

Fiduciary Corner

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Comperio views the issue of low default deferral rates as the single biggest obstacle in achieving favorable retirement outcomes for participants and plan sponsors.

Auto Enrollment

Second Generation of Automatic Enrollment Strategies

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Automatic Savings Features Are Evolving

Since the Pension Protection Act of 2006, automatic enrollment and automatic contribution rate increases have become popular features of 401(k) plan design. In fact, recent surveys indicate that between 40% to 50% of 401(k) plans have automatic saving provisions.

While automatic features have helped participation and saving rates, there is concern that low default deferral rates can result in low savings rates. Also, auto enrollment is largely applied only to newly eligible employees. And even though automatic contribution increase provisions are common, they are often available on an opt-in basis.

Comperio views low default rates as the single biggest obstacle in achieving favorable retirement outcomes for participants and plan sponsors. Many plans today have better 401(k) participation rates, but lower average deferral rates due to auto enrollment with target deferrals of 3% of compensation.

There is a significant amount of research supporting the fact that participants, on average, need to save between 12-15%[†] of their compensation.

With the typical auto enroll structure, they are saving 4.5%[‡]. This means many participants will achieve about 30% of what they need in retirement.

Comperio has experience working with clients to structure plan design to achieve better participant outcomes (getting participants to a higher savings level).

There are other plan design strategies for auto enrollment beginning to emerge in the marketplace. Here are a couple of “second generation of automatic enrollment” strategies: See examples on next page.

[†] Includes Employee and Employer contributions

[‡] 4.5% average savings is based upon 3% auto enroll and 50% match on the deferral

Auto Enrollment - *Second Generation of Automatic Enrollment Strategies* (Continuing from Page 1)

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There is a second generation of auto enrollment services that are designed to improve retirement outcomes for participants

Automatically enroll all eligible employees

Research shows that since automatic enrollment began to gain traction in 2006, participants won't take action to reverse an action taken that is good for their savings health. This pattern of inertia holds true even when plans begin enrolling existing employees that have traditionally not participated in the plan.

Increase the auto enrollment level to 6%

In addition to the lack of outrage from participants being automatically enrolled into the plan, recent studies confirm that setting initial deferral rates as high as 6% improves outcomes with virtually no changes in opt out rates. Currently, 52% of employers that offer automatic enrollment set the initial savings rate at 4% or more. Many plans that, for example, match employee contributions 50% up to 6% are still auto enrolling only at a 3% compensation level.

Automatically increase deferral rates

Higher deferral rates help individuals achieve better retirement outcomes but it is difficult to implement all at one time. All 401(k) plan recordkeepers offer the ability to automatically increase savings rates. 80% of employers with automatic enrollment offer automatic escalation and a full 64% of those employers set the maximum threshold at 10% of compensation or more.

Best practices are suggested

The Defined Contribution Institutional Investment Association (DCIIA) recently released an updated white paper which reviewed best practices for leveraging automatic provisions to achieve a better income replacement ratio in retirement. In Design Matters – The Influence of DC Plan Design on Retirement Outcomes the DCIIA suggested implementing the following features:

- Automatically enroll all employees and periodically do an enrollment “sweep” of employees into the plan.
- Establish the initial default deferral rate at a minimum of 6%.
- Implement automatic contribution rate increases of at least 1% annually.
- Allow the auto escalation contribution cap to be at least 10% of compensation.

A large contingent of retirement plan sponsors and consultants were initially concerned that participants would react negatively to being automatically enrolled. The reality is that 8.5 out of 10 participants that are automatically enrolled stay in the plan and do not opt out. This has been a great success for auto enrollment and achieving the goal of getting employees participating in their 401(k) plan. The next step is structuring an auto enrollment program that can support participants in achieving desired retirement outcomes.