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New Research from EBRI:

Higher Starting Point Would Significantly Increase Retirement Security “Success”

WASHINGTON—Setting a higher starting point for 401(k) contributions would make a significant difference in improving workers’ likelihood of a financially viable retirement, according to new research.

Most private-sector employers that automatically enroll their 401(k) participants do so at a default rate of 3 percent of pay, a level consistent with the starting rate set out in the Pension Protection Act of 2006, but a rate that many financial experts say is far too low to generate sufficient assets for a comfortable retirement. Raising the default saving rate to 6 percent would significantly increase the chances for achieving retirement adequacy “success” for both low- and high-income workers, according to a new analysis by the nonpartisan Employee Benefit Research Institute (EBRI).

Using its proprietary Retirement Security Projection Model[®] (RSPM), EBRI evaluated the impact of raising the default contribution rate on younger workers (with 31–40 years of simulated 401(k) eligibility) to see how many would be likely to achieve a total income real replacement rate of 80 percent at retirement—within the typical range of replacement rates suggested by many financial consultants.

A key variable in considering the impact of auto-enrollment in 401(k) plans with automatic escalation of contributions is whether workers who change jobs continue to save at their previous (and typically higher) contribution rate, or whether they “start over” in the new job at the typical lower automatic deferral rate of 3 percent.

Under the EBRI modeling, more than a quarter (25.6 percent) of those in the lowest-income quartile who had previously NOT been modeled to have a financially successful retirement (under the actual default contribution rates) would be successful as a result of the increase in starting deferral rate to 6 percent of compensation. Even workers in the highest-income quartile would benefit, although not as much: Just over 18 percent who would not be successful under the actual default contribution rate would be successful due to the higher 6 percent default rate.

“This study shows that substantial increases in success rates were found for both low- and high-income employees if employers raised the default 401(k) contribution rate to 6 percent of pay,” said Jack VanDerhei, EBRI research director and author of the report.

Full results are published in the September *EBRI Notes*, “Increasing Default Deferral Rates in Automatic Enrollment 401(k) Plans: The Impact on Retirement Savings Success in Plans With Automatic Escalation,” available online at www.ebri.org

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