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Do Employees End Up With More Retirement Income Under Automatic Enrollment 401(k) Plans Than Final-Average Defined Benefit Plans? EBRI Says in Many Cases, Yes.

Washington, D.C. – February 26, 2019 — The Employee Benefit Research Institute (EBRI), a private, nonpartisan, nonprofit research group, has released a new study examining the level of benefits that 401(k) plans with automatic enrollment provide compared to final-average defined benefit (DB) plans — with some potentially surprising results.

The Issue Brief is “How Much Would It Take? Achieving Retirement Income Equivalency Between Final-Average-Pay Defined Benefit Plan Accruals and Automatic Enrollment 401(k) Plans in the Private Sector.” In it, EBRI’s Retirement Security Projection Model® is used to compare simulated retirement benefits available under 401(k) plans with automatic enrollment relative to benefits available from a counterfactual simulation of a high-three-year, final-average-pay defined benefit plan.

All things equal, it shows that DB plans would typically have to accrue at more-generous rates to “break even” with auto-enrollment 401(k) plans. For example:

- In its baseline case, EBRI found that the defined benefit “break-even” rate — or the percentage accrual rate that would be required in order for a final-average DB plan to generate the same retirement income that is projected to come from 401(k) plan eligibility under automatic enrollment for a given worker cohort — are rarely less than 1.5 percent of final pay.

- In only 2 of the 16 combinations of wage quartiles and years of plan eligibility for males are defined benefit “break-even” rates less than 1.5 percent of final pay per years of service.

- For women, only 5 of the 16 combinations have “break-even” rates under 1.5 percent.

“EBRI’s modeling results show a strong advantage for automatic enrollment 401(k) plans over final-average defined benefit plans under this scenario,” said Jack VanDerhei, EBRI research director and author of the study. “However, when subjected to various ‘stress tests’ this can change.” VanDerhei notes that, for example, by reducing the rate of return assumptions by 200
basis points and increasing the annuity purchase price to reflect recent bond rates, results show that in many cases the automatic enrollment 401(k) plans lose their comparative advantage to the final-average defined benefit plans.

VanDerhei points out that this research is important because “in considering shifts in plan availability and design, plan sponsors, providers, and policy makers naturally look for comparisons in the outcomes provided. Unfortunately, the comparisons are frequently limited by a paucity of real-world data.”

Copies of the report summary are available at ebri.org.

About EBRI:

The Employee Benefit Research Institute is a private, nonpartisan, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and financial security issues. EBRI does not lobby and does not take policy positions. The work of EBRI is made possible by funding from its members and sponsors, who include a broad range of public, private, for-profit, and nonprofit organizations. For more information go to www.ebri.org