Greater Protections for Inactive 401(k) Accounts

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GAO finds that forced transfers erode in value and people lose track of inactive accounts.

Millions of Americans – almost 40 percent of workers – leave their jobs each year, and many fail to specify what should be done with their 401(k) savings. If the balance is small, employers can transfer it out of the plan. Specifically, under the Internal Revenue Code, former employers can transfer balances of less than $5,000 into an IRA account. In addition, as employees move in and out of jobs, they face the task of managing multiple accounts.

A recent report by the U.S. Government Accountability Office – ***401(k) Plans: Greater Protections Needed for Forced Transfers and Inactive Accounts*** – examined: 1) what happens to forced transfers over time; 2) the challenges of managing multiple accounts and what could be done to help; and 3) how other countries deal with the challenges of inactive accounts.

Prior to 2001, in the absence of instructions from the participant, employers could pay out 401(k) balances of $5,000 or less. In order to protect small balances, 2001 legislation reduced the payout limit to less than $1,000 and required employers to roll over amounts between $1,000 and $5,000. The same legislation also required the U.S. Department of Labor (DOL) to prescribe the investment options for these forced rollovers. Essentially, under the regulations issued in 2004, the plan satisfies its fiduciary obligation if the investment preserves the dollar value of the rolled balances. In other words, the money can be invested in a money market fund. The problem is that the fees charged to the forced transfer accounts often outpace the low returns earned by the conservative investments prescribed by the DOL's safe harbor rules, causing account balances to decline.

How prevalent is the problem of forced transfers out of 401(k)s? According to data provided by the Social Security Administration (SSA) – who knew they had these data!! – over the period 2004-13, separated employees left more than 16 million accounts of $5,000 or less in workplace plans, with an aggregate value of $8.5 billion. Moreover, current law also allows employers to force out accounts with more than $5,000. For example, a plan can force out an account with a balance of $20,000 if less than $5,000 is attributable to contributions from the current employer.

The other issue is the challenge of managing a number of accounts over the individual's lifetime. Companies are frequently restructured and plans are terminated, merged, or renamed. If accounts are lost, key information may be held by different plans, different service providers, or different government agencies. The United States, unlike several countries that GAO looked at, does not have a central pension registry.

In response to the problems identified, GAO made four recommendations. On the congressional side, GAO suggested: 1) amending the law to enable plans to invest the assets of forced 401(k) transfers in higher yielding investments, such as those included in the qualified default investment alternatives for 401(k) balances; and 2) repealing the provision that allows plans to disregard rollovers when identifying balances eligible for transfer. On the executive side, GAO recommended that DOL convene a task force to consider setting up a pension registry and that the SSA make information on potential vested benefits more accessible to individuals before retirement.

In response, DOL said that it would be happy to set up a task force but noted it does not have the authority to require the reporting necessary to establish a registry. It also disagreed with the proposal to broaden the investment option, arguing that the current conservative investment options are the best way to preserve principal. SSA disagreed with the recommendation to make potential private retirement benefits more available to individuals before retirement, because it would place the agency in the position of having to answer legal questions about private plans.

How exhausting! The problems identified by the GAO are relatively small, well defined and fixable. We are one of the greatest countries in the world. We should be able to overcome the challenges associated with inactive account balances.