Reducing Retirement Savings Leakage, p. 2

This *EBRI Notes* article summarizes discussion on new ways to reduce retirement plan "leakage," presented at the Employee Benefit Research Institute’s 78th policy forum in Washington, DC, on May 12, 2016.

- A recurring issue with defined contribution (DC) savings plans such as the 401(k) is the risk of "leakage"—preretirement reductions in plan savings by workers, either through loans, hardship withdrawals, or payouts at job change.

- There have been widely varying estimates of how big of a problem leakage actually is, and what the potential reactions may be by both retirement plan sponsors and participants if new preretirement access restrictions were imposed. For instance, for many workers the option of being able to take a loan from their 401(k) account is seen as a major incentive for them to participate.

- A 2014 analysis by EBRI found that approximately two-thirds of the impact of diminished retirement savings due to leakage was associated with the cashouts that sometimes occur at job change. Others have pointed out that 401(k) loans, which sometimes are criticized as a significant source of retirement savings leakage, actually account for the smallest amount of pre-retirement savings loss.

- To highlight new work on leakage, the Employee Benefit Research Institute (EBRI) devoted part of its 78th policy forum to the topic of "Retirement Challenges and Reforms;," focusing in particular on “Reducing Leakage and Incubating Savings.” The May 12 event in Washington, DC, brought together about a hundred benefits-related experts to discuss a variety of retirement and health topics.

- The leakage-focused session involved the presentation of a simulation model by the Retirement Clearinghouse (RCH) concerning outcomes of “Auto Portability,” or automated and presumptive plan-to-IRA and plan-to-plan transfers of retirement savings as workers change jobs.
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J. Spencer Williams, president and CEO of RCH, noted that about 12.5 million Americans with defined contribution plans, such as 401(k)s, change jobs every year and face the decision of what to do with their retirement savings: move them to the new employer’s retirement plan (if they can), move them to an individual retirement account (IRA), leave them in the old plan, or take them out of the plan (which triggers a withdrawal penalty if taken before age 59-1/2).

Based on research and actual experience with employers, Williams said the RCH has developed a fairly simple engagement model with both incoming and departing employees—aimed in particular at those with small 401(k) balances ($5,000 or less, which collectively amount to about $8.8 billion a year)—that would apply both a rollover/transfer presumption and a near-automatic process that, together, is projected to reduce retirement plan leakage by 50 percent.

The model was built by Dr. Ricki Ingalls, chair of the Computer Information Systems and Quantitative Methods Department at Texas State University and principal at Diamond Head Associates consulting firm. Ingalls’ specialty is developing computer models that deal with a process and then random events that can occur during that process, so as to figure out how to improve the process. In this case, the process was what workers, employers and recordkeepers do when an employee changes jobs.

Using EBRI and other data, RCH determined that, of the 12.5 million people who change jobs every year, about 40 percent (or about 5 million people) have less than $5,000 in their retirement account. Williams said a surprising find...
from EBRI data was that the employee turnover rate was about 28 percent annually, “which means every 3.3 years or so an individual worker is changing jobs.”

**Figure 1**

![Diagram](image)

*Source: Retirement Clearinghouse*

With no changes in the rollover process, Williams said about $10 billion will be lost to retirement plan cash-outs over a 30-year period.

The essence of the Auto Portability approach, he said, is to create a mechanism of electronic records matching for individuals between their former employer’s retirement plan and the new employer plan so that their retirement savings are automatically transferred.

“We know from behavioral studies that this population of job changers, particularly with very small balances, is inert. They really don’t respond. And when they do respond, they cash out,” Williams said. “Auto-portability is about changing a behavior similar to auto-enrollment, whereby we do it for them. And it has an opt-out mechanism so that somebody can opt out if they need the money.”

Based on actual participant data, Williams said about 37 percent of job-changing workers cash out because they need the money, while the remaining 63 percent who take money out of their retirement accounts do so because “it’s the easiest path available,” despite the penalty and taxes they will pay by doing so.

Williams said about 16 percent of the job-changing population with small accounts go to an employer that does not have a 401(k) plan but later switch to a new employer that does. About 8 percent retire, but the large majority goes to a new employer that also has a 401(k) plan.

Other than educational efforts aimed at retirement plan participants, Williams said the two major technical problems with Auto Portability have been achieving cooperation among 401(k) recordkeepers and getting the U.S. Department
of Labor to agree with the “negative consent” provision, under which the transfer of funds is presumed to be chosen unless a participant actively chooses to withdraw the funds.

Williams noted that “this is not just a concept” and is currently being used by the RCH client base. “The electronic records matching and the technology work,” he said. Of the 1,500 retirement plan participants where they have been able to match accounts, “the measured average account balance in the employer plan increases by about 45 percent. By creating this default path, we incubate those savings accounts.”

RCH plans to publish research findings on its results sometime later this year.

Endnotes


3 https://www.rch1.com/

4 https://blog.rch1.com/blog/interesting-finding-emerges-from-the-auto-portability-simulation
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