Capitalize

The true cost of forgotten 401(k) accounts.

Authored by the Capitalize research team

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Summary

For many years, experts have suspected that there are a large number of 'forgotten' or 'left-behind' 401(k) accounts in the US retirement savings system. These 'forgotten accounts' represent 401(k) savings that have been left behind by people who have changed jobs or terminated employment. They're often referred to as 'inactive' accounts by policy experts, and 'stranded' or 'orphaned' 401(k) accounts by the media.

Until now, though, there's been no rigorous analysis performed to estimate just **how many forgotten 401(k) accounts exist, how much money is in them, and what the forgotten 401(k) problem could be costing us** — both as individual savers and in aggregate.

Over the past several months, **Capitalize has analyzed each of these challenges using a range of data sources and in consultation with leading retirement policy experts, including the Center for Retirement Research at Boston College**. Our analysis illustrates just how large and costly the forgotten 401(k) phenomenon really is:

- As of May 2021, Capitalize estimates that there are **24.3 million forgotten 401(k) accounts** in the US. By the end of 2021, we estimate that there will be almost 25 million forgotten 401(k) accounts.

- These forgotten 401(k) accounts have approximately **$1.35 trillion of assets in them**, representing **20% of the $6.7 trillion total assets in 401(k) plans**.

- **Each year, another 2.8 million 401(k) accounts are left behind** by people who leave jobs.

- **Leaving behind a string of forgotten 401(k) accounts could cost an individual almost $700,000 in foregone retirement savings** compared to consolidating in a single low-fee, optimally allocated retirement account - whether an IRA or another 401(k).

- In aggregate, these forgotten 401(k) accounts could be **missing out on $116 billion in additional savings annually** due to the risk of higher fees and lower investment returns from sub-optimal asset allocations.

- Forgotten 401(k) accounts also **impose a burden on employers, with up to $700 million in employer fees paid to administer forgotten 401(k) accounts annually**.

The implications of this are significant. While the 401(k) model has evolved to be the default method of saving for retirement, **the forgotten 401(k) phenomenon exposes one of its key limitations: an employer-sponsored system breaks down because people change employers regularly**. We're motivated to shine a light on this problem and believe the private sector has a key role to play in reducing the friction associated with these transition points.

Background

Most Americans who save for retirement today do so through a workplace defined contribution (DC) plan. **Much like healthcare, we've come to expect that retirement accounts are a benefit provided by the employer**. Among workplace retirement plans, defined contribution plans like 401(k)s are by the far the most common — in fact, 64% of employees have access to a DC plan as of March 2021.[1] By the end of 2020, Americans had accumulated over $6.7 trillion in 401(k) accounts.[2]

In theory and in practice, **there are many positives of an employer-sponsored retirement account like a 401(k)**: employers can "nudge" us to save and invest; contributions can be diverted automatically from each paycheck in a way that's invisible to the participant, and; regular contributions means we invest regularly over time, allowing us to 'dollar cost average' into potential long-term returns.

Unfortunately, **there's a structural problem that lies at the heart of the 401(k) market: we change jobs every few years, which means our connection to any given 401(k) account is fleeting. On average, we'll change jobs twelve times in our lives** — that could mean dealing with up to twelve different 401(k) accounts during the course of a career.[3] Put differently, every three or four years we need to decide what to do with the money we've saved in our current 401(k) account.

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[1] Bureau of Labor Statistics, "Employee Benefits in the United States, March 2020" https://www.bls.gov/opub/ted/2021/67-percent-of-private-industry-workers-had-access-to-retirement-plans-in-2020.htm

[2] Investment Company Institute, "The US Retirement Market, Fourth Quarter 2020." https://www.ici.org/faqs/faq/401k/faqs_401k#:~:text=As%20of%20December%2031%2C%202020.and%20public%2Dsector%20employers)

[3] Bureau of Labor Statistics. "Number Of Jobs, Labor Market Experience, And Earnings Growth: Results From A National Longitudinal Survey." August 22, 2019. https://www.bls.gov/news.release/pdf/nlsoy.pdf

There are several options available to savers at those points of job change:

1. Roll over their 401(k) savings into an individual retirement account (IRA).

2. Roll over their savings into a new 401(k) account — if permitted by the new employer's plan.

3. Withdraw ("cash out") their assets.

4. Leave their money behind in the former employer's 401(k) plan.

While the first three options tend to be 'active' decisions, the fourth option is largely a 'passive' one: **people have many priorities in the middle of a job transition, and the path of least resistance is often to leave their 401(k) account behind for some period of time**.

The result is that people can steadily accumulate multiple 401(k) accounts as they move throughout their career: potentially three different 401(k) accounts per decade for workers in industries where retirement benefits are common.

While anecdotes abound on the perils of leaving money behind in an old 401(k) account, **surprisingly little analysis has been done on the magnitude and costs of this phenomenon, which we label the "forgotten 401(k) problem."**[4]

To better illuminate the size and costs of this problem, Capitalize conducted the most rigorous analysis on the forgotten 401(k) phenomenon. By combining public data, 401(k) recordkeeper reporting, and in-house analysis with the aid of leading retirement policy experts, we answer the following key questions in this white paper:

1. How many forgotten 401(k) accounts are there, and how much money is in them?

2. What are the potential costs of these forgotten 401(k) accounts for individuals and the system as a whole?

3. What costs are borne by employers in connection with these forgotten 401(k) accounts?

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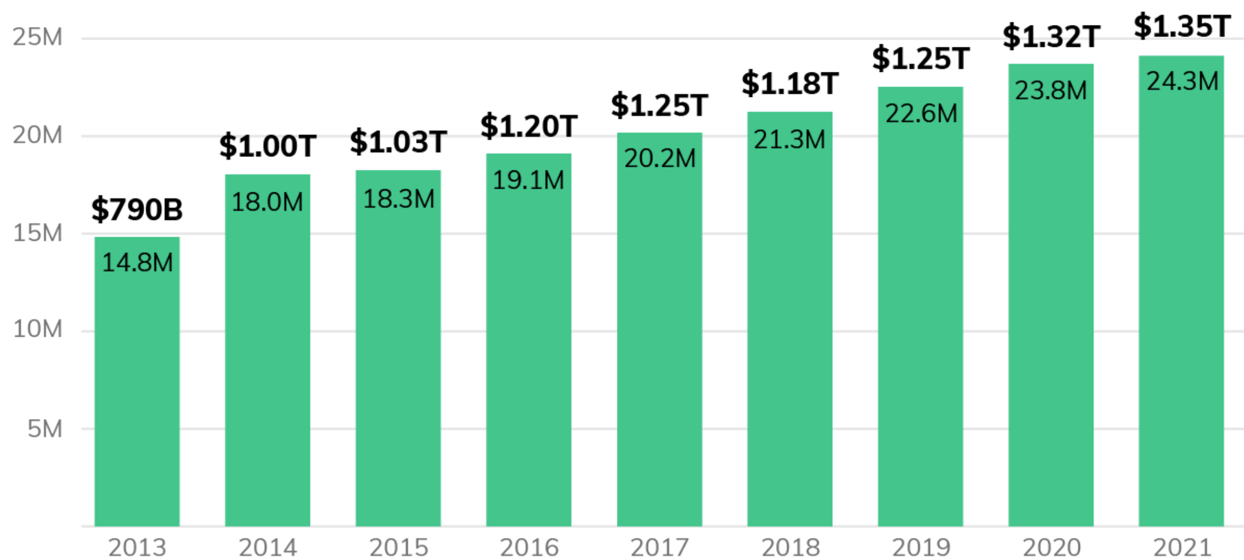
[4] A 2013 article from ING Direct USA claimed there was about $1 trillion in orphaned 401(k) assets, but this was based on limited survey data of questionable quality.

Size of the forgotten 401(k) problem

As of May 2021, Capitalize estimates that there are approximately **$1.35 trillion in forgotten 401(k) accounts** based on estimates of 24.3 million forgotten 401(k) accounts with an average balance of $55,400 per account.

Total forgotten 401(k) accounts and associated assets per year since 2013 (as of May 2021)



How many forgotten 401(k) accounts are there? 24.3 million as of May 2021

As of May 2021, Capitalize estimates that there are **24.3 million forgotten 401(k)s, with an additional 2.8 million forgotten 401(k) accounts added each year** as a result of job changes and terminations.

- The starting point for calculating the current stock of forgotten 401(k) accounts is the Department of Labor (DOL) Form 5500 database. Each employer (or "plan sponsor") offering a 401(k) plan must report certain information on the plan and its participants to the DOL annually. This public data provides an important starting point in any effort to analyze the current state of the 401(k) market.

- The latest year for which full Form 5500 data is available is 2018. In 2018, the Form 5500 database suggests that 21.3 million 401(k) plan participants had a positive

balance account connected to a former employer from whom they have separated — i.e. forgotten or left-behind 401(k) accounts. This number has increased steadily from 14.8 million accounts in 2013.

- In order to calculate the *current* (2021) stock of forgotten 401(k) accounts, Capitalize had to estimate the number of additional forgotten 401(k) accounts created each year to add to the 2018 starting point.

- Vanguard 401(k) plan reports provide us with some data on what terminating participants do with their accounts each year. In 2018, 4.8% of Vanguard plan participants changed jobs but left their account behind in their old employer's plan.[5]

- Capitalize applied that 4.8% rate to the 58.8 million active participants with non-zero account balances in 2018 according to the DOL's Form 5500 database. This yields an estimated 2.8 million additional forgotten 401(k) accounts each year.

- Some percentage of these forgotten 401(k) accounts will be shut and/or liquidated — known as the "attrition rate." Common causes of this attrition are the death of the account owner or the eventual transfer of the account assets. Capitalize assumed an annual attrition rate of 7% based on our consultation with the Center for Retirement Research (CRR). This 7% estimate was inferred based on a comparison of GAO and Form 5500 records for the years 2004 to 2013. The GAO data detailed the gross flow of newly forgotten accounts in that timeframe, whereas analysis of Form 5500s showed the net number of forgotten accounts in 2013. Comparing these two data points allowed us to infer a 7% attrition rate to conform the data sources.[6]

- Taking the 2018 stock of 21.3 million inactive 401(k) accounts, adding 2.8 million new forgotten 401(k) accounts per year since then, and applying a 7% annual attrition rate results in a 2021 estimate of 24.3 million forgotten 401(k) accounts in the market today.

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[5] Vanguard, "How America Saves 2019 Report" Page 110.
https://pressroom.vanguard.com/nonindexed/Research-How-America-Saves-2019-Report.pdf.

[6] Attrition rate assumptions based on consultation with Center for Retirement Research (CRR) at Boston College.

What is the average balance in each forgotten 401(k) account? $55,400

As of May 2021, Capitalize estimates that the average forgotten 401(k) balance is $55,400 based on our analysis of data from the Department of Labor, 401(k) recordkeepers, and Census Bureau.

- Form 5500 data for 2018 shows total defined contribution plan assets of $6.26 trillion and 80.1 million total participants with non-zero balances. This implies an average balance of $78,200 per 401(k) account.

- Simply applying this average balance to the number of forgotten 401(k) accounts, however, is likely to overstate the total assets in forgotten 401(k)s. Conversations with industry stakeholders reveals that those who passively leave their assets behind are likely to have balances that are lower than the national average, much like those who prematurely withdraw or 'cash out' their assets.

- Plan data provided by 401(k) recordkeepers provides some data points to estimate the balance of left-behind 401(k) accounts. In 2018, the 4.8% of Vanguard plan participants who switched jobs and left their 401(k) behind accounted for 3.4% of Vanguard's defined contribution assets under management (AUM).[7] Taking that ratio — 3.4/4.8 — and applying it to Vanguard's overall average account balance — $92,148 — suggests an average balance of $65,300 for forgotten 401(k) accounts.

- We believe that Vanguard balances are likely to be higher than the national average given Vanguard's focus on larger plans. As a result, we applied this ratio to the average balance of *all* 401(k) participants from the Form 5500 database ($78,200) to estimate an **average balance of $55,400 for forgotten 401(k) accounts in 2018.**

- Despite the general increases in asset prices and 401(k) balances between 2018 and 2021, we did not increase this number out of conservatism.

- Capitalize also reviewed the U.S. Census Bureau's *Survey of Income and Program Participation (SIPP)*, although we ultimately did not factor this into our estimates. This survey found the average 401(k) balance for *all* employees leaving their job was $66,000 in 2014. This analysis did not distinguish between left-behind accounts and

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[7] Vanguard, "How America Saves 2019 Report" Page 110.

those cashed out or rolled over; however, our disaggregation of the SIPP data is supportive of our forgotten 401(k) balance estimate.[8]

Costs of forgotten 401(k) accounts: Savers

While leaving behind a 401(k) is often the path of least resistance, forgotten 401(k) accounts can cost individuals and the system as a whole.

- Analysis performed by Capitalize suggests **that individuals could miss out on nearly $700,000 in retirement savings over the course of their lives due to forgotten 401(k) accounts** from higher fees and lower investment returns.
- In aggregate, **savers could be missing out on a combined $116 billion in additional retirement savings each year** by leaving behind 401(k) accounts.

The two key drivers of these gaps are:

- **The risk of higher fees:** the risk of a forgotten 401(k) account being in one of the many high-fee 401(k) plans which, unfortunately, continue to exist.
- **The risk of lower returns:** the risk of a forgotten 401(k) account being invested in a low-return instrument like a money market mutual fund (MMMF) rather than a diversified portfolio of higher-returning investments.

For the purposes of this analysis, Capitalize compared the fees and investment returns in a forgotten 401(k) account to those of a well-allocated IRA to illustrate the potential cost of having assets tied to a forgotten 401(k) account, but the same analysis can be done to compare a forgotten 401(k) to a low-fee, well-allocated 401(k) and would yield similar conclusions: **there's a significant risk of missing out on asset growth by forgetting savings in a previous 401(k) if that forgotten account is not optimized**.

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[8] We calculated the total value of separated accounts in 2014 by multiplying the SIPP average balance by the number of annual separating employees with a 401(k). We then removed the estimated value of cash outs and rollovers from that year, assuming that 60% of annual cash outs and rollovers were from a given year's separation; this is in line with a two year period post separation for cashouts and rollovers to typically occur. We then divided the remaining sum by the average number of newly forgotten 401(k)s to find an average forgotten 401(k) balance of ~$60k in 2014.

What are the fees paid in forgotten 401(k) accounts?

Many participants in a 401(k) assume that their accounts are fee-free. In reality, 401(k) providers charge participants fees that are generally tied to the assets they've saved in the plan. The total fee has two main components:

- Individual investment fees are paid for investments in ETFs and mutual funds. These are known as "expense ratios." Some ETFs and mutual funds have higher expense ratios than others, meaning participants pay more to invest in them. These tend to be the largest fees in 401(k) accounts and are almost always paid by participants.

- Investment management fees and administrative ("recordkeeping") fees are paid to offset the cost of managing the plan. These can be paid for by the employer, the participants, or be shared between them. Administrative fees are typically lower than investment management fees and are more likely to be covered by employers.[9]

While employers can choose to pay some or all of these fees themselves, a substantial portion of these fees are passed along to participants; a 2018 survey found that **85% of employers passed the entirety of investment management costs on to participants**, and another 12% shared the cost with participants**. For administration fees, 63% of employers passed the entirety onto participants** with the remainder sharing the cost or paying for the fees themselves.[10] Again, the largest costs come from investment management fees that are most often passed to participants. In other words, **participants are on the hook for a substantial part of these fees** and, in some cases, all of them.

In addition, 401(k) fees are often difficult for participants to find: a 2020 survey from TD Ameritrade found **that 73% of participants didn't know how much they pay in 401(k) fees**.[11] This problem only becomes worse the longer people have separated from their employer.

Unfortunately these fees can be meaningful: according to the Investment Company Institute (ICI) in 2020, **the median annual 401(k) fee is 0.85% of total assets**. This number is even

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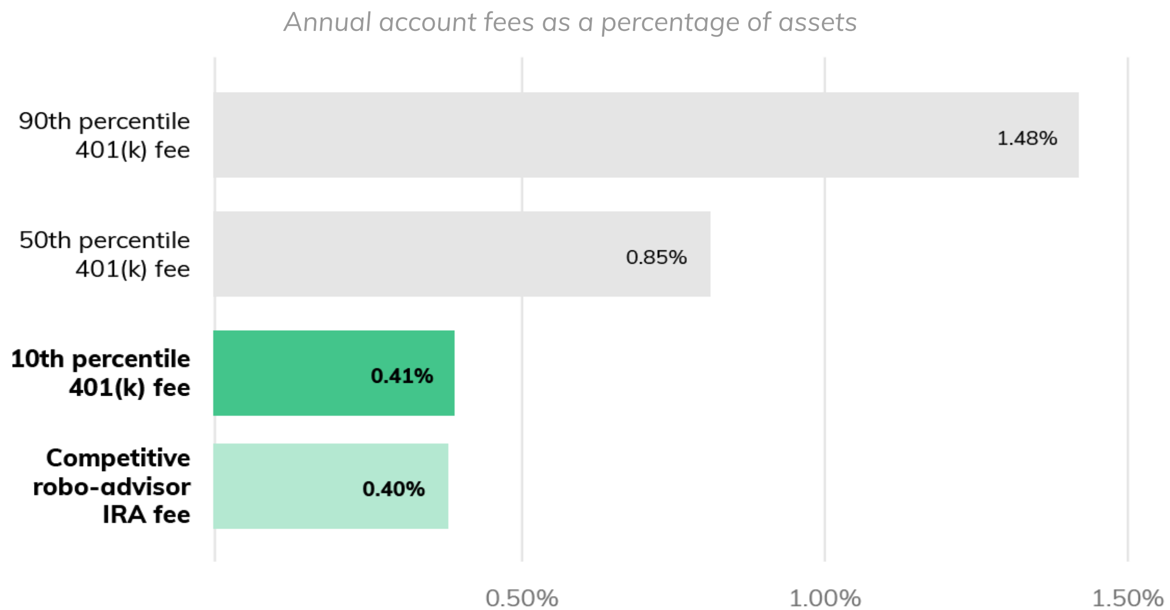
[9] 401(k) Averages Book, 21st edition.

[10] Survey from Callan, an institutional investment consulting firm in 2018. Survey covered 152 DC plans of varying sizes, from fewer than 500 participants to over 100,000, and less than $50 million to over $5 billion.

[11] TD Ameritrade, Are 401(k) fees Eating Into Your Retirement? Now Might Be a Good Time to Check." August 2020. https://tickertape.tdameritrade.com/retirement/401k-fees-and-retirement-savings-15672.

higher for some plans; **the 90th percentile fee is 1.48% of total assets, with some of the smallest plans exceeding 2%.**[12] This compares to typical advisory and investment fees between 0.20% and 0.36% for market-leading providers of 'automated' or robo-advisor IRAs, though some offer even lower fees.[13] The top decile 401(k) plan fees are similar - demonstrating the wide variation in fees that unfortunately persists.



The difference in fees between a high-fee forgotten 401(k) and a low-fee retirement account, whether an IRA or another 401(k), can be stark. For an account with a balance of $55,000:

- In a low-fee IRA or 401(k) plan charging 0.40%, an account-holder will pay $220 in fees per year.
- In the 401(k) charging 0.85%, an account holder will pay $468 in fees per year, or 2x the low-fee account.
- In the 401(k) charging 1.50%, an account-holder will pay $825 in fees per year, or almost 4x the low-fee account.

[12] Brightscope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2017; August 2020. https://www.ici.org/system/files/attachments/pdf/20_ppr_dcplan_profile_401k.pdf.

[13] Typical advisory fee range based on current fee structure of independent robo-advisors Betterment and Wealthfront, and robo-advisor products of Fidelity and Vanguard. Some providers do not currently charge an advisory fee.

A 401(k) charging 1.50% annual fees places it close to the 90th percentile for total plan costs. **Thankfully, there have been concerted efforts to reduce 401(k) plan fees, and some plans also offer favorable pricing on mutual funds and ETFs.[14] While the number of participants suffering from fees of close to 1.50% is limited, our analysis is meant to highlight the risks to savers if their forgotten 401(k) happens to be in a high-fee plan where all fees have been passed-along** — unfortunately, this still happens to be the case for too many participants today.

Put differently, a forgotten 401(k) account might very well be sitting in a high-fee 401(k) plan which would lead to greater fee leakage over time.

How much do we lose because of stale or sub-optimal asset allocation in forgotten 401(k) accounts?

A well-allocated retirement account could outperform a poorly allocated forgotten 401(k) by over 9x in a single year, with that difference rising over time due to compounding.

A larger potential problem than the fees charged by forgotten 401(k) accounts is that individuals lose track of what their assets are invested in (known as "asset allocation"). This can lead to a dramatic underperformance of forgotten 401(k) accounts over time.

Specifically:

- 401(k) plans are legally allowed to force out forgotten 401(k)s with balances between $1,000 and $5,000 into what is called a **Safe Harbor IRA**. This is known as a "Forced Rollover."[15] These Safe Harbor IRA accounts usually default to portfolios that protect initial principal but have very low returns — such as a money market mutual fund (MMMF) or stable value fund. A MMMF is a highly liquid investment with extremely low risk and very low returns — **typically below 1% annually[16].** A stable value fund is composed of bonds — it's also low risk with slightly higher returns,

[14] Some 401(k) plans are able to receive institutional pricing on certain funds within their retirement plans.

[15] Note that the $5,000 balance limit does not include any assets held in the plan as a result of a prior rollover - so higher balance accounts can be impacted by this if they were transferred from another 401(k).

[16] There are many money market mutual funds available; consider Fidelity's popular Government Money Market Fund (SPAXX) and Treasury Money Market Fund (FZFXX), Schwab's Value Advantage Money Fund (SNAXX), and Wells Fargo's Cash Investment Money Market Fund (WFAXX), each with 10 year annualized returns below 1%.

typically around 2% annually[17]. For comparison, consider that Vanguard's popular S&P 500 ETF (VOO) has seen 10 year annualized returns of nearly 14%.[18]

- Some 401(k) plans still automatically **default to low-risk, low-growth investments**. According to Vanguard, between 2010 and 2019, an average of 13% of 401(k) plans defaulted to either a money market mutual fund (MMMF) or stable value fund.[19] While 401(k) plans are getting better at defaulting into instruments like target-date funds, there's still a meaningful chance that a forgotten 401(k) sits in a low-growth investment by default.

- **Even well-allocated portfolios require attention eventually.** As investments gain or lose value, the portfolio's asset allocation will shift. Failure to periodically rebalance that portfolio could lead to sub-optimal investment decisions that do not align with the investor's long term financial goals. This could result in too much risk exposure, or too little, depending on the investor.

To illustrate this point, consider an alternative scenario where an individual is invested in a well-allocated retirement account. This could be a robo-advisor IRA, a managed account 401(k), or a well-diversified portfolio created by the participant. To get a sense of what returns could be from that well-allocated retirement account, consider that over the past three years, managed IRA (robo-advisor) portfolios have averaged **8.8% annual returns** for retirement accounts *after fees*, though some averaged over 11% in that timeframe[20]. For this comparison, we assumed fees would total 0.4%, so average returns before fees would total 9.2%.

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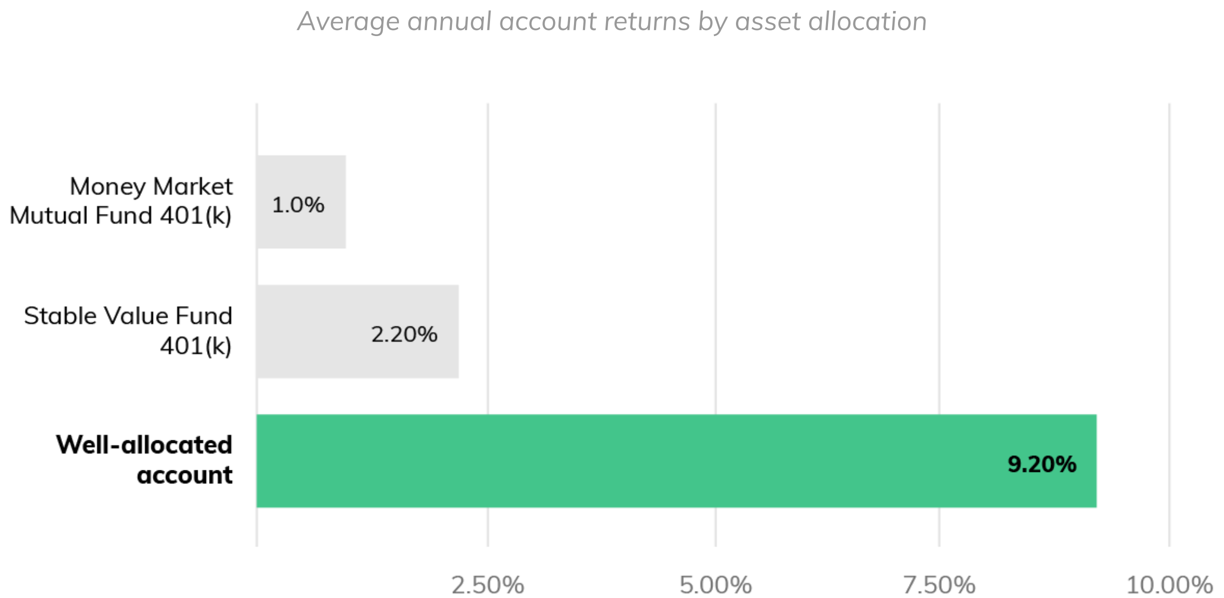
[17] Vanguard Investments - Stable Value. Accessed May 3, 2021.
https://institutional.vanguard.com/web/cfv/fund-list/?filters=stb.&sortBy=assetClass&viewType=quarterEndReturnsNAV

[18] Vanguard, "VOO - Vanguard S&P 500 ETF" Accessed May 3, 2021.
https://investor.vanguard.com/etf/profile/VOO

[19] Vanguard, "How America Saves 2020 Report" Page 65.
https://institutional.vanguard.com/ngiam/assets/pdf/has/how-america-saves-report-2020.pdf.

[20] Backend Benchmarking, *Robo Report & Robo Ranking: Winter 2021 Edition*, Published February 10th, 2021. p. 38.
https://storage.googleapis.com/gcs-wp.theroboreport.com/TBLTKs2bLA6MNKHm/4Q20%20Robo%20Report%20%26%20Ranking.pdf.

Average annual account returns by asset allocation



Let's apply these different returns to a $55,000 balance:

- If a poorly allocated account is invested in a low growth asset — like a money market mutual fund that returns 1% a year — that would produce $550 in returns.

- If a well-allocated account has a return of 9.2%, its return would be $5,060. **That's more than 9x more than the forgotten 401(k) return** with the money market allocation.

Note — this math applies to a well-allocated 401(k) or IRA. Our point is that **the chances of being sensibly allocated decline the longer an account is forgotten, so there's a meaningful chance forgotten 401(k) assets are earning much lower returns than they should be.**

Putting it together: the potential for significant missed retirement asset growth

If we consider the total impact of fees and returns, **those 24.3 million forgotten 401(k) accounts with $55,400 average balances could be missing out on an additional $116 billion in retirement assets** by not being in well-allocated, low fee accounts**.** Here's how:

- The higher investment returns (9.2%) compared to the 1% growth in the money market mutual fund allocated account results in a per account difference of $4,510.

- The lower fees (0.4%) compared to the 0.85% fees results in a per account difference of $248.
- After a single year, the well-allocated, lower fee account balance would be $59,840 compared to $55,083 in a poorly optimized account — **a total of $4,758 more.**
- That difference — $4,758 — multiplied by 24.3 million accounts totals $116 billion.
- **This calculation is assuming that all these forgotten 401(k)s are in poorly allocated portfolios — which may not be the case**. That's a topic we'll be exploring in future research.

At the individual level, a well-allocated retirement account in the long term could yield nearly **$700,000 more to use towards retirement over 30 years — or about 13x more than a forgotten 401(k) in a low-return investment.** Consider three account scenarios, all starting with $55,000 balances at the age of 35:

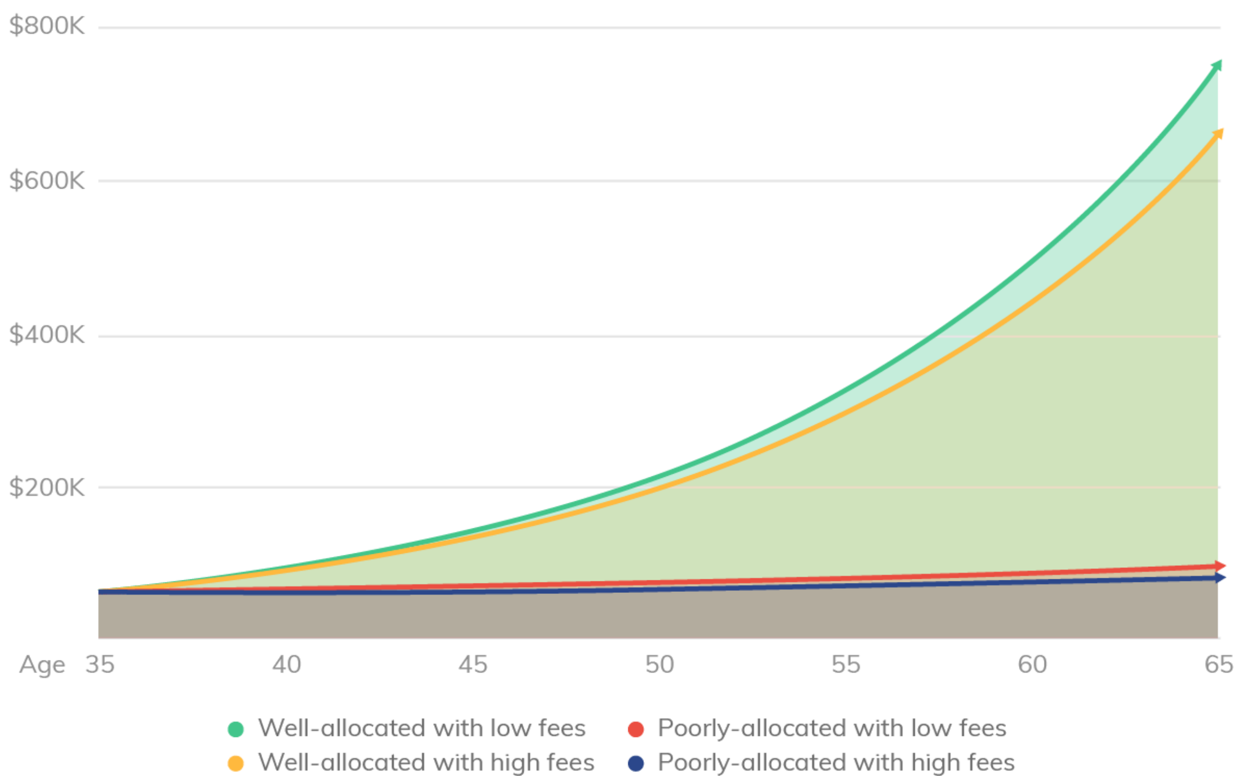
Scenario	**Starting balance:** $55,000 at age 35	**Age: 45** *10 years*	**Age: 55** *20 years*	**Age: 65** *30 years*
1	**Forgotten 401(k) in a money market mutual fund** • Yearly fees: 0.85% • Annual growth: 1.0%	$55,914	$56,759	$57,616
2	**Forgotten 401(k) in a stable value fund** • Yearly fees: 0.85% • Annual growth: 2.2%	$63,742	$72,889	$83,349
3	**Well-allocated, low fee IRA or 401(k)** • Yearly fees: 0.40% • Annual growth: 9.2%	**$139,085**	**$323,273**	**$751,378**

Note: annual fees for forgotten 401(k) are based on median plan fees from Brightscope / ICI Survey, assuming participants pay all fees.

To put $700,000 into perspective:

- The USDA estimates raising a child to age 17 costs on average $233,610.
- Four years of tuition for an expensive private college will cost about $220,000 — *without any financial aid or scholarships.*
- In Q1 2021, the median home sale price was about $350,000.

Impact of asset allocation and account fees over the life of a retirement account (based on a $55K starting balance over 30 years)



Costs of forgotten 401(k) accounts: Employers

Individuals are not the only stakeholders who pay for the forgotten 401(k) phenomenon — employers are also subject to higher costs and risks as a result of these left-behind 401(k)s. This is because many costs of providing a 401(k) plan are tied to the number of plan accounts — a number that includes the accounts of both current *and* former employees. In aggregate, **Capitalize estimates that employers could be paying up to $700 million in additional 401(k) plan costs tied to forgotten 401(k) accounts each year.**

These costs can be broken down into three categories:

1. Annual administrative and recordkeeping costs per plan participant

Administrative and recordkeeping fees are typically assessed on a per-participant basis — so, the more participants in the plan, the higher the cost. While administrative fees are a smaller component of the total fees than investment management fees, they can still be significant. Employers are more likely to cover all or some of the recordkeeping and administration costs associated with the 401(k) than the investment fees — a recent survey suggested nearly 40% of employers pay at least some portion, with 18% paying the entirety of the fee.[21] Importantly, a participant is *not* defined as an active employee — it is defined as any individual who maintains a 401(k) account in the plan, which includes former employees who have left their 401(k)s behind. **Put differently, employers may be paying recordkeeping and administrative fees for the forgotten 401(k) accounts of former employees.**

To estimate the total cost to employers of those 24.3 million forgotten 401(k)s, we estimated the weighted average administrative and recordkeeping fee per participant. First, we analyzed the distribution of participants across plan sizes (see table below). Secondly, to estimate the cost per participant, we reviewed plan cost data from a variety of sources, including industry reports and provider pricing information. This returned weighted average estimates between $39 and $96.[22]

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[21] Callan, 2018

[22] We reviewed data from a variety of sources, including industry publications (401(k) Averages Book, NEPC Defined Contribution Progress Report 2020) as well as leading providers (E.g. Vanguard, Guideline, Human Interest).

Distribution of 401(k) participants by plan size[23]

Number of plan participants	% of total participants in plan category
1 to 10	1.3%
11 to 25	2.6%
26 to 50	3.2%
51 to 100	4.0%
101 to 250	6.1%
251 to 500	5.6%
501 to 1,000	6.3%
1,001 to 2,500	10.0%
2,501 to 5,000	9.1%
5,001 to 10,000	9.9%
> 10,000	42.0%

Next, we considered what portion of forgotten 401(k) accounts would be in plans where administrative and recordkeeping fees were covered by employers. We reviewed multiple scenarios to estimate the impact of these fees. Our median scenario assumed that employers would be responsible for 30% of administrative fees associated with forgotten 401(k)s; this resulted in a potential total employee cost between $285 million and $700 million annually depending on the weighted average cost per participant. The median estimate was $470 million. We chose a fairly conservative estimate because this topic requires further research to validate the number of forgotten 401(k)s in accounts where employers shoulder the burden of administrative fees.

[23] EBRI. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2018" Published March 4, 2021.https://www.ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_526_401kxsec.4mar21.pdf?sfvrsn=80823a2f_6.

2. Legal risks and settlements as a result of ERISA lawsuits

Employers who provide a 401(k) plan are exposed to legal risks under ERISA. For example, employers bear a fiduciary duty in connection with the plan and can be sued by plan participants for breaches of that duty. Employees or former employees may contend that their employer failed to keep their account fees "reasonable" — and could be eligible for significant compensation. In 2020, there were over 200 such class-action lawsuits — this is more than *twice* the number of such suits filed in 2018. Importantly, **former employees with forgotten 401(k) accounts are able to participate in these lawsuits if they eventually discover that their 401(k) accounts have suffered.**

When analyzing recent class action lawsuits, we estimate that employers could end up paying millions to settle ERISA complaints:

- The settlement amount assumes the average alleged excess fee per employee would be 1% — in other words, plan fees were 1% higher than they should have been.
- The assumed average job tenure for each employee was five years — that would mean the employer needs to compensate them for five years of excess fees in the settlement.
- In addition, an employer is responsible for legal fees that are generally about equal to the settlement value.
- In total, **a plan with 500 participants might end up paying close to $2,500 per participant in a settlement, or about $1.25 million total.**

One way plan sponsors try to manage this risk is by buying more fiduciary liability insurance to protect against lawsuits. Unfortunately, those premiums increased by 35% in 2020 as a result of increasing demand. In other words, employers are getting squeezed from several directions.

Ultimately, the more forgotten accounts remain in an employer's plan and the longer they sit there, the greater the risk for the employer.

3. Use of administrative and compliance time to manage former employee plans

When employees move on from their jobs but leave their 401(k)s behind, the employer still has significant obligations to maintain their retirement accounts. For example:

- The employer must ensure that all ERISA requirements are met, such as providing participants with relevant plan information and funding information each year. This can be a burdensome task, but the stakes are high — failing to do so could lead to legal action.

- When former employees need information about their plan, they frequently contact their former HR team given the lack of a national lost-and-found account database. Answering those questions takes up valuable time.

While these costs are hard to quantify, they are real and add meaningfully to the direct per participant costs incurred by an employer for forgotten 401(k) accounts. What's worse, these benefits are provided to *former* employees and divert dollars that could be invested in improving benefits for *existing* employees.

Conclusion

The forgotten 401(k) account problem is an increasingly large phenomenon: 24.3 million forgotten 401(k) accounts housing $1.35 trillion in assets, with almost 3 million more added each year.

Unfortunately, **the forgotten 401(k) problem appears to be a recurring, structural part of the modern retirement savings market**: when 401(k) accounts are tied to employers and we change employers regularly, many of us will leave those accounts behind for some extended period of time. During that time, we're likely to incur ongoing 401(k) account fees, and there's a risk that our money is forgotten in one of the higher-fee plans that unfortunately persist. We may also suffer from foregone investment returns from having our money invested in a low-return instrument, or a portfolio that isn't regularly updated since it's not being monitored.

How can we reduce the magnitude of the forgotten 401(k) problem? Policymakers, employers and private sector institutions have a role to play. At Capitalize, we believe several key initiatives can meaningfully reduce the cost of forgotten 401(k) accounts:

- **Making it easier to locate old 401(k) accounts:** there is currently no national database for lost-and-found 401(k) accounts, despite Congressional proposals in the past. Senators raised this idea again in May 2021, though it remains to be seen if it will pass into law.

- **Simplifying the rollover process:** we've written before on the outdated nature of the current 401(k) rollover process, and we're passionate about modernizing it. Making it easier for employees to roll over their accounts at the point of job change into another 401(k) or an IRA would dramatically reduce the number of forgotten 401(k) accounts.

- **Providing terminated employees with user-friendly tools, not legalese and paperwork:** many employers meet their legal obligation to give terminating employees some information on their options. Unfortunately, that information is often dense, legalistic, and full of jargon. Naturally, then, it's frequently ignored. Giving users simple, modern tools to decide what to do, and move their money if they want, is more likely to lead to informed decisions and fewer forgotten 401(k) accounts.

By shining a light on the size and cost of the problem, we hope to encourage industry stakeholders to pay closer attention to what we believe is one of the largest, underappreciated reasons for why the aggregate level of retirement savings in America is not what it should be.

Disclosures

This white paper was last updated in May 2021.

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