Labor Department Proposes Auto-Transfer Plan for Small 401(K) Accounts

Each year, nearly 15 million American workers change jobs, with many leaving their 401(k) accounts behind. The Department of Labor (DOL) is trying to relieve this headache for plan sponsors and keep employee accounts more complete by proposing a rule that would transfer retirement balances left behind to participants' 401(k) plans at their new employers.

If the **proposed rule** is finalized, it would clear the way for companies to automatically transfer abandoned 401(k) accounts between $1,000 to $5,000 to financial technology firm Retirement Clearinghouse LLC (RCH) of Charlotte, N.C. RCH would hold the assets in an individual retirement account (IRA) when an employee leaves a job or if the plan is terminated; the assets would then automatically transfer when the employee moves to a new company and opens a corresponding 401(k) account.

RCH needs the DOL approval because current law bans the firm from accepting a fee for the automatic transfer on behalf of the participant from the old employer to the new one. RCH said it uses locate, match and transfer technology that scans record keepers—who voluntarily provide data—to determine whether the participant has found a new job.

Slowing the Leakage

This auto portability proposal is in line with other automatic 401(k) plan features, like auto enrollment and escalation, that are designed to encourage saving for retirement. It also addresses what RCH calls a cash out, or leakage, crisis.

RCH runs a National Retirement Savings Cash Out **Clock**, which shows that nearly $62 billion has been cashed out of 401(k) plans this year. Of the nearly 15 million defined-contribution participants who change jobs annually, RCH notes about 40 percent cash out of their 401(k). This leakage can have a damaging impact on the total amount participants save for retirement. Additionally, money taken out of retirement accounts before age 59 ½ is subject to regular income tax plus a potential 10 percent penalty tax.

The proposal may stem the flow of the largest source of leakage from 401(k) accounts today. The Employee Benefit Research Institute estimates that the proposed rule would reduce cash outs by nearly half.

Currently, employees are left with the responsibility to transfer 401(k) assets from one company to another. Moving to a new job can create a lot of stress, and adding the transfer paperwork only adds to that burden. Many employees choose to do nothing, leaving the employer with the added account to manage.

Today's employers have options, too, when it comes to managing assets left behind. If the amount vested is under $1,000, employers who have it written in their plan documents may send a check to the employee; often this is done as soon as administratively possible. For vested accounts between $1,000 and $5,000, the employer may elect to distribute as well, but this amount must be transferred to a newly created IRA for the participant.

Before any involuntary distributions, plan sponsors must give 30-days notice to participants so they can decide whether they agree with the plan.

The proposed rule would also relieve plan sponsors of any fiduciary liability when handling the transfer of 401(k) accounts. As with any decisions concerning 401(k) plan management, plan sponsors must act in the best interest of the participant. Under the proposal, once the assets are moved to RCH's IRA, plan sponsors would no longer have any fiduciary responsibilities to that participant's account. Moreover, removing these low and often inactive accounts will most likely reduce administrative costs.

Potential Drawbacks to Consider

While the new rule could be helpful in limiting some of the leakage issues affecting workers, the proposal has not received universal support from employers or from employee advocates. Despite the DOL's best efforts to formulate an effective solution, plan sponsors may not want to have participants' accounts automatically transferred. In some cases, the transfer may not be a good option because assets may not be invested optimally for a participant's needs. In addition, plan sponsors might not be keen on sharing participants' personal information with the clearinghouse.

A Proposal Worth Watching

Preventing money from being cashed out of 401(k) plans helps participants build retirement nest eggs over time. The proposed rule, which would automatically transfer low-balance 401(k) plans from one employer to another on behalf of a participant, could be helpful in limiting this leakage and reducing cash outs. But with any proposed rule or law, it's important to think through any potential unintended consequences and how they could affect employees and plan sponsors.