

B | Retirement Security Project at BROOKINGS

POLICY BRIEF

Small Retirement Accounts: Issues and Options

David C. John, J. Mark Iwry, Christopher Pulliam, William G. Gale¹

September 2021

¹ John is the deputy director, Retirement Security Project, at the Brookings Institution and a senior strategic policy adviser at AARP's Public Policy Institute. Iwry is a nonresident senior fellow at Brookings and a visiting scholar at the Wharton School, University of Pennsylvania. Pulliam is a research analyst at Brookings. Gale is the Miller Chair and Director, Retirement Security Project at Brookings. The authors thank Arnold Ventures for financial support and Grace Enda and Claire Haldeman for research assistance. This policy brief is an abridged version of "Small Retirement Accounts: Issues and Options," which can be found here: <https://www.brookings.edu/wp-content/uploads/2021/09/Small-Accounts-discussion-draft.pdf>

Financial Disclosure

Iwry periodically provides, in some cases through J. Mark Iwry, PLLC, policy and legal advice to plan sponsors and providers, government officials, academic institutions, other nonprofit organizations, trade associations, fintechs, and other investment firms and financial institutions, regarding retirement and savings policy, pension and retirement plans, and related issues. Iwry is a member of the American Benefits Institute Board of Advisors, the Board of Advisors of the Pension Research Council at the Wharton School, the Council of Scholar Advisors of the Georgetown University Center for Retirement Initiatives, the Panel of Outside Scholars of the Boston College Center for Retirement Research, the CUNA Mutual Safety Net Independent Advisory Board, a network of advisors to an investment firm, and the Aspen Leadership Forum Advisory Board. He also periodically serves as an expert witness in federal court litigation relating to retirement plans. The authors did not receive any financial support from any organization or person for any views or positions expressed or advocated in this document. They are currently not an officer, director, or board member of any organization that has compensated or otherwise influenced them to write this paper or to express or advocate any views in this paper. Accordingly, the views expressed here are solely those of the authors and should not be attributed to any other person or any organization.

Small Retirement Accounts: Issues and Options

“Mighty Oaks from Little Acorns Grow”

14th Century English Proverb

I. Introduction

Every new retirement saver starts with a small account. Over time, balances can grow with continuing contributions by savers or employers, investment earnings, and tax benefits. Not all accounts, however, grow very much. Some account balances are cashed out early, while others are eaten away by administrative and management fees. In far too many cases, employees lose track of their past accounts. These situations make retirement planning more difficult and endanger retirement security for millions of households.

The existence of accounts with small balances is an inevitable byproduct of retirement systems, like those in the United States and several other countries, where individualized, employer-based accounts and automatic enrollment provisions are widespread. And of course, not all small balances are undesirable. New savers and those with lower incomes will inevitably have smaller balances, and small retirement benefits are preferable to no benefits.

Nevertheless, public policies that enable people to navigate the problems that small accounts create could help millions of households save more adequately for retirement. Increasing people’s retirement income by just \$1,000 a year could also help states and the federal government save several billion dollars that they otherwise would have spent for retiree support programs (Trostel, 2017).² There is also an important equity component to addressing small

² However, the problems raised by small accounts are not the same as those raised by inadequate saving. For example, consolidating all of one’s small accounts into one larger account may not be sufficient to generate

accounts, as they are especially prevalent among Black and Hispanic/Latino IRA holders.

In this policy brief, we address issues raised by the presence of small accounts and present five sets of solutions: extensive reform of rollover and account consolidation rules; enhancement of the saver’s credit; creation of a national dashboard and/or a default account consolidator; and developing a system where each worker has only a single account over the course of their career.

II. Background

The number of small retirement savings accounts in the United States can be linked to several factors. The first is the steady shift from employer-funded and managed defined benefit (DB) plans, which pool resources, toward more individually based, worker-funded saving in 401(k) plans and individual retirement accounts (IRAs). In addition, small accounts can result from the structure of an employer-based retirement system, where each employer has its own plan, and balances do not automatically move from one to the next when workers change jobs. A third factor is the expansion of retirement programs to cover more mobile and lower-to-moderate-income workers, including the expansion of automatic enrollment, which increases participation but also creates many new – and hence – small accounts (Madrian and Shea, 2001; Gale et al., 2009).

About 16 percent of households that have IRAs and 20 percent of households with defined contribution (DC) plans have balances that are “small” – defined for our purposes as below \$10,000.³ The prevalence of such accounts is higher among young, low- and moderate-

adequate retirement wealth. On the other hand, those with high income replacement rates from Social Security – that is, lifetime low earners – might have adequate retirement income despite having only a small private retirement account.

³ Note that using household data will understate the prevalence of small accounts because, for example, if two partners in a household each have account balances of \$6,000, then each individual would have a small account, by

income, and Black and Hispanic/Latino households.

The number of small retirement accounts is likely to grow as more states, and potentially the federal government, establish Automatic IRA and similar programs that mainly serve lower-to-moderate-income workers.⁴ Currently, each of the state-facilitated Auto IRA programs in operation in California, Oregon, and Illinois has average account balances of less than \$1,000.⁵ These initially small balances are to be expected not only because the programs generally began recently but particularly because they are designed to serve lower-income, first-time savers who can contribute only relatively modest amounts.

III. Issues raised by small accounts

A. Administrative Costs and Fees

Small accounts are especially vulnerable to having their rate of return and even their balances significantly affected by administrative fees. In 2017, one study estimated the median annual DC plan recordkeeping fee was \$59 (Schirmer, n.d.). This amount, if charged to savers, can deeply affect small accounts. For example, an annual fee of \$50 represents a full 5 percent (500 basis points) of a \$1,000 balance but only 0.05 percent (5 basis points) of a \$100,000 balance. If investors earn 3 percent per year on investments, the \$50 fee is equal to a 167 percent tax on the smaller account's return but only 1.67 percent on the larger account's return. The account with the smaller balance would decline over time but the larger account would continue

our definition, but the household would be recorded as having a balance of \$12,000 and thus not having a small account.

⁴ Auto IRA legislation has now been passed by legislatures in ten states: California, Colorado, Connecticut, Illinois, Maine, Maryland, New Jersey, New York, Oregon, and Virginia (Center for Retirement Initiatives, n.d.).

⁵ California: CalSavers Retirement Savings Program (2020); Oregon: Sellwood Consulting LLC (2021); Illinois: Center for Retirement Initiatives (2021).

growing. To the extent that small account holders earn lower rates of return than owners of large accounts, these effects are exacerbated.

B. Leakage from the retirement system

Aggregate pre-retirement withdrawals of retirement savings (“leakage”) appear to be large. Goodman et al. (2021) found that, in 2015 alone, 15 percent, or \$50 billion, of withdrawals from DC plans and IRAs went to pre-retirement age people. Not all pre-retirement withdrawals are problematic, of course. Providing pre-retirement liquidity may well encourage plan participation by assuring potential savers that they can access their retirement savings in the event of financial hardship. And taking early withdrawals may be necessary or desirable in some circumstances – for example, divorce or health crises. However, the most common reason for early withdrawals is job separation (GAO, 2009).

The rules governing withdrawals from tax-qualified plans when workers change jobs can be difficult for individuals to navigate. They reflect complex tradeoffs between public policy objectives and the often-conflicting interests of savers, plan sponsors, financial providers, and other players in the market. Generally speaking, pension policy in this area seeks to promote saving at reasonable cost and to preserve benefits for retirement by maximizing portability and minimizing leakage. Current rules encourage rollovers over cashouts and prevent plan sponsors from unilaterally cashing out accounts exceeding \$1,000.

C. Lost Accounts

Accounts can be lost for any of several reasons, including the employer treatment of small balances upon job separation, as discussed above. In addition, former employees who have

been cashed out may leave checks uncashed or change their postal and email addresses. Former employers may terminate plans, change providers, go out of business, be acquired, or change the company's name. Nonresponsive terminating employees who have their small plan accounts involuntarily rolled over to an IRA may not receive the plan's or IRA's required notifications and thus remain unaware that they even own an IRA.

It is not easy for savers to find lost accounts or for custodians of abandoned or “orphan” accounts to find missing participants. Each of the three federal pension agencies and the Social Security Administration offer resources that can be helpful, but – separately and in the aggregate – they are far from comprehensive, and the information they provide cannot be accessed from one central location.

Goodman, Mukherjee, and Ramnath (2021) find that small IRA accounts, regardless of how they were opened, are more likely to be abandoned than larger accounts. They show that the probability that an abandoned account is reclaimed within ten years of the participant turning 72 – the age at which people must start taking distributions from IRAs – increases with account balance, plateauing at around 60 percent for accounts larger than \$3,000. Small accounts involuntarily rolled into an IRA because they belonged to a nonresponsive terminating employee are about 10 times more likely to be abandoned than small accounts that are not involuntarily rolled over.

IV. Policy Options

Small account problems arise in a number of countries, especially where retirement accounts are mandatory or auto enrolled. These countries have dealt with small account issues in a variety of ways. One approach is for workers to own a single account that receives all

contributions over time as the worker moves from employer to employer. Other major interventions include: a dashboard where savers can manage all their accounts; information campaigns; caps on fees; and automatic consolidation. While each of the systems has its own characteristics based on its country's financial system, traditions and political situation, there are enough similarities that their experience can help to inform policymakers in this country.

For the United States, we explore five options. First, we would improve the rollover process in various ways. We would require all defined contribution plans to accept rollovers after protecting them from inadvertent disqualification and after requiring sending plans to use standardized, uniform protocols for fund transfers and standardized rollover verification data. In addition, we would extend the deadline for completing certain rollovers and prevent shrinkage of automatic plan-to-IRA rollovers by allowing them to be invested in target date funds and no-fee accounts. Finally, we also support "automatic portability" rollovers between employer plans when employees change jobs.

Second, we would reform the Saver's Credit, a tax credit available to low- and moderate-income taxpayers who contribute to a retirement plan, by making the credit refundable and providing it as a 50 percent government matching contribution that is more likely to be saved than spent because it would be deposited in the saver's retirement account.

Third, an American online retirement dashboard, like those that are being used or developed in several other countries with defined contribution systems, should be created to help savers better manage their retirement preparations. While automatic features have made huge strides in simplifying enrollment, saving, and investing, the retirement system remains fragmented and complex and requires decisions that most people are not equipped to make. A dashboard would include an online registry allowing each worker to track their retirement

accounts and benefits. It could also offer services such as recovering and consolidating lost accounts, projecting future income, or even providing or referring unbiased financial advice to users (more information about the dashboard proposal can be found in John, Enda, Gale, and Iwry 2020).

Fourth, the United States could further promote the existing automatic portability arrangements or additional similar arrangements, which facilitate rollovers from a former to a current employer's plan when an individual changes jobs, unless the individual elects otherwise. This corresponds roughly to "account follows participant," or, in the United Kingdom, "pot follows member" consolidation.

More far-reaching forms of consolidation could look beyond just accounts in a former employer's plan and a current employer's plan. For example, some countries have established a national clearinghouse entity to handle all recordkeeping and to automatically consolidate a wider range of retirement accounts, regardless of how long they have existed or whether they are workplace related.

Finally, policy makers could implement a "single account" system, in which workers could have only one retirement account, which follows them from job to job like Social Security.⁶ Of course, savers who want to diversify for any reason – e.g., among different plans, IRAs, tax treatments, providers or provider types, etc. – would be free to have as many different types of plans and accounts as they pleased, and employers could continue to offer their own retirement plans. Although this single account approach is sometimes referred to as a lifetime provider policy, the purpose is not that the provider remains the same over the worker's lifetime but that the worker be able to have a single account over their lifetime, always with the option to

⁶ For more extensive discussions, see Gale, Holmes, and John (2016), Baker et al. (2020), and Silcock (2021).

select and change the provider.⁷

V. Conclusion

Small and inactive retirement savings accounts are a largely inevitable feature of the existing U.S. retirement saving system. They are expensive to open and maintain for both savers and providers, easily lost or drained early, and hard to consolidate into other retirement accounts. However, there are reforms that could reduce all of these problems and provide savers with greater retirement security.

⁷ For comparison, in the Social Security program, each worker has a single account and accrues benefits over the course of their lifetime. A somewhat closer analogy would be the industry-wide, collectively bargained multiemployer pension system: there, as a worker moves between jobs with different participating employers, each employer contributes for the worker to the same plan.

References

- Baker, M., Jethwa, C., Adams, J., Pike, T., and Silcock, D. 2020. “Policy Options for Tackling the Growing Number of Deferred Members with Small Pots.” Pensions Policy Institute. <https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf>
- CalSavers Retirement Savings Program. 2020. “CalSavers Retirement Savings Program Participation & Funding Snapshot: Data as of 10/31/20.” <https://www.treasurer.ca.gov/calsavers/reports/participation/calSavers-participation-and-funding-snapshot-20201031.pdf>
- Center for Retirement Initiatives. 2021. “State Data Snapshot: Illinois Secure Choice.” Georgetown University, McCourt School of Public Policy. <https://cri.georgetown.edu/wp-content/uploads/2020/11/illinois-program-data.pdf>
- Center for Retirement Initiatives. n.d. “State Initiatives 2021: More New Programs to Launch While Others Consider Action.” Georgetown University, McCourt School of Public Policy. <https://cri.georgetown.edu/states/>
- Gale, W.G., Holmes, S.E., and John, D.C. 2016. “Retirement Plans for Contingent Workers: Issues and Options.” Brookings Institution. <https://www.brookings.edu/research/retirement-plans-for-contingent-workers-issues-and-options/>
- Gale, W.G., Iwry, J.M., John, D.C., and Walker, L. 2009. *Automatic: Changing the Way American Saves*. Brookings Institution Press. <https://www.brookings.edu/book/automatic/>
- GAO. 2009. “401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers’ Retirement Savings.” Report to the Chairman, Special Committee on Aging, U.S. Senate. United States Government Accountability Office. <https://www.gao.gov/assets/gao-09-715.pdf>
- Goodman, L., Mackie, K., Mortenson, J., Schramm, H. 2021. “Leakage from Retirement Savings Accounts in the U.S.” Working paper. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450866
- Goodman, L., Mukherjee, A., and Ramnath, S. 2021. “Set it and Forget it? Financing Retirement in an Age of Defaults.” Working paper. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3864530
- John, D.C., Enda, G., Gale, W.G., and Iwry, J.M. 2020. “A Retirement Dashboard for the United States.” Brookings Institution. <https://www.brookings.edu/research/a-retirement-dashboard-for-the-united-states/>
- Madrian, B.C. and Shea, D.F. 2001. “The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior.” *The Quarterly Journal of Economics* 116(4).
- Schirmer, P. n.d. “Fees for 401(k) Services: What Plan Sponsors Need to Know.” Harris CPAs. <https://harriscpas.com/fees-for-401k-services-what-plan-sponsors-need-to-know/>

Sellwood Consulting LLC. 2021. "OregonSaves Program: Monthly Dashboard as of March 31, 2021." <https://www.oregon.gov/treasury/financial-empowerment/Documents/ors-board-meeting-minutes/2021/2021-03-Program-Report-OregonSaves-Monthly.pdf>

Silcock, D. 2021. "How Have Other Countries Dealt with Small, Deferred Member Pension Pots?" Pensions Policy Institute.
<https://www.pensionspolicyinstitute.org.uk/media/3694/20210112-ppi-small-pots-international-report-final.pdf>

Trostel, P. 2017. "The Fiscal Implications of Inadequate Retirement Savings in Maine." Margaret Chase Smith Policy Center, The University of Maine.
<https://mcspolicycenter.umaine.edu/wp-content/uploads/sites/122/2017/03/final-aarp-report.pdf>