

FOR IMMEDIATE RELEASE: March 18, 2010

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New Research from EBRI:

Low-Income Workers Likely to Benefit More Than Thought from Auto-Enrollment in 401(k) Plans

WASHINGTON—New research from the nonpartisan Employee Benefit Research Institute (EBRI) finds that auto-enrollment of participants in 401(k) plans is likely to be most beneficial to young and low-income workers, although high-income workers are likely to benefit from it as well.

It also confirms earlier results that large employers adopting auto-enrollment have significantly increased the employer “match” to their workers’ own 401(k) contributions.

The EBRI research, published in the April 2010 *EBRI Issue Brief* being released today, is the first to compare actual plan design parameters from large employers that adopted automatic enrollment since 2005. The results show an even greater positive impact on workers’ 401(k) accumulations than earlier simulation analysis by EBRI performed two years ago.

Concerning the higher employer match rates, EBRI’s research notes that this may result from large employers providing a “quid pro quo” to their workers in return for either freezing or closing their defined benefit (pension) retirement plan.

The article, “The Impact of Automatic Enrollment in 401(k) Plans on Future Retirement Accumulations: A Simulation Study Based on Plan Design Modifications of Large Plan Sponsors,” is in the April 2010 *EBRI Issue Brief*, being released today and online at www.ebri.org. It is authored by EBRI Research Director Jack VanDerhei, who has performed numerous computer simulation projects focusing on retirement income security.

This is an expansion of earlier results released in January, which found that large employers adopting automatic enrollment in their 401(k) plans have generally increased the “employer match” to participant’s accounts—in some cases, by a significant amount. The EBRI research is the first using actual plan information on employer contribution rate information both before and after adoption of auto enrollment (see www.ebri.org/pdf/PR.863_21Jan10.Matches.pdf).

“The modifications to 401(k) plans made by sponsors in response to the Pension Protection Act of 2006 will be very important for retirement income adequacy in this country. Adding these more realistic assumptions to our simulation model will allow us to more accurately demonstrate the relative improvements in retirement accounts, especially for young and low-income workers,” VanDerhei said.

Key points of the new EBRI research:

Significance of auto-enrollment: Automatic enrollment of participants in 401(k) plans, which was encouraged by provisions in the Pension Protect Act of 2006, is designed to overcome some of the drawbacks of voluntary enrollment by getting more workers to save in their workplace retirement plan. Auto-enrollment for 401(k) plans has been demonstrated by previous EBRI research to have substantial potential benefits for some employees.

New EBRI research: This EBRI study analyzes plan-specific data of 1,000 large defined contribution plans for salaried employees from Benefit SpecSelect™ (Hewitt Associates LLC) in 2005 and 2009 to compare a subsample of plan sponsors that did not have auto-enrollment in 2005 but that had adopted it by 2009. Actual plan information on both auto enrollment and employer contribution rate information were coded both before and after adoption of auto-enrollment from 225 large 401(k) plan sponsors and found that the average change was positive in each of the following three categories:

- The first-tier match rate (i.e., how much of the first dollar of employee contribution is matched).
- The effective match rate (the total employer matching contribution received if the employee contributes enough to get the maximum match).
- The average total employer contribution rate (the combination of matching and non-matching employer contributions).

Modeling analysis: This analysis was used in a series of programs to simulate the account balances employees are likely to have at retirement age as a consequence of participating in 401(k) plans. The analysis indicates that the adoption of automatic enrollment in 401(k) plans is likely to have a very significant positive impact (even greater than EBRI simulated in 2008) in generating additional retirement savings for many workers, especially for young and low-income workers:

- Under baseline assumptions, the median 401(k) accumulations for the lowest-income quartile of workers currently age 25–29 (assuming all 401(k) plans were voluntary enrollment plans as typified by the 225 large plan sponsors described above) would only be 0.08 times final earnings at age 65.
- However, if all 401(k) plans are assumed to be using the large plan sponsor auto-enrollment provisions, the median 401(k) accumulations for the lowest-income quartile jumps to 4.96 times final earnings (if 401(k) participants revert back to the default contribution when they change jobs) and 5.33 times final earnings (if they retain their previous contribution level when they change jobs).
- There are also large increases even for high-income workers: The multiple under a voluntary enrollment scenario is 2.41 times final earnings compared with 9.15 or 9.81 under auto-enrollment, depending on the assumptions for employee reversion to default contribution rates upon job change.

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