Council Position

Participant Rollovers from Qualified Retirement Plans

DC PLAN INVESTMENT COUNCIL

Synopsis

There is ample evidence[1] that individuals who work with a professional advisor enjoy better retirement outcomes than participants left to their own devices. Current and proposed regulations however can prevent the advisor to a retirement plan from also providing advice to individual participants if that advisor receives compensation from that advice. Of particular concern is participants' ability to access advice from the person they know well, who can help them most when they separate from service to retire: the advisor to the plan. It is ironic that participants should be unable to obtain service from the plan advisor just as they experience the most pressing need for retirement investment guidance. To help larger numbers reach successful retirement outcomes, the Council urges regulators to review applicable regulations with the ultimate goal to exempt from prohibited transaction status the provision of advice to participants by that plan's advisor(s) at the time of a distributable event.

About the Council

The Council advocates for successful qualified plan and participant retirement outcomes through the collaborative efforts of experienced, qualified retirement plan advisors, investment firms and asset managers, and defined contribution plan service providers. The Council accomplishes this mission by its focus on:

- Identification of duties, responsibilities and attributes of the professional retirement plan advisor
- Sharing our professional standards with plan sponsors who are responsible for the success of their plans
- Providing collective thought capital to decision makers, product providers, legislators and the public,
- Giving voice to the retirement plan advisor community

[1] Studies by Charles Schwab and Company, EBRI, and ING

Participants who work with an advisor enjoy superior retirement outcomes

A large body of research provides evidence that individuals who work with a professional advisor enjoy superior retirement outcomes, irrespective of personal income, age, gender and other factors.

The 2010 edition of the Retirement Confidence Survey conducted annually by the Employee Benefits Research Institute found that 33% of workers and 32% of retirees seek the investment advice of a professional advisor within any given 12-month period.[2] Another study conducted in 2010 by the ING Institute for Retirement Research based on 14,000 users of INGCompareMe.com found that the amount of time participants spend with advisors is a key driver of long term retirement success. The savings rate of individuals who spend a great deal of time discussing their investments or their plan for the future with a financial advisor is three times that of individuals who do not spend any time with an advisor. Even among those individuals who have met with a financial advisor only once or twice, the savings rate is 1.5 times that of individuals who have not spent any time with an advisor.

The study conducted by the ING Institute for Retirement Research also found that individuals who work with an advisor have accumulated a retirement account twice the size of those who don't. The retirement nest egg of individuals who spend a great deal of time with their advisor is even larger, at more than three times the amount accumulated by individuals who have never met with an advisor. Individuals who work with financial advisors also have more money available after covering essentials every month, which could be indicative of a more responsible spending behavior instilled by advisors. The study notes that "while time spent working with a financial advisor does increase with age and household income, the effect of that time can still be seen within age and income cohorts. Regardless of age or income, more time working with a financial advisor can be seen in increasing amounts of retirement savings."[3]

[2] Helman, Ruth, Copeland, Craig, and Vanderhei, Jack, The 2010 Retirement Confidence Survey: Confidence Stabilizing, But Preparations Continue to Erode, Employee Benefits Research Institute Issue Brief (March 2010) 22-23

[3] ING Institute for Retirement Research, Working with an advisor: Improved Retirement Savings, Financial Knowledge and Retirement Confidence (December 2010) 5-6

"The New Rules of Engagement for 401(k) Success"[4], a study conducted by Charles Schwab in June 2010 and published in September 2010 found that 70 percent of working Americans who participate in a 401(k) plan say the plan is their only or primary source of retirement savings. However, less than half (47%) feel very confident when it comes to making investment decisions and 53 percent find retirement benefits even more confusing than health care benefits. An analysis of 401(k) plans serviced by Charles Schwab and Company finds that use of advice can have a positive impact on participant savings, diversification, and investing behavior. For example, the study found that 70 percent of participants who receive advice on their 401(k) plan account make changes to their deferral rates, and their savings rates nearly double as a result, jumping on average from 5 percent to 10 percent of pay. Similarly, the average participant who has not received professional advice invests in fewer than 4 asset classes, but participants who receive advice use a minimum of 8 asset classes. When markets go through periods of unusual volatility, the vast majority of advice users stay the course in their 401(k) portfolio. For instance, the Charles Schwab study found that 92% of advice users remained fully invested through the down market of July 2008 - February 2009 and for the market rebound through the remainder of 2009.

In a press release, Steve Anderson, head of Charles Schwab Retirement Plan Services concluded that "when we look at participant behaviors and results among the 401(k) plans we service at Schwab, the use of professional help and guidance is one of the biggest factors in 401(k) success."

In a paper published in October 2010, Professor Kathryn L. Moore reported results of a study supporting the benefits of investment "Help" delivered by target-date funds, managed accounts and online investment advice based on actual experience. Drawing data from seven large 401(k) plans for the period from January 2006 through December 2008, the study

[4] Charles Schwab and Company, The New Rules of Engagement for 401(k) Success (September 22, 2010) 27-37.

found median annual return for plan participants who used one of three forms of investment "Help" almost 2 percent (186 basis points) higher, net of fees, than the median annual return for participants who did not use any investment "Help".[5] On an average 401(k) plan account with a balance of $59,381[6], 186 basis points amount to $1104.49 per year. Professor Moore concludes that "it does not seem unreasonable to assume that good investment advice should lead to higher returns, at least if the investment advice is not too costly."

When a distributable event occurs such as separation of service, many participants roll over retirement plan assets to an Individual Retirement Account (IRA)[7]. The decision to roll over retirement plan assets, often made without the help of a professional advisor, can worsen the retirement outlook of participants who do not give careful consideration to all the characteristics of the IRA account to which they transfer assets, or to the characteristics of the various plans where they have accumulated account balances or benefits. For this reason, we believe that it is critical for the long term retirement success of US workers to have access to a professional advisor at the time of a distributable event to guide them through the choices available.

[5] Moore, Kathryn L., Regulating Investment Advice for 401(k) Plan Participants: Is More Advice the Answer? (February, 08 2011). NYU Review of Employee Benefits and Executive Compensation, Chapter 5, 2010.

[6] Vanderhei, Jack, Holden, Sarah, and Alonso Luis, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009, Employee Benefits Research Institute Issue Brief (November 2010)

[7] Based on its studies of the IRA Rollover market, Spectrem Group estimates that in any given year approximately 50% of all US retirement plan assets available for rollover are actually rolled into an IRA, 5-8% is transferred to another qualified plan at the new employer, 10-12% is allocated to some kind of income arrangement (including annuity distribution options) and 15-20% goes out in taxable withdrawals. The remainder (10%-30%) is left in the plan.

Participants should be free to use the services of their advisor of choice

In their evaluation of an advisor for their personal retirement assets, participants freely consider if the person sitting across the desk is the right advisor for them and why. We contend that participants should be free to choose the advisor best positioned to meet their needs, regardless of whether this advisor does business with the sponsor of the plan or not. At the time of a distributable event, it is logical for a participant to turn to the person who knows their personal financial situation best: in many cases, the advisor to their 401(k) plan. For many, this advisor may be the only professional advisor they've ever met. Paradoxically, those who turn to the plan advisor at the time of a distributable event find out that this person is the one advisor whom they are not allowed to hire because current or proposed regulations prevent the advisor to a retirement plan from also providing advice to individual participants if that advisor receives compensation from that advice. Participants are left to wonder why the person trusted by their employer to provide advice is not right for them as an individual investor and whether the employer should have trusted this advisor in the first place.

We contend that the advisor to the plan is generally best positioned to provide participant advice and should not be precluded from doing so. Indeed, the purpose of offering retirement plans is to drive US workers to successful retirement outcomes and plan advisors are in a unique position to mitigate the self-defeating participant behaviors that stand in the way. The plan advisor may be the only advisor with whom they will have a discussion about retirement funding in their entire lifetime. The plan advisor may not be the best advisor for each and every participant in a given plan but we argue that excluding the plan advisor from providing participant advice precludes a participant from considering a logical and often comfortable choice, and runs contrary to the intent of ERISA.

We advocate for freedom of choice because our end objective is about retirement success and the proper outcome can only be achieved with a comprehensive review of all sources of retirement funds including defined contribution plans, defined benefit plans, non-qualified deferred compensation, stock ownership plans, stock options, and personal assets. The increased emphasis on retirement readiness as the gauge to evaluate the success of retirement plans impels service providers, plan sponsors and their advisors to aggregate information about all accounts held by participants. Armed with information about all the plans offered by a given sponsor, plan advisors are in a unique position to help participants make an educated decision regarding their distribution options. Yet, they are the one option not available to participants today.

With clear professional standards, solicitation of personal business at the time of a distributable event can be exempt of prohibited transaction status

Clearly, professional standards need to be established that denounce rollovers not in the best interest of participants. The Council does not condone advisor recommendations to roll over retirement plan assets for the sole purpose of increasing compensation; it is fair to require (1) information and education about all distribution options available to eligible participants (2) affirmative participant election to rollover assets to an IRA, (3) a demonstrable retirement benefit for each and every rollover transaction. On the other hand, we consider a rule prohibiting plan advisors from delivering participant advice at the time of distribution inappropriate because it assumes that personal recommendations from a plan advisor are inherently wrong or conflicted when in reality, studies show that participants relying on plan advisor recommendations are making a better-informed decision.

Retaining assets in the plan often may be in the best financial interest of plan participants, but it is not always the case. Larger plans are generally in a position to negotiate lower fees from investment management firms and service providers; they are also in a better position to access high-quality investment managers not ordinarily available to individual investors. Conversely, a retiring participant with a sizable account balance accumulated over a long career at a small organization may be able to find a solution with lower investment costs and a broader selection of investment options outside the organization's plan. With the help of an advisor, an individual with participant accounts in multiple plans may be able to access a wider choice of options at lower investment costs in a consolidated personal account. Moreover, the ease of managing asset allocation in a consolidated account reduces the chances of investment overlap and helps control risk. Under certain circumstances such as the failure of a plan sponsor to meet fiduciary obligations, it could even be detrimental to a participant's best interest to keep her assets in the plan.

Equipped with years of information about individual participants (employment history, goals, financial literacy, risk profile), the plan advisor is often the person best equipped to provide advice to a participant at the time of a distributable event such as retirement. However, fiduciary rules may hinder or preclude the advisor from getting involved at all.

Going beyond regulation, we propose the promotion by the Council of the following professional best practices that apply uniformly to all distributions of plan assets including rollovers to an IRA, plan-to-plan rollovers, periodic distributions and lump-sum distributions.

At the participant level:

1. Gathering of financial information pertinent to the transaction such as the account balance and asset allocation of known participant accounts,

2. Explanation of the pros and cons of the transaction including alternatives available, breadth of investment options, fiduciary process, asset allocation options, accessibility, cost and service,

3. Provision of information regarding investment options available and the diversification benefits of a distribution,

4. Quality consultation with each individual concerned to collect facts and circumstances with the ultimate goal of establishing the client's retirement investing needs and objectives,

5. Concerted discussion of the client's personal tolerance for risk and documentation of the agreed upon risk profile, and

6. Recommendation of investments suitable for the client's specific situation.

At the plan level:

1. Presentation of the participant distribution advice service to the named fiduciary and the plan committee if one is present, and

2. Disclosure of the service to plan sponsors

Bottom Line: Retirement Success for Participants

All the evidence available to us indicates that participants with the benefit of professional guidance achieve superior retirement outcomes. The advisor advantage is not solely an artifact of the profile of advice users in terms of age, occupation or income, but also reflects the positive behavioral changes that advisors bring about in working with the participant population. To achieve a successful retirement, the vast majority of participants require some sort of professional help, particularly at the critical time of distribution when the potential loss of retirement readiness is particularly great. Professional Retirement Plan Advisors are in a unique position to deliver the assistance participants need at the time of a distributable event because of their knowledge of the plan, of the participants and, their commitment to abide by established professional standards. For this reason, the Council argues that participant guidance provided at the time of a distributable event by Professional Retirement Plan Advisors that have a relationship with the plan should be exempt from prohibited transaction status. We urge the Department of Labor to initiate a full review to identify rules and regulations that deprive participants of access to the one source of advice that will help them achieve a successful retirement.