Auto-Portability: What it is, Why it's Needed, and How it Will Strengthen Retirement Security

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Each year, approximately **5 million Americans** with small retirement accounts (defined as having balances of less than $5,000) change jobs and are forced by their former employers to take distributions from their retirement savings accounts. This sets off a complicated process that often leaves the individual with less savings set aside for retirement.

Federal law enables employers to initiate **mandatory distributions** for employees with account balances of less than $5,000 when they leave the company. A participant typically has 30 to 60 days to coordinate a rollover into a new employer's plan. If they don't take action, these account balances are either cashed out (for balances under $1,000) or rolled over into a Safe Harbor IRA account and invested in conservative funds that earn virtually no interest.

According to the Retirement Clearinghouse (RCH), a private company that assists in **retirement account rollovers**, the complicated process of initiating a rollover into a new employer's plan leads to over **54% of participants** with small-balance accounts instead choosing to cash out their savings within a year of changing employers. In the process, they incur substantial penalties and taxes. Even worse, many participants simply lose track of their accounts, thus effectively abandoning their hard-earned savings.

There is a solution. Auto-portability represents one way to address these problems. This approach would automatically transfer savings to active retirement plans with the new employers when workers are subject to mandatory distributions. The system would tap into existing recordkeeper databases to match the worker's active retirement account and move it automatically from the old employer's plan to the new employer's plan. Individuals could opt out of the automatic transfer if they elect to manage those savings differently.

Lawmakers, regulators, and plan sponsors have the opportunity to prevent cash-out of retirement savings accounts and reduce the number of lost accounts by facilitating the adoption of auto-portability. This action can significantly improve retirement security for millions of Americans.

Auto-Portability Can Prevent Billions in Retirement Savings Leakage

A **simulation** by the Employee Benefit Research Institute (EBRI) and Retirement Clearinghouse demonstrates how auto-portability can avoid billions of dollars in retirement savings leakages. The research shows that auto-portability could reduce cash-outs from $320 billion to $164 billion and increase roll-ins from $15 billion to nearly $130 billion over the course of 40 years for participants with small-balance accounts. A reduction in this type of retirement savings leakage would be very helpful for workers.

Plan sponsors play a role in contributing to the high rates of cash-outs among small balance accounts. Because small accounts have a larger ratio of administrative costs to account savings, plan sponsors have an incentive to move these accounts out of their plans when employees leave a company. Due to the complex nature of moving retirement savings into a new employer's plan, and the desire to avoid having to create an additional IRA account separate from the employer's plan, many owners of these small accounts simply opt to cash out.

Unfortunately, this trend hits minority groups particularly hard. The cash-out rate among African-American participants is **more than double** the average rate among all defined contribution plan participants, with the rate among Hispanic participants following close behind. This increased cash-out rate among African-American contributors is probably a consequence of the average size of their retirement accounts. **Research from the Urban Institute** shows that average retirement savings of African-American families are roughly one-sixth the size of average retirement savings of white families. Since African-American participants are more likely to have smaller account balances, they are disproportionately affected by mandatory distributions when changing jobs. Auto-portability would go a long way toward reducing leakages and improving retirement security for this community.

Auto-Portability Can Help Reduce the Number of Lost Accounts

According to **guidance** issued by the Department of Labor (DOL) in 2014, a plan sponsor must take a number of steps to locate the owner of a lost account. The process includes sending certified mail, contacting designated plan beneficiaries, and using free electronic search tools. Unfortunately, due to reported **inconsistencies in enforcement** and confusion among plan sponsors about exactly what steps are required, sponsors have historically been slow to take action to find lost accounts. However, there is reason to believe this may be starting to change for the better. Since the DOL recently increased enforcement efforts, plan sponsors are seeking to address this issue to avoid incurring fines and other penalties for non-compliance.

Fortunately, the same system that facilitates auto-portability would help plan sponsors improve compliance with lost-account rules. Tapping into the network of recordkeeper databases would enable plan sponsors to find lost-account owners and reduce the number of accounts that are lost in the first place. When a worker changes jobs, that worker's old and new accounts could be easily tracked, found, and merged together through the database associated with auto-portability. As more plan sponsors adopt auto-portability provisions, the probability of being able to merge accounts **grows substantially**. Widespread adoption of auto-portability would lead to a significant reduction in the total number of lost accounts and alleviate the regulatory challenges facing plan sponsors.

Support for Auto-Portability Is Growing

The glaring need to address leakages from retirement savings accounts has led to increased support for auto-portability provisions over time. In the past few years, groups of both **Democratic** and **Republican** U.S. senators and representatives have sent letters to the DOL asking them to issue guidance encouraging the use of auto-portability.

The Retirement Clearinghouse has spent the better part of the past decade advocating for the opportunity to manage a national auto-portability program. Until recently, this was not possible, because federal law prohibits plan managers from transferring a participant's savings to a new employer's plan without the participant's consent. However, on July 31, 2019, the DOL **issued an exemption** to the Retirement Clearinghouse, freeing them from the prohibited transaction restriction. This allows RCH to facilitate the transfer of an employee's account balance to their new employer's plan without requiring affirmative consent from the employee. As a result, this exemption clears the way for RCH to begin establishing auto-portability services and the accompanying national database needed for this to work.

While this was certainly a positive first step in facilitating the adoption of auto-portability, it's clear that additional action could help ensure more-widespread benefits. First, it is imperative that plan sponsors integrate these auto-portability provisions into their plan designs. Without increased universal adoption by plan sponsors, many of the benefits of auto-portability won't be realized. Second, federal lawmakers and regulators should take broader action to allow more companies to offer auto-portability services, which would foster competition and facilitate entrance into the newfound auto-portability market.

Conclusion

While millions of Americans have invested in employer-sponsored retirement accounts, the burdensome process of initiating a rollover causes many participants to cash out their accounts when changing jobs. If policymakers do not address this problem, retirement accounts will continue to suffer from unnecessary leakages and many workers will lose valuable retirement savings. Auto-portability is a simple solution that would go a long way toward addressing the issue of leakages by reducing cash-outs and preventing accounts from being lost. Regulators and plan sponsors should take action to further facilitate the adoption of auto-portability, and in doing so, improve the retirement security of millions of Americans.

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Additional Resources

Bipartisan Policy Center, "**Report of the Commission on Retirement Security and Personal Savings,**" June 2016.

Center for Retirement Research at Boston College, "**An Analysis of Retirement Models To Improve Portability and Coverage**," March 2018.

Retirement Clearinghouse and Employee Benefits Research Institute, "**Auto Portability Research & Simulation,**" June 2016.