RETIREMENT SERVICES

# Retirement Plan Service Providers Could Benefit From Offering Sidecar IRAs

Sidecar IRAs — still relatively uncommon in the retirement industry today —may benefit plan providers and plan participants, and help promote retirement readiness while many Americans struggle to save for the future.

## SIDECAR IRAS MAY PRESENT A SIGNIFICANT OPPORTUNITY FOR RECORDKEEPERS

Retirement plan service providers are starting to take notice of an old idea that represents a new opportunity: The payroll deduction Roth IRA (sometimes called a "sidecar" IRA). It's a tool that could encourage higher savings rates and improve retirement outcomes, while helping plan providers strengthen relationships with plan sponsors and participants.

Not to be confused with a deemed IRA, which is adopted as part of a qualified retirement plan, a sidecar IRA is merely another way for employers to encourage additional saving, especially by younger employees. By providing a flexible vehicle with short- and long-term benefits to an increasingly transient workforce in the throes of what has been described as a retirement "crisis", sidecar Roth IRAs may be a viable way to promote retirement readiness and address three problems:

1. Reducing asset "leakage" and accounts left behind by providing a home for retirement assets from former employers' plans;
2. A lack of short-term savings that leads some individuals to withdraw money from their retirement accounts during financial emergencies; and
3. Participant shortfalls at retirement due to lost gains suffered as a result of early withdrawals.

Beyond providing potential solutions to some of the most vexing questions facing the retirement industry today, sidecar IRAs present two opportunities for retirement plan service providers:

1. Provide nomadic millennials who frequently change jobs or work multiple part-time "gigs" with a flexible vehicle for their retirement savings that can be contributed to from multiple sources and accept rollovers from previous employer-sponsored retirement plans; and
2. Give those who are less able or willing to save for retirement a savings option that may offer the flexibility to help address emergency expenses.

A retirement provider offering this type of account could see benefits on both ends of the spectrum by increasing assets under management while reducing the asset leakage that results from upwards of $70 billion in withdrawals annually.[1]

A survey by the LIMRA Secure Retirement Institute showed that two-thirds of workers are interested in an automatic emergency savings account to go with their workplace retirement accounts, and 89% of employers are interested in offering one.[2]

As the United States' economy evolves, so too should its retirement system. A payroll deduction sidecar IRA would benefit younger, lower-income workers, while also creating potential revenue growth for recordkeepers.

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## NEW DEMAND FOR AN OLD RETIREMENT IDEA

The dramatic decline in the availability of defined benefit pension plans since the mid-1980s has raised the bar for defined contribution plan savings. Consequently, the more savings options plan providers can make available to plan sponsors, the better plan sponsors can help participants prepare for the future.

A sidecar Roth IRA provides defined contribution plan savers with an additional tax-advantaged opportunity to save for retirement, along with the flexibility to access those savings for short-term needs. It's not a new idea, but a sidecar may have never been more necessary than it is right now.

The Economic Growth and Tax Relief Reconciliation Act of 2001 introduced the "deemed IRA," a retirement savings account similar to an IRA, but as part of a defined contribution plan. While deemed IRAs have been available for nearly 20 years, they have not been widely utilized. This may be due to the additional administrative burdens for plan sponsors, as well as the fact that deemed IRAs only benefit participants who have maxed out their 401(k) contributions. Deemed IRAs are unlikely to be a feasible alternative for millennials.

A more feasible solution for millennials may be the simpler and more flexible sidecar Roth IRA.

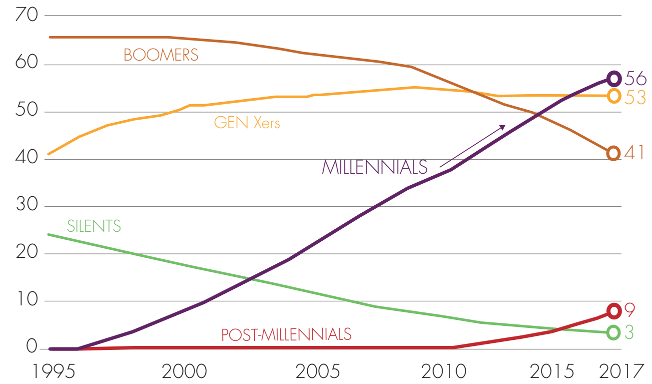
## IMPROVE RETIREMENT READINESS FOR MILLENNIAL SAVERS

According to the Bureau of Labor Statistics, there are 56 million millennial workers in the labor force as of 2016. The median job tenure of "younger workers" – between ages 25-34 – was just 2.8 years as of January 2016, three times lower than workers ages 55-64 (10.1 years).[4]

Those two statistics paint a troublesome picture for the retirement system: transient young workers, in the age of automatic enrollment, changing jobs habitually, leaving a trail of old retirement accounts in their wake.

Millennials became the largest generation in the labor force in 2016

U.S. labor force, (in Millions)




Note: Labor force includes those ages 16 and older who are working or looking to work. Annual Averages shown.

Source: Pew Research Center[3] analysis of monthly 1994-2017 Current Population Survey (IPUMS).

A readily available sidecar IRA alongside a plan gives this population a central hub for their retirement savings, encouraging retirement readiness down the road while also potentially eliminating some of the administrative and fiduciary risk for their former employers.

For a retirement provider, offering a sidecar Roth IRA could present a way to reach a generation with $200 billion of annual purchasing power[5] by creating:

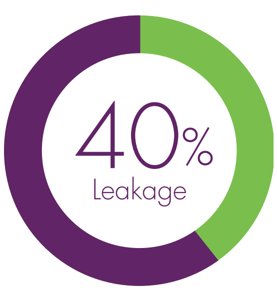
1. Greater connection between the saver and the provider's brand, thus increasing engagement across multiple products or services.
2. Increased likelihood of capturing rollovers from these savers in the case of job changes.
3. Higher potential for lifelong relationships with millennial participants who save in DC plans and sidecar IRAs during their careers, then roll those DC accounts into IRAs for withdrawal at retirement.

Offering sidecar IRAs can help retirement providers generate additional value from existing client relationships. This is particularly true for those providers large enough to have a hand in many aspects of the retirement market. It's typically less expensive to retain a client than it is to attract a new one.

## IMPROVING RETIREMENT OUTCOMES FOR RELUCTANT SAVERS

According to PriceWaterhouseCoopers' 2017 Employee Financial Wellness Survey, respondents' top financial concern was not having emergency savings for unexpected expenses.[6] That marks the sixth consecutive year that a lack of emergency savings was the top concern for the full-time employed adults surveyed.

According to a Transamerica study, 27% of participants have taken a loan or early withdrawal from their DC account or IRA.[7] Assets that are used for non-retirement needs leak out of the retirement system and often evaporate, along with their revenue potential. In fact, according to a 2013 federal study, for each $1 contributed to retirement accounts by savers under the age of 55, $0.40 leaks out.[8]




By retirement accounts savers under the age of 55

Source: Transamerica Center for Retirement Studies, December 2016

A significant portion of that leakage is the result of withdrawals taken to meet immediate financial needs, described as "financial shocks" by the Aspen Institute.[9] The median cost of a financial shock is $2,000. That is a serious problem in a modern economy where 44% of Americans say they would have difficulty paying a $400 emergency expense without selling something or borrowing money.[10]

More than 60% of plan sponsors plan to take steps during 2018 to reduce plan leakage.[11] By working with plan sponsors to aggressively combat leakage, plan providers can:

- Help improve retirement outcomes for participants.
- Help plan sponsors retain and grow plan assets.
- Help improve current and future provider revenue streams.[12]

Offering a sidecar IRA will not be an immediate remedy for what ails the retirement system, but it's a step toward addressing a problem. Providers who advocate and support the idea could benefit from participants' reduced withdrawals and increased savings.

## DESIGN QUESTIONS REMAIN FOR PROVIDERS

While sidecar accounts are simple and have broad support in theory, there is still the question of what type of account and contribution arrangement makes the most sense for providers, plan sponsors and participants.

### *Roth IRA Represents Best Option for Sidecar Account*

What type of vehicle would best serve the needs of savers? A health savings account (HSA)? A standard savings account? Or a new use for a proven vehicle like a Roth IRA?

Weighing the Options

## POTENTIAL SIDECAR ACCOUNT VEHICLES

| | HSA[13] | SAVINGS ACCOUNT | ROTH IRA[15] |
|---|---|---|---|
| **Limits** | $3,540 Individual/ $6,900 Family | Unlimited | $5,500 under 50 $6,500 50 and over (Contributions not permitted for individuals earning over $135,000 or married couples earning more than $199,000) |
| **Withdrawal Penalties** | 20% penalty for non-medical distributions. | N/A | 10% penalty on withdrawals of earnings. Distributions of earnings before age 59½ and before the account is five years old may be subject to taxes and penalties. |
| **Tax Benefits** | Tax-free withdrawals, but only for medical expenses. | None. | Tax-free withdrawals of post-tax contributions |
| **Portability** | Individually owned following employment termination. | Always individually held, separate from employer plan. Does not accept rollovers. | Individually owned, accepts rollovers, can be rolled over. |
| **Stability** | Depends on investment options offered. | Little risk of loss. | Depends on investment options offered. |

Even with potential taxes and penalties on withdrawals of earnings, the Roth IRA may be the best choice as it checks many of the relevant boxes for a sidecar account:

- Allows post-tax contributions, meaning withdrawals of principal can be made tax-free.
- Can be run in parallel with a retirement plan with an employer's payroll deduction set-up.
- Is portable and can accept rollovers for employees who change jobs.
- Offers long-term savings and earning potential.

A Roth IRA is already a widely utilized savings vehicle with name recognition among Americans, and providers offering 401(k)s and other DC plans already have a relationship with the employers and employees a sidecar would benefit.

The $5,500 maximum annual contribution for a Roth IRA allows younger participants to save for retirement alongside their 401(k) plan, but with the comfort of knowing that the funds are available for short term financial needs, at potentially a lower cost than a 401(k) withdrawal.

### HOW WILL CONTRIBUTIONS BE MADE TO A SIDECAR?

The payroll deduction structure used by most employers has proven to be simple and successful, creating an out-of-sight, out-of-mind way for participants to save for retirement. The most effective version of a sidecar would incorporate this structure.

## AUTOMATIC ENROLLMENT OR AFFIRMATIVE ENROLLMENT?

While automatic enrollment is the best way to engage retirement savers – studies have shown that it can increase participation by 50 to 60 percentage points[16]– there has been no regulatory guidance for auto enrollment outside of DC plans. Until employers receive guidance for sidecar accounts similar to that offered by the Pension Protection Act of 2006 for automatic enrollment in 401(k)s and other DC plans, auto enrollment may be a non-starter.

In any event, a sidecar might be better served with an affirmative opt-in or opt-out enrollment.


"Active decisions increase enrollment by 28%."

Source: Jeremy Burke, Angela A. Hung, Jill E. Luoto, "Automatic Enrollment in Retirement Savings Vehicles", September 2015

A Harvard University studied showed that forcing an active decision increases enrollment by 28%.[17] That's not as dramatic as the average increase with full automatic enrollment, but it is still a significant improvement. With affirmative enrollment, the employer can present the benefits of both the 401(k) plan and the sidecar IRA together to the participant during sign-up. In designing the benefit, plan sponsors may want to consider whether to give participants the flexibility to adjust their contribution levels between the plan and the IRA as their financial needs evolve.

## PROVIDERS CAN OUTSOURCE SIDECAR IRA ADMINISTRATION

For providers that do not offer IRA products and those that have concerns about whether sidecar IRAs have the potential to grow, some specialized IRA providers give providers the option to outsource sidecar IRA solutions.

An outsourced sidecar IRA solution reduces recordkeeping, compliance, and customer service costs that can plague large financial institutions, but allows large providers to continue offering a potentially more profitable IRA product. In addition:

- An open architecture investment platform means large providers can offer sidecar IRAs with their own investment options, protecting asset-based revenue.
- A branded client portal protects the provider's brand and increases awareness among accountholders.
- Integration with existing systems simplifies the process for opening new accounts.
- Sidecar IRAs, direct rollover IRAs, and workplace IRAs operate as part of the same solution.

By outsourcing to a firm that specializes in IRAs, plan providers eliminate the need to deal with administrative issues like account statements and tax reporting, allowing them to focus on their core business.

## IT'S THE RIGHT TIME FOR PROVIDERS TO CONSIDER OFFERING SIDECAR IRAS

In light of the current state of the U.S. retirement system, a sidecar solution can help strengthen the short- and long-term financial well-being of participants and, in turn, the American economy itself. Based on flexibility, portability, contribution limits, withdrawal rules, and long-term benefits, a Roth IRA appears to be best-suited to act as a sidecar account.

Aside from creating advantages for individuals and families, a sidecar IRA as a normal complement to retirement plans would create multiple opportunities for providers. These could include:

1. Reduced asset leakage related to financial shocks for lower-balance participants.
2. Higher rollover capture rates when sidecar accountholders change jobs or retire.
3. Greater connection between savers and a provider's brand.

One route toward creating this type of sidecar is outsourcing some portion of the product design, recordkeeping, and account servicing to a third party specializing in IRAs.  In some instances, outsourcing could potentially lower recordkeeping and administrative costs for providers while increasing their investment revenues and market share.  With all of that in mind, it's the right time for providers to consider offering a sidecar IRA as a standard complement to their retirement plans.

## ABOUT MILLENNIUM TRUST

While automatic enrollment and contribution escalation have proven to be best practices for helping more Americans save more for retirement, these plan features had an unexpected side effect – an increase in the number of small accounts left behind by former employees. Safe Harbor IRAs have become a best practice for addressing issues related to small accounts, and heightened regulatory scrutiny has some plan sponsors reconsidering whether they should adopt automatic rollovers for all small plan accounts.

Who We Are

2005

year we began offering our automatic rollover IRAs

What We Do

- Automatic Rollover IRAs
- Workplace IRAs
- Direct Rollovers
- Uncashed Checks
- Search Services

Who We Work With

1,500 TPAs
consultants
financial advisors
60,000+ plan sponsors
attorneys
recordkeepers

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