is the leading global provider of risk management, insurance and reinsurance brokerage, and human resource solutions and outsourcing services. We have 66,000 colleagues worldwide. Aon unites to empower results for companies in over 120 countries via innovative and effective risk and people solutions and through industry-leading global resources and technical expertise.

As the global leader in human resources solutions, Aon Hewitt is the largest independent provider of administration services for retirement plans, serving more than 14 million retirement plan participants in the U.S. Our 12,000 retirement and investment colleagues are dedicated to helping plan sponsors maximize retirement outcomes for their employees. We are honored to be a part of the discussion about the important topic of participant plan transfers and account consolidation to help facilitate lifetime plan participation and improve the retirement security of Americans.

According to our data, approximately 85% of assets that leave qualified defined contribution (DC) plans are rolled over to either an individual retirement account (IRA) or another qualified retirement plan and 15% are cashed out or forced out (due to force out rules for small balances). The data tell a different story when we look at worker behavior —primarily because workers with smaller balances are less likely to roll over their accounts to a qualified plan and more likely to cash out their balance. More than half of workers (52%) received their benefits as cash or were forced out, slightly higher than the percentage (48%) that opted to roll their balance over.[1] This means that while workers with large balances tend to continue to benefit from tax deferral, frequent job changers or those who are unable to accumulate significant balances are highly likely to eradicate their balance when they leave their employer. To the extent that this habit is repeated with each job change, workers can be left with very little or no retirement savings, in spite of saving along the way.

Cashing out retirement savings or even moving balances outside of the employer-provided system into the IRA environment can significantly impact workers' financial outlook. The impact of cash outs is obvious–retirement savings are eliminated. Employees who choose to roll retirement money into an IRA also risk losing key features from within the employer-provided system, which can significantly impact long-term savings goals. These benefits include:

- Enhanced purchasing power: Because larger DC plans have hundreds or thousands of participants and assets of tens of millions of dollars or more, enhanced purchasing power allows them to offer institutional class investment products to employees at a lower cost for similar products than an individual would purchase on his/her own in an IRA.
- Access to unbiased tools and resources: These tools often include education, modeling tools, online advice, managed accounts, lifetime income solutions and access to experienced phone representatives. Like the investments in the plan, these are usually offered at a much lower cost than what is available to individuals outside of the employer system. In addition, employees who also have a defined benefit (DB) plan with their employer benefit from integrated modeling tools that allow them to better manage their retirement savings.
- Employer expertise: By participating in a qualified plan, workers benefit from the fiduciary oversight and expertise of the plan sponsor and often outside experts in areas such as selecting investment options and reviewing plan design alternatives. This expertise provides a layer of protection, giving comfort and confidence that an expert party is acting in the best interest of plan participants.

[1] Aon Hewitt, *2016 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2016).

The process for moving money from plan to plan is especially difficult and inhibits the retention of dollars in the employer system. The current cumbersome process for consolidating 401(k) accounts results in many U.S. workers with retirement savings in a number of 401(k) plans sponsored by several different employers. Increasing portability and facilitating account consolidation are keys to curbing cash out behavior and improving the overall ability for Americans to retire.

Our testimony will answer the questions posed by the Council and provide three recommendations to modernize the process of transferring retirement plan assets in an effort to preserve retirement assets in the employer system.

I. Description of the problem

What are the current practices for rollovers into qualified plans and account consolidation?

The process participants must follow to rollover money between qualified retirement plans varies from recordkeeper to recordkeeper and sometimes from plan to plan. Typically, we see the following:

- Participant logs into their former plan's website to request a total distribution of funds to be rolled over to his/her new employer's plan.
- Participant receives a check from the former employer plan.
- Participant logs in to the new employer's plan website to enter the amount of the rollover and investment elections. This action generates a form that is mailed to the participant to sign and return with the following required documentation: the rollover check, payment information details and proof that the former employer plan is qualified.

As simple as these steps sound, the process is often rife with pitfalls. Participants will send forms without attaching the rollover check, forget to send required documentation, or have the former employer plan mail the check directly to their new employer's plan without required documentation. The last point is especially problematic because the new employer must develop a process to hold and track checks while they wait for the rollover form and documentation to be received. If the proper documentation is not received within a specified period of time, the information is sent back to the participant.

Other complications occur when participants elect to have the former employer mail the rollover check directly to the new plan, but it is "lost in the mail" and never received. In some instances, months can go by before participant's notice their money has not been deposited into the account in the new plan. This results in great frustration and lost earnings to participants. In some cases, the frustration of delays leads participants to request the former or new plan make up lost earnings.

These complications can result in participants being dissuaded from trying to transfer money from one plan to another in the future.

II. What regulations influence transfers?

There are three questions and answers in Treasury regulations (Reg.) that have the largest impact on what participants do with their balances upon termination:

1. Participants must pay a 20% mandatory withholding tax unless the distribution is to a qualified plan.
2. In general, participants who are under age 59 ½ must pay an additional 10% income tax penalty on distributions.
3. Plan administrators must provide participants with an easy-to-read document explaining the rights to a rollover and the consequences of cash out.

The implications of the above Q&A provide additional support for retaining dollars in the tax deferred system by incorporating penalties (the “stick” approach).

The disclosure requirement in Internal Revenue Code (Code) section 402(f) and Reg. section 1.402(f) is meant to provide clarity regarding the penalties and tax implications, and provide information to help the plan participant understand the alternatives–including the option for a participant to take a direct distribution and within 60 days decide to roll over the full or partial distribution to the receiving employer plan.

Reg. section 1.401(a)(31) allows a plan administrator to prescribe procedures for electing a direct rollover, this includes the information a plan administrator can require from a participant when electing a direct rollover. The procedure may include any reasonable requirement for information or documentation from a participant. For example, it is reasonable for the plan administrator to require that a participant provide a statement from the receiving plan that the plan will accept the direct rollover for the benefit of the participant and that the receiving plan is, or is intended to be, a qualified trust under section 401(a) but not a defined benefit plan.

The practical outcome of the flexibility above is that plan sponsors have some latitude and flexibility with respect to the documentation and procedures required to accept a rollover. Recordkeepers, in practice, have developed procedures and documentation requirements that lack consistency, and are often written in legal and technical terms that make it more difficult for the typical participant to navigate the process. There is limited incentive to streamline and simplify. This is driven primarily by the need to ensure that the former employer plan is a qualified plan as defined under Code section 401(a) and hence that the money from that plan will not taint or disqualify the receiving employer plan.

Code section 402(c) defines eligible rollover distributions that may be rolled over to an eligible retirement plan. The rollover is either a direct rollover as described in Reg. section 1.401(a)(31)-1 (which is the distribution paid directly to an eligible retirement plan) or a contribution of an eligible rollover distribution to an eligible retirement plan that satisfies the 60 day time period requirement in Code section 402(c)(3) and Reg. 1.402(c)-2.

This regulation provides clarity regarding the rollover rules, and does not directly lead to any challenges or problems with plan consolidation.

Finally, the flexibility added to roll across plan types 401(k), 403(b), and Governmental 457(b) plans increased portability and ease of retaining dollars in the employer system. This is an important development in supporting plan consolidation.

III. How do loans impact transfers?

a. Single vs. multiple.

The number of outstanding loans has no real impact on plan transfers other than it may take longer for participants to pay off multiple loans (if permitted by the plan) before they are able to transfer their account balance to a new plan.

b. Treatment upon separation of service.

Workers who have a loan outstanding at the time of job separation often find it challenging to find money to pay off their loan before transferring their account balance to a new plan. As a result, approximately two-thirds of workers with a loan outstanding default on it at the time of termination/retirement, which can significantly impact workers' financial wellbeing and ability to adequately save for retirement. Our 2015 data show:[2]

- 25% of workers have at least one loan outstanding.
- Average loan amount outstanding is 20% of the total plan balance.
- Among participants with a loan, 44% of workers have multiple loans outstanding when more than one loan is available in the plan.

Typically, plan sponsors offer workers one or more of the following options to repay their loan(s) at the time of termination/retirement:

- Repay in full within a specified period of time after termination, as defined by the plan sponsor (typically within 30-90 days).
- Leave the account balance in the plan and continue making loan repayments until the loan is paid in full. Just over half of plans (54%) allow individuals to continue loan repayments after they have terminated employment, up from 44% of plans in 2013.[3]
- Take a distribution from the plan (total or partial) and foreclose/default on the loan.
- Rollover their entire balance, minus the outstanding loan amount, and continue making repayments on the outstanding loan.

Outstanding loans discourage plan-to-plan transfers because they prevent individuals from retaining their entire balance in a single place until the loan is repaid. Because repaying the loan is often difficult (either administratively or financially), loan defaults are often the unfortunate outcome of a plan-to-plan transfer that does take place.

[2] Aon Hewitt, *2016 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2016).
[3] Aon Hewitt, *2015 Trends & Experience in Defined Contribution Plans* (Lincolnshire, IL: Aon Hewitt, 2016).

IV. What other factors complicate this, including:

a. Plan type: Generally, a participant can roll over any part of a distribution from a Traditional IRA, Simple IRA, SEP-IRA, Governmental 457(b), Qualified 401(k) Plan, 403(b) plan to a Qualified 401(k) Plan. Designated Roth accounts (401(k), 403(b), or 457(b)), can be directly rolled to other Designated Roth Accounts. (See Appendix)

b. Money type

- Roth contributions can be rolled over to a Roth IRA or Designated Roth Account (401(k), 403(b), 457(b)). Any amounts distributed must be rolled over via direct (trustee-to-trustee) transfer. Our research shows 42% of employers still have not adopted Roth 401(k) contributions in their plans and do not permit roll-ins of Roth monies.[4]
- After-tax contributions can be rolled over to any qualified employer plan as long as the employer's plan allows. In 2015, 48% of employers allowed for after-tax contributions to the plan.[5]
- Pre-tax contributions can be rolled over to any qualified employer plan as long as the employer's plan allows.

While flexibility has increased over time, portability is still limited as a result of plans not offering the full spectrum of contribution types within every plan. That said, plan sponsors carefully design and manage their plan design, and we support retaining that plan sponsor flexibility in spite of the potential negative impact on portability.

c. Investment types, including annuities: Participants investing in lifetime annuities within 401(k) plans pay a higher fee for the guarantee of the lifetime income the investment provides. If participants choose to roll this benefit to another qualified plan, they lose the benefit for which they've paid a higher fee. Older investments that may be illiquid, like unique government bonds or unpriced insurance contract securities, can complicate and delay plan transfers (because they are difficult to value) or result in a possible loss of funds at liquidation.

While negatively impacting portability, these types of investments offer unique features that suit certain populations and plan sponsors' goals, so we recommend retaining plan sponsor flexibility to be innovative and provide unique solutions that meet the needs of their workforce.

d. Brokerage windows: In 2015, 3% of participants invested in brokerage windows, with an average balance of $284,699, compared to an average balance of non-brokerage investors of $90,497.[6] Brokerage investments generally are required to be liquidated in order to be rolled into another plan upon employment termination, thereby hampering plan consolidation and flexibility. However, we believe lawmakers should not devote time to making significant industry changes to address the needs of a small fraction of the workforce who are less prone to cash outs. Instead, more time should be spent on facilitating portability for the more typical participant.

[4] Aon Hewitt, *2015 Trends & Experience in Defined Contribution Plans* (Lincolnshire, IL: Aon Hewitt, 2016).
[5] Ibid.
[6] Aon Hewitt, *2016 Universe Benchmarks* (Lincolnshire, IL: Aon Hewitt, 2016).

e. Fees and expenses:[7] While participants are not generally charged to roll out/in assets, administrative fees incurred for plan participation can have an impact. If individuals have multiple small balances, they could wind up paying multiple administrative fees and erode their retirement income unnecessarily.

Furthermore, when rolling dollars from an employer plan to an IRA, participants lose access to the scale and purchasing power of their employer plan due to the shift into the retail environment. Consider this: in 30 years, a $10,000 investment compounded at 5.25% net of fees produces a balance of $44,000. A seemingly small investment fee of 25 basis points per year would deplete this balance by $3,000—almost one-third of the starting amount.

Impact of incurring multiple administrative fees

Because more plans than ever are charging administrative fees as a flat dollar amount per account, it is important for individuals to consolidate accounts to pay as little in fees as possible. The difference between one account and multiple accounts can be profound.

Assuming each plan has a flat dollar administrative charge of $60 per year, a person with four accounts from prior employers would be paying an extra $240 each year. This amount compounded over 30 years at 5% interest results in almost $16,000 of avoidable expense for the participant at retirement.

V. What is the experience of participants in transferring assets or attempting plan consolidation?

Based on feedback we receive from participants, there is a fair amount of confusion about transferring assets and they feel the process is very time consuming. Participants have difficulty with:

- Understanding the order in which to request the transfer of assets (request payment from the former employer's or sending plan, then contact the receiving plan to rollover assets).
- Locating the "Rollover" option on the new plan's website, devoting the time necessary to complete the forms and file the paperwork.

The complexities and potential pitfalls of the rollover process mean many participants are not able to complete the process. Depending on the approach implemented by the plan sponsor or recordkeeper, failure rates can exceed 30%. Verifying that assets are qualified has created a system that hinders successful plan transfers.

By contrast, the process of rolling money into an IRA is generally seamless, electronic, and supported by high touch representatives and technology solutions. Because rollover capture is a financial driver and benefit to many plan providers, significant investments have been made to make the IRA rollover process as simple and snag-free as possible. Generally, qualified plan recordkeeping and support is not as profitable, due to the institutional and competitive pricing, and plan sponsors and providers are sensitive to the regulations described above that encourage that additional documentation be required. The result is a stark difference in the experience between a rollover to an IRA and a plan-to-plan transfer.

[7] According to Aon Hewitt's *2015 Trends & Experience in Defined Contribution Plans* report, 39% of plans charge participants a periodic dollar fee per account for administrative expenses. This percentage has been steadily rising from 14% in 2011 to 26% in 2013. At the same time, the percentage of plans who charge administrative fees through fund fees with revenue sharing has dropped from 83% in 2011 to 52% in 2013 to 40% in 2015.

VI. What communications from sponsors and/or plan administrators are available to help guide these activities?

Plan sponsors/plan administrators generally provide information on how to transfer money in/out of plans through the following:

- **Summary Plan Description:** Provides general information on how to roll assets into the plan.
- **Plan website:** Guides participants through the "withdraw money" process for their options to either leave their money in the plan, rollover to another qualified plan or IRA, or cash out (noting tax consequences). In addition, reminders and guidance regarding the process of how to transfer money into the plan can be provided at the time of new plan enrollment.
- **Communication:** Sent to participants at the time of termination/retirement outlines the different options they have to keep/take money from the plan.
- **Brochure "stuffers":** Sent to terminated/retired participants and further highlights plan options.
- **Call center representatives:** Provide education on options available to keep/take money from the plan.

VII. The role of technology, including current technology, supporting transfer and consolidation process, standards in effect, or differences which across the system today.

Due to the lack of connectivity between recordkeeping systems, there are no automated solutions to facilitate plan-to-plan transfers seamlessly. Furthermore, many plan sponsors require transfers to be a paper transaction to provide proof of qualification. The result is a complex and manual process that typical participants find difficult and frustrating to follow.

For these reasons, as noted above, many participants find it easier to transfer retirement funds to an IRA, especially in instances where their employer uses a recordkeeper that offers a proprietary IRA in spite of the potential for higher fees when moving from a large employer plan. In this situation, rollovers can be easily transferred to that recordkeeper's IRA with no paperwork required. One only needs to open a financial magazine or watch television advertisements to know that this option is heavily marketed to participants. When this marketing is coupled with the ease of transferring, it is no wonder the IRA rollover is so appealing.

VIII. State-sponsored retirement savings initiatives, and considerations for transfers and consolidations.

A number of states are considering, or have passed legislation creating a variety of plan structures. Now that portability is supported across a large number of plan types, we would encourage flexibility and portability to be extended to these new plan structures where feasible. We recognize that, depending on the actual design and approach selected by the states, compatibility with the employer system may or may not be feasible. For example, if annuity mandates are included in state provisions, employer plans may not be able to easily support these structures.

IX. Development of proposal of model forms and technology standards.

As defined contribution plans provide the backbone of the retirement savings for an increasingly mobile workforce, easing the plan transfer process will go a long way to improving retirement savings for American workers. Aon is pleased to provide the following three recommendations to facilitate successful plan-to-plan transfers while maintaining employer flexibility to design and manage plans to meet the needs of their employees.

1. Streamline the process steps for a plan consolidation.

2. Create an automated clearing house, based on the Automated Customer Accounts Transfer Service (ACATS).

3. Facilitate the transfer of loans from plan-to-plan by adding repayment flexibility upon plan transfer.

Each of these ideas is discussed in more detail below.

1. Streamline the process steps for a plan consolidation.

For ideas to facilitate ease of inter-plan transfers, Aon suggests looking to other geographies for ideas and experience. A great example is Australia's super streaming process, which enables the consolidation of superannuation accounts. In order for this process to work effectively, each plan (fund) has an assigned Tax File Number. When workers change employers, they can choose to consolidate all prior accounts into their new fund by providing the Tax File Numbers of their prior and new plan(s). Forms and processes are simple, and providers are given only three business days to complete the consolidation.

Aon Hewitt suggests adopting and adapting some of the most effective features of the Australian super streaming solution in order to simplify the rollover process.

We propose that when workers change employers, a standard form would be issued in both online and paper format by the employer or plan provider for the worker to authorize the automatic rollover of their retirement account balance from the former plan into the new employer's plan. Tax identification numbers would be required for each plan, and a centralized database managed by a third party entity (e.g., the U.S. Department of the Treasury) would be available to confirm qualification, thus negating the need for special letters or other documentation. The tax identification numbers could be required to be included on each plan's website, as well as be available on a public website by plan name.

Certain investment structures would require special disclosures, including:

- Investment funds with a liquidation fee or penalty.
- Investments that are not valued daily.
- Investments that include an insured guarantee or other lifetime income features.

Specifically, the following features would be required:

- An independent party (government sponsored or funded) would issue an identifier (Plan ID) to all employers.
- A standardized form would be developed and all employers would be required to distribute it to newly hired workers electronically or in print.

- A list of all employer IDs would be available for the worker to input the ID of the former and new employer on the rollover form on a public website, as well as on each plan's website.
- The new employer would send the form electronically to the independent party to facilitate the money transfer process between trustees, with appropriate connection to the plan recordkeepers.

Most importantly, for this solution to work, the government would need to give plan sponsors confidence that they will not be at risk of disqualification if nonqualified assets are inadvertently accepted in their qualified plans by utilizing this process.

2. Create an automated clearing house, based on the Automated Customer Accounts Transfer Service (ACATS).

Whether to further automate Aon's first recommendation, or simply to facilitate the payment transfer component of the plan consolidation process, a process could be developed for trustees to "talk" to each other to facilitate money movement for qualified plans, similar to what is currently in place for other asset transfers. In the U.S., the foundation for this has already been laid through the Automated Customer Account Transfer Service (ACATS). ACATS is a service that standardizes the ability to transfer funds, speeds transaction settlements, and, ultimately reduces operating costs by efficiently automating the transfer of customer accounts from one brokerage firm/bank to another.

To utilize ACATS, a trustee must be a member of the Depository Trust Company (DTC). Currently, most major trust companies are members of the DTC and already have the capability to automate transfers between trust companies holding assets for qualified plans. Because this process is already firmly established, the biggest investment would be to standardize and automate the process of transferring accounts seamlessly between recordkeepers and trustees. It should be noted that ACATS accommodates various processing capabilities, including automated CPU-to-CPU transfers and secure internet communications.

As mentioned above, the solution to automate plan transfers results in an overall savings to participants and plan sponsors. Plans experience lower administrative fees due to reduced numbers of accounts, as well as reduced costs from eliminating manual processing and participant support navigating a complex process. Participants benefit from cost savings because they are not paying administrative fees on multiple accounts. Both plan sponsors and participants enjoy the streamlined plan transfer process and ease of account consolidation.

3. Facilitate the transfer of loans from plan-to-plan by adding repayment flexibility upon plan transfer.

As noted earlier in this testimony, loans create a barrier to plan consolidation and are at high risk of default upon employment termination. Some employers facilitate post-termination repayment, but even with that added flexibility there is a deterrent to plan consolidation.

Allowing the rollover of loan balances from one employer to another would provide a valuable benefit to employees and would reduce leakage. However, loan repayment is complicated and in today's regulatory environment, allowing loan rollovers would be an administrative burden. To provide flexibility for loan repayment upon job change, as well as limit the risk of inadvertent loan defaults and/or administrative complexity, we recommend:

- If employers agree to accept loans, allow a 90-day grace period prior to loan payment commencement, with flexibility to amortize the loan over a different set of parameters consistent with the new plan's provisions.
- Update the model form for rollovers, to be completed online or in paper, to include needed information about the loan and to create consistency across the industry.

Enabling the transfer of loans would give employer plans an additional edge over IRAs and we predict a measureable and significant decrease in leakage via loan defaults.

X. Conclusion.

Modernizing the process of plan-to-plan asset transfers for American workers is paramount to ensuring long-term participation in the employer-provided retirement system. This system provides workers with expertise, protections and cost savings that are not available in the retail market. Plan sponsors, legislators and regulators have the opportunity to streamline the procedure by reducing the paper needed and certification required. Facilitating loan transfers, if permitted by employer plans, would further strengthen the employer system.

We appreciate the opportunity to share our data, resources, expertise and recommendations with the Council as you continue your efforts to help simplify the portability of retirement plans and improve the retirement security for all Americans. Thank you.

Appendix

ROLLOVER CHART

1/23/2015

		Roll To							
		Roth IRA	Traditional IRA	SIMPLE IRA	SEP-IRA	Governmental 457(b)	Qualified Plan[1] (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roll From	Roth IRA	YES[2]	NO	NO	NO	NO	NO	NO	NO
	Traditional IRA	YES[3]	YES[2]	NO	YES[2]	YES[4]	YES	YES	NO
	SIMPLE IRA	YES,[3] after two years	YES,[2] after two years	YES[2]	YES,[2] after two years	YES,[4] after two years	YES, after two years	YES, after two years	NO
	SEP-IRA	YES[3]	YES[2]	NO	YES[2]	YES[4]	YES	YES	NO
	Governmental 457(b)	YES[3]	YES	NO	YES	YES	YES	YES	YES[3,5]
	Qualified Plan[1] (pre-tax)	YES[3]	YES	NO	YES	YES[4]	YES	YES	YES[3,5]
	403(b) (pre-tax)	YES[3]	YES	NO	YES	YES[4]	YES	YES	YES[3,5]
	Designated Roth Account (401(k), 403(b) or 457(b))	YES	NO	NO	NO	NO	NO	NO	YES[6]

[1] Qualified plans include, for example, profit-sharing, 401(k), money purchase and defined benefit plans
[2] Only one rollover in any 12-month period
[3] Must include in income
[4] Must have separate accounts
[5] Must be an in-plan rollover
[6] Any amounts distributed must be rolled over via direct (trustee-to-trustee) transfer to be excludable from income
For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans.