EBRI
EMPLOYEE
BENEFIT
RESEARCH
INSTITUTE®

EBRI News

1100 13th St. NW • Suite 878 • Washington, DC 20005
(202) 659-0670 • www.ebri.org • Fax: (202) 775-6312

For Immediate Release: June 27, 2008
Contact: Jack VanDerhei, EBRI, 202/775-6327, vanderhei@ebri.org
John MacDonald, EBRI, 202/775-6349, macdonald@ebri.org

New Research from EBRI:

Analysis Shows "Automatic" 401(k) Features Likely to Be Big Help in Generating New Retirement Savings

WASHINGTON—New analysis by the nonpartisan Employee Benefit Research Institute (EBRI) finds that the "automatic" 401(k) features in the Pension Protection Act of 2006 (PPA)—such as auto-enrollment of workers and auto-escalation of their savings contributions—are likely to have a very significant positive impact in generating additional retirement savings for many workers, especially for low-income workers.

Using its Retirement Security Projection Model,® EBRI simulates (under several assumptions) the likely impact of 401(k) plan sponsors switching from voluntary enrollment systems to automatic enrollment designs with automatic escalation. The full report, published in the June *EBRI Issue Brief*, "The Impact of PPA on Retirement Savings for 401(k) Participants," available online at www.ebri.org It is the first report of its kind to quantify how the PPA's 401(k) provisions will affect a wide variety of workers based on various income and participation factors.

The "automatic" provisions of PPA created incentives for 401(k)-plan sponsors to automatically enroll workers in the retirement savings plan, to automatically increase their savings rate over time, and to direct their contributions into a default mix of investments appropriate for their age. Workers can choose to opt out or to change their savings rates or investments, but must take positive action to do so. The PPA provisions reflect an attempt to overcome workers' well-documented inertia and inaction when left to make savings and investment decisions on their own.

The EBRI analysis found that, when results are aggregated across all income categories, the increase in the value of 401(k) accumulations at age 65 as a multiple of final earnings for those currently ages 25–29 would be approximately 2.4 to 2.6 times final salary by switching from voluntary enrollment to automatic enrollment.

Although the aggregate results favor automatic enrollment, distributional analysis of the differences between the two systems indicates that the higher paid are not likely to benefit as much from such a change. But even for the top 25 percent of these workers (when ranked by 401(k) accumulations as a multiple of final earnings), there are large increases: the multiple under a voluntary enrollment scenario is 1.8 times final earnings, whereas auto-enrollment provides multiples ranging from 6.5 to 10.4, depending on auto-escalation of contributions.

"To the extent that 401(k) sponsors decide to switch from voluntary enrollment systems to the new automatic enrollment plan designs in PPA, many workers will have increased retirement savings, especially those in the lowest-income quartile," said Jack VanDerhei, EBRI research director and co-author of the analysis. "For example, a 25-year-old worker making $25,000 a year would be likely to have a median increase in 401(k) accumulations of between $92,000 and $166,000 in today's dollars by age 65 as a result of these changes."

The concept of auto-enrollment has been studied since the mid-1990s. Support for the concept grew as various studies showed relatively low participation rates among young and low-income workers, and as more defined benefit plan sponsors began freezing their plans for future (and sometimes current) employees. The PPA created incentives for plan sponsors to implement this concept with its 401(k) safe-harbor auto-enrollment and auto-escalation provisions.

However, the EBRI analysis notes that the extra retirement savings expected to be generated by auto-enrollment will still not be enough for certain workers to be able to meet savings targets that would provide for a 75 percent or 90 percent chance of sufficient income for their full retirement. When comparing income replacement targets generated in previous EBRI research work with the simulated 401(k) accumulations in the current analysis—even with the large increases that can be expected for many workers under PPA-type auto-enrollment plans, and with current-law Social Security benefits—additional resources will still be needed for many workers.

EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. www.ebri.org

###

PR #806