Defined Contribution
Institutional Investment Association

10 YEARS
2010-2020

Five Practical Barriers to Better Retirement Outcomes

Assessing Challenges and Taking Action

Contributors

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EXECUTIVE SUMMARY

The Defined Contribution Institutional Investment Association (DCIIA) has identified five potential roadblocks to developing adequate financial retirement resources. The goal of this paper is to raise awareness and encourage action. To help defined contribution plan sponsors address potential issues, at the end of each section we have provided a key takeaway along with questions that plan sponsors can use to address these issues.

The five potential roadblocks to successful retirement outcomes are:

1. Missing participants
2. 401(k) loan leakage
3. Movement of assets out of plans via rollovers
4. Participants leaving the plan at retirement
5. Obstacles to in-plan annuities

INTRODUCTION

One definition of a successful retirement is having financial resources sufficient to meet projected needs without a steady income stream. Various barriers to successful retirement outcomes have cropped up over the past four decades. These barriers partially result from the way the US private sector retirement system has evolved, and in particular, how today's defined contribution (DC) plan has shifted from a supplemental savings-oriented vehicle to become the primary source of retirement income for most Americans.

DCIIA has identified five potential roadblocks to developing adequate financial retirement resources. This paper's goal is to raise awareness of these barriers and encourage action.

1. MISSING PARTICIPANTS

Automatic enrollment has been a boon to retirement preparation by enabling participants to save early, with automatic escalation helping to increase balances. An unintended consequence of auto enrollment, however, is that participants may adopt a "set it and forget it" mindset. Consequently, participants do not engage in retirement planning. Low engagement may contribute to retirement balances being left in prior employers' 401(k) plans. With the increase in the number of unengaged participants and a higher number of jobs held in a lifetime, the issue of "lost or missing" participants from the perspective of plan sponsors and their service providers is likely to grow. A higher number of missing participants means that more individuals are likely to be unaware of what the balance of their total retirement savings is, and their success in retirement may be hindered unnecessarily.

Fast Facts

According to a LinkedIn study, since the mid-1980s the number of companies that people have worked for in the five years after graduating college has nearly doubled.

The Bureau of Labor Statistics (BLS) states that younger Baby Boomers (those born between 1957 and 1964) held an average of 11.7 jobs from ages 18 to 48.

A generational survey recently conducted by Capital Group showed that 30 percent of Millennials have held three jobs or more over the past five years, compared to 10% of Gen Xers and 6% of Boomers.[1]

This issue is not limited to those individuals who may have changed jobs and left no updated contact information. Missing participants also include individuals who are unresponsive to communications or who do not accept distributions from the plan. Not taking distributions from the plan can complicate matters even more when required minimum distributions (RMDs) come into play, and penalties for not taking withdrawals can further erode savings. Research from Retirement Clearinghouse and Boston Research Technologies showed that those participants most likely to need the funds from these account balances are far more likely to be the ones missing, with low-income households twice as likely to include missing participants.[2]

KEY TAKEAWAYS

Locating missing participants is an effort plan sponsors should undertake.

Key Questions to Consider

- What is our plan's current process for managing participant information and ensuring it's updated?
- Are we collecting personal information such as cell phone numbers and personal email addresses that are less likely to change following a move or separation?
- Are we leveraging the latest digital technologies to manage data and/or to try to track down missing participants?
- What are our industry peers doing to manage this issue?
- Can any of our service providers offer helpful advice or resources?
- Are our participant communications visually appealing and easy to recognize (our company brand), read and understand? Are calls to action clearly spelled out?

Locating missing participants has generally been more challenging than plan sponsors have expected. Written communications may go unread for several reasons: lack of interest; participants' inability to differentiate plan communications from general marketing solicitations; incorrect contact information; or a more complex issue, such as M&A activity resulting in a company or recordkeeper name that may not be familiar to the participant.

Social media may appear to be a good way to reach former employees. Even the US Department of Labor (DOL) has suggested using platforms like Facebook to find missing participants. In practice, however, these platforms present challenges. Social media platforms were not designed for identifying people, so plan sponsors cannot be certain that they are contacting the correct individual. The DOL has also proposed dedicating staff to locating missing participants, but plan sponsors often lack resources to dedicate to finding former plan participants.

2. 401(K) LOAN LEAKAGE

Study upon study[3] has raised concerns about participant retirement preparedness. Auto-enrollment and auto-escalation features adopted after the passage of the Pension Protection Act of 2006 (PPA) increased participation and savings rates, yet the industry has been unable to prevent premature distribution of retirement savings. One major cause of this leakage has been 401(k) loan defaults. In fact, a recent TIAA Institute study found that the success of automatic enrollment has had the negative consequence of increasing loan leakage even as participant contributions have grown.[4]

In 2015, the Pension Research Council (PRC) estimated annual leakage from loan defaults to be $6.3 billion, driven by an 86 percent default rate among separated participants.[5] Prior to this study, defaults following termination were difficult to identify because defaults were reported in Form 5500 filings as regular distributions of benefits. Following the PRC study, a Deloitte study[6] in October 2018 updated the annual loan default figure to $7.3 billion. Deloitte calculated the cumulative 10-year loss to retirement security to be $2.5 trillion. It considered the aggregate impact of taxes, penalties, lost earnings with opportunity costs, and losses to each defaulting participant to be nearly $300,000 on average.

Limited reporting requirements have limited plan sponsors' abilities to understand loan default activity in their plans. As the saying goes, "You can't manage what you can't measure." Loan program monitoring is typically oriented toward annual Form 5500 reporting elements, such as total loans outstanding and annual defaults by active participants. As a result, plan sponsors rarely monitor year-over-year defaults following death, disability, involuntary termination and voluntary termination. Recent IRS changes to Form 1099-R will require sponsors to report on qualified plan loan offsets upon severance from employment or plan termination. With this change, DOL oversight is likely to increase, which may lead to more plan sponsor monitoring. For example, a recent report issued by the Government Accountability Office (GAO) suggests that the DOL enhance Form 5500 reporting to include and break out loan defaults by separated employees as well as active ones, to help provide better visibility on the issue.

Plan sponsors need more help in addressing loan leakage. Available information about the efficacy of current measures to address loan leakage (e.g., extended repayment through ACH) suggests limited impact on defaults. The IRS recently extended the repayment period after a default as part of the Tax Cuts and Jobs Act of 2017 (TCJA); however, cash-constrained participants still face the challenge of navigating these complex rules and they must also be able to repay. According to a 2019 report from Vanguard[7] just four percent of borrowers in DC plans extended repayment through ACH after separation.

Eliminating loans as a plan feature is probably not a viable answer to preventing inadvertent leakage. Recent research[8] shows us that participants often borrow to pay off debt or for other financial emergencies. Without the loan feature, they could be forced to take a hardship withdrawal—which is guaranteed leakage. In fact, hardship withdrawals have been increasing,[9] due to regulatory changes this year that make them easier for participants to take. If loans were eliminated, this increase could get even worse. In the previously cited study, Deloitte recommended finding the right balance of product innovation, plan design and technology to improve financial wellness and retirement readiness. Specifically, Deloitte proposed:

- Products as solutions – including 401(k) loan insurance to automatically prevent loan defaults as well as the cascading impact of taxes, penalties, lost earnings and total account cash-outs
- Policies – More robust education and loan risk awareness, or greater limitations on loans
- Technology – Automated post-separation repayment or auto rollover (i.e., the automated movement of an inactive participant's outstanding loan balance from a former employer's plan to his or her account in a new employer's plan).

KEY TAKEAWAYS

Plan sponsors have found preventing the premature distribution of retirement savings to be difficult. One major cause of leakage is 401(k) loan defaults, about which plan sponsors do not have a good understanding because of limited reporting on default activity in their plans.

Key Questions to Consider

- Are we regularly monitoring our auto enrollment / auto escalation policies and opt-out rates relative to our loan leakage rates?
- How effectively are we communicating about outstanding loans to employees who are departing the organization?
- Do we have a good understanding of the loan default activity within our plan?
- Are our loan policies and procedures aligned with industry innovations and best practices?
- Are we ensuring participants are aware of other options besides taking out a 401k loan (i.e., other types of loans)? Are we clearly communicating the impact, timeline and their responsibilities around a 401(k) loan?
- Can any of our service providers offer helpful advice or resources?
- Are we leveraging the latest digital technologies to manage this issue?

3. MOVEMENT OF ASSETS OUT OF PLANS VIA ROLLOVERS

Individual retirement accounts (IRAs) represent the largest single repository of US retirement assets, holding almost one-third of those assets, according to the Investment Company Institute (ICI).[10] In addition, the IRA can be a significant element in enabling people to save for retirement, especially those without access to a qualified retirement plan. For participants that do have access to qualified retirement plans, however, the potentially higher cost of rolling assets from a qualified plan into an IRA can erode savings and impede an individual's ability to have a good retirement outcome.

Rolling assets into an IRA from a qualified retirement plan has happened so commonly that such rollovers became a primary focus of the DOL's "fiduciary rule" regulatory efforts. These regulatory efforts drew attention to the practice, to the extent to which it was occurring, and to the circumstances under which it occurred. Employee Benefit Research Institute (EBRI) data show conclusively that when savings exist, they are made overwhelmingly in workplace retirement plans. According to the ICI, over half of traditional IRA-owning households had assets in their IRAs that came from employer-sponsored retirement programs, with 82 percent stating that they had rolled over their entire retirement account.[11] Two primary reasons cited in the ICI study from a participant perspective for rolling assets into an IRA included the desire to preserve tax treatment and an aversion to leaving assets with a former employer. Participants may also want to consolidate their retirement assets in one place to facilitate easier decision-making. It's important to note that these participant actions have typically taken place in plans whose design is set up for a standard lump-sum benefit payment at retirement or other separation, and an expectation that the participants will leave the plan at that time.

One roadblock to rolling retirement assets into a new employer's qualified plan is the administrative burden placed on participants. Despite regulatory guidance to encourage sponsors to facilitate such "roll-ins," the administrative burden is typically higher than when participants roll assets into an IRA, and certainly higher than when they cash out completely. Plan sponsors often perceive an additional burden to be confirming the qualified status of the rollover, when in reality Revenue Ruling 2014-9 makes this confirmation a fairly easy task. Verifying the fund source and reviewing Form 5500 data for qualified status is all that is required to confirm. Many participants therefore take the easier route and move their assets to an IRA, which may not be the most efficient choice. Others simply ask for a check. Administrative burdens can play a role in whether participants choose to stay put, move into a new qualified plan, or move assets into an IRA. In addition, marketing materials for low-cost IRAs and the ease of transferring assets into them can make this option seem like a far easier process than rolling assets into a new qualified plan, notwithstanding emerging standards of care for investment professionals that will apply to rollovers both at termination as well as retirement.

There is extensive industry debate over the average fee levels in an IRA versus a qualified plan, and whether rolling assets into an IRA may result in higher costs for similar investments. The extent to which fees differ depends on the IRA and plan involved. Some plan sponsors are beginning to encourage separated plan participants to remain with the plan. If participants keep their balances in the plan, the higher total assets help to keep investment and other administrative costs low, which benefits all plan participants. Blanket statements about either IRA fee levels versus qualified plans, or which option one should select, are fraught with issues. Nevertheless, in some cases, keeping assets in a qualified retirement plan may benefit both the participant and the plan sponsor.

KEY TAKEAWAYS

One roadblock to rolling retirement assets into a new employer's qualified plan is the perceived administrative burden, which is typically higher than when rolling assets out of a former employer's qualified plan into a recordkeeper-affiliated IRA or even cashing out completely.

Key Questions: Rollovers

- Do we have a clearly stated policy as to whether we want to encourage employees to leave their assets in our DC plan when they leave the organization?
- If we want to encourage participants to keep their assets in our plan, are we clearly communicating this viewpoint, along with the potential benefits of doing so?
- Can new employees seamlessly transfer assets into our plan?
- Do we have procedures in place to facilitate efficient confirmation of qualified plan assets from rollovers per Revenue Ruling 2014-9:
  - employee certification of the source of the funds
  - verification of the payment source (on the incoming rollover check or wire transfer) as the participant's IRA or former plan
  - if the funds are from a plan, looking up that plan's Form 5500 filing, if any, in the Department of Labor's EFAST2 database for assurance that the plan is intended to be a qualified plan

4. PARTICIPANTS LEAVING THE PLAN AT RETIREMENT

Arming retirees with the facts about the benefits of keeping their assets within a qualified retirement plan can be beneficial to both retirees and their plan sponsors, if the appropriate features/ options are available. According to the Social Security Administration Life Expectancy Calculator, the average female who turned age 65 on June 30, 2019, could expect to live an additional 21.4 years, so it is reasonable to expect the retirement phase to last for 20 years or more.[12] When asked about the subject, 42 percent of employees expressed anxiety around what to do with their DC plan assets. Of those who ended up moving assets out of the plan upon retirement, 88 percent did so because they felt they could improve investment performance outside the plan, 82 percent felt they could get better investment choices outside the plan, and 39 percent wanted to purchase an annuity or another product not available in their 401(k) plan.[13] Making it attractive and easy for participants to stay in a qualified plan after retirement can help maintain higher plan asset levels and lower fees, which is beneficial to both plan sponsors and participants.

As plans have evolved, pushing participants out of the plan at retirement may no longer be the sponsor's intention or preference. A plan with an older workforce can see a significant decrease in assets as employees retire and move their assets. This decrease in assets can cause minimum thresholds for lower investment management fees to be crossed, thus infringing on the assets of current participants. Participants may erroneously think that they must take their assets out of the plan after retirement. In addition, retirees may transfer assets because they want to consolidate all of their retirement assets and/or believe they must do so to receive advice on a majority of household savings. Minimum withdrawal thresholds, check-writing fees or simply not being able to establish periodic payments from the plan can also make keeping savings within the plan unattractive.

While administrative difficulties may cause some participants to leave the plan, other factors may also play into this decision. For example, plans may have limited investment options geared toward benefit distribution. There may be limited education about retirement and budgeting. Retirees may find better overall services and solutions elsewhere. The task of turning an account balance into a retirement "paycheck" can be quite overwhelming for participants; there is great need for more and differentiated communication and education for those individuals nearing retirement.

In today's digital world, people expect increasingly high levels of customization and personalization. Each participant is unique. Having an incomplete picture of an employee's or retiree's finances can make addressing deeper financial well-being topics, like retirement- income adequacy, difficult. Tools to help with spending, budgeting and investing in retirement certainly exist, but most tools focus on getting participants to the finish line, not on what they can or should do after they cross it. Increasing the quality of these tools can make it enticing for participants to stay in the plan.

KEY TAKEAWAYS

Providing education, communication, tools and investment options directly related to the retirement phase could boost plan retention of retirees, while also providing benefits to plan sponsors as well as both active and retiree populations.

Key Questions: Leaving the Plan at Retirement

- Are we conveying that sponsors owe the same fiduciary duty to all participants in a qualified retirement plan, whether active or terminated?
- Are we following industry / peer best practices around reducing administrative difficulties for retirees who keep assets in the plan?
- How well do we understand our employees' and retirees' unique financial circumstances? How are we helping them to understand those circumstances themselves?

5. OBSTACLES TO IN-PLAN ANNUITIES

Predictable lifetime income is an attractive option for many participants, and annuities are likely to be a part of this type of retirement solution. In the DC industry, there are currently many perceived obstacles to adding annuities in 401(k) plans, including fees and portability.[14] Despite those perceived obstacles, according to data collected by Hueler Companies, there is allocation activity in the annuity market.

Annuities

Hueler Companies found that among rollover transactions: 11% went directly to insurers or a top-10 annuity distributor in the independent broker-dealer channel; 10% went to a single independent broker-dealer with significant variable annuity marketing efforts, averaging costs of 85 to 200 basis points (bps) per year; and another 40% went to broker dealer/mutual fund firms with active annuity marketing efforts, particularly those aimed at pre-retiree and retiree populations.

NOTE: The information presented is related to asset flow and it is not known if the end investment was an annuity.

Evaluating the different types of annuity products is key to making the right decision, especially when it comes to features and fees. One of the biggest perceived plan sponsor obstacles for including lifetime income annuities as a plan option has been assuming the fiduciary responsibility for selecting an insurer. The vast majority of plan sponsors have not wanted to undertake this responsibility from either an operational or a fiduciary perspective;[15] however, with the passage of the SECURE Act and the safe harbor it provides, the annuity industry is hopeful that plan sponsors will now seriously consider adding an annuity option to defined contribution plans.

Given that investment managers will always have a place in DC plans, many plan sponsors and their consultants or advisors have developed thoughtful processes to evaluate them. The selection and ongoing monitoring processes — and even the decision whether to retain or replace a manager — can come into question due to many factors. Selecting an insurance provider introduces additional considerations. Features such as solvency may play a more important role given the promise of a longer-term obligation, but with the passage of the SECURE Act and the safe harbor provided, the burden of selecting an annuity provider has eased. Even with safe-harbor protection and guidance provided, the addition of a new type of provider in the plan will require some additional/different analysis that may be new to many plan sponsors, consultants and other decision-makers.

Participant education about annuities, and income in general, has been limited. Plan sponsors may be reluctant to implement a solution or add new educational topics that they do not fully understand. Awareness about the value of annuities within a portfolio is therefore generally lacking, but as demand for retirement income solutions increases, it will become important to boost education around how and why to consider annuities in the retirement portfolio.[16]

KEY TAKEAWAYS

Participant education about annuities has been limited, and plan sponsors may be reluctant to implement a solution where they are uncertain about how to evaluate different annuity products and insurance companies, as well as the process for replacing products that are suboptimal.

Key Questions: Leaving the Plan at Retirement

- Have we recently assessed retirement income options for our plan?
- Do we have a process / framework that would allow us to assess annuity providers within the context of being a fiduciary?
- Can any of our service providers offer helpful advice or resources?

CONCLUSION

While there may be other barriers to better retirement outcomes, recognizing the above five is a good first step to improve retirement readiness for America’s defined contribution plan participants. We encourage plan sponsors and their service providers to discuss actions that can be taken to address these administrative, operational and inertia-based challenges. Having conversations with service providers and industry associations, as well as collaborating with other like-minded plan sponsors, can go a long way to help remove some of these barriers, thereby making the participant’s road to a successful retirement as smooth as possible. Solving these challenges is not “all or nothing” – but over time, if industry participants commit to taking incremental action to address them, we can make real progress toward enabling America’s workers to retire with financial security.

▶ Call to Action

ADDITIONAL DCIIA RESOURCES

Visit our online Resource Library for these related publications:

Design Matters: The Retirement Tier
October 2019
DCIIA has published a series of brief white papers and related resources highlighting a retirement tier's potential components, exploring its benefits and challenges for plan sponsors, and providing a roadmap for implementation.
Design Matters: Plan Distribution Options

Design Matters: Plan Distribution Options
Taking Money Out for Retirement
May 2018
DCIIA believes that one of the primary roles of a DC plan should be to create adequate retirement income for the plan's participants. This paper covers topics including: common distribution practices today, reconsidering and updating plan objectives and design, retiree-friendly distribution programs, and educating participants about their retirement choices.

Plan Leakage
February 2016
A study on the psychology behind leakage of retirement plan assets
The results from an industry survey of 5,000 retirement plan participants confirm that plan leakage remains an issue, one that ultimately is undermining the critical public policy goal of preserving assets for retirement savings.

Retirement Income Solutions: A Guide for Plan Sponsors,
December 2015
Considerations and case studies to help employers understand and evaluate retirement income options
With this paper, DCIIA describes many of the tools and withdrawal strategies (both guaranteed and non-guaranteed) that support plan participants' income needs as they move toward and live in retirement.

Rethinking Defined Contribution Communication and Education
December 2013
The thoughts and suggestions contained in this paper are intended to be a first step in rethinking the way we approach retirement savings communication and education.

ENDNOTES

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[13]The American College New York Life Center for Retirement Income, "The American College's Rollover and Consumer Attitudes Survey," The American College of Financial Services, 2017.

[14]Callan Institute, "2019 Defined Contribution Trends Survey," 2019.

[15]Ibid.

[16]Steve Parrish, "2019 American College Guaranteed Lifetime Income and Annuity Study," The American College New York Life Center for Retirement Income, February 2019.

ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of America's workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA's diverse group of members include investment managers, consultants and advisors, law firms, record keepers, insurance companies, plan sponsors and other thought leaders who are collectively committed to the best interests of plan participants.

For more information, visit: **www.dciia.org**.

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