Vanguard moves to automatically transfer small 401(k) balances

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MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

Engaging Retirement Clearinghouse should markedly reduce leakages and increase saving

Rejoice! Vanguard has hired **Retirement Clearinghouse LLC** to automatically transfer small balances from one 401(k) plan to another. This is a win for Vanguard and its customers, for Retirement Clearinghouse, which has been working on this project for many years, and for the retirement system as a whole.

This initiative should dramatically reduce leakages and increase 401(k) balances. Each year, millions of Americans leave their jobs and cash out their holdings, because it is very difficult to roll money from one 401(k) to another. Others leave their money in the plan, but fail to specify what should be done with their balances. If the balances are small (less than $5,000), employers can transfer them into an IRA account, where they are invested in money market funds. Such accounts can have fees that exceed their low investment returns, causing account balances to decline.

Many years ago, Spencer Williams and Tom Johnson came up with a solution – automatically consolidate small accounts so that employees can aggregate their savings as they change jobs. They created Retirement Clearinghouse LLC to serve as the platform to consolidate balances. Consolidation helps the employees accumulate a more adequate level of retirement saving, because research shows that hitting the $20,000 milestone makes participants much more likely to preserve their balances. And consolidation helps sponsors fulfill their fiduciary duty and cut aggregate plan costs by reducing the number of stranded accounts. Consolidation also helps providers to increase assets under management and reduce the headaches associated with mandatory distributions, stranded accounts, and uncashed checks for missing participants.

While Williams and Johnson have had the technology for years, it took a long time to get buy-in from government regulators. Their proposal created a complicated situation. Potential customers wanted to know who has fiduciary responsibility for this service. A Labor Department advisory opinion clarified that Retirement Clearinghouse is the fiduciary for these transactions. But, the Employee Retirement Income Security Act of 1974 prohibits fiduciaries from self-dealing. That is, fiduciaries are not allowed to earn fees as a result of their recommendations. Hence, Retirement Clearinghouse needed an exemption from this provision, **which they got in 2019**.

Retirement Clearinghouse also needed buy-in from the major financial services firms. One would have thought that by focusing on accounts under $5,000 the company would not have been a threat to the big players. But that step too appears to have taken time. Good for Vanguard!

I have no idea about the financial arrangements between Vanguard and Retirement Clearinghouse, but, in past releases, Retirement Clearinghouse envisioned charging a few dollars per month in custodial fees for the holding period between plans and a maximum $59 fee for the electronic transfer to a new plan. The goal is to keep the small balances in an IRA for as short a period as possible before transferring them to a new plan.

In short, the cashing out and loss of small accounts is a well-defined and serious problem. Retirement Clearinghouse offers a solution. It is lovely to see a win for the 401(k) system.