

The image shows the T. Rowe Price logo in white, three-dimensional lettering mounted on a dark, textured wall. The background of the slide features a large window with a view of a green lawn and trees, and the silhouettes of two people looking out. The logo is positioned in the upper right quadrant of the slide.

T. Rowe Price

Success of Auto Enrollment and Auto Increase: Using Behavioral Finance to Improve Retirement Planning

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T. Rowe Price Retirement Plan Services



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Focus for Discussion

- **Four Key Retirement Decisions Employees Face**

1. Whether to participate in a retirement plan

2. How much to contribute to the plan

3. How to invest contributions

4. How to manage money in retirement

} **Focus for Discussion**

- **Lessons Learned from Behavioral Finance**

- Auto-Enrollment and Overcoming Participant “Inertia”

- Auto-Increase and Hyperbolic Discounting

Participation in Retirement Plans

- **Issue: Employees Do Not Participate**

- 3 out of 10 employees do not participate in their retirement plan
- Employees miss out on tax benefits & employer match

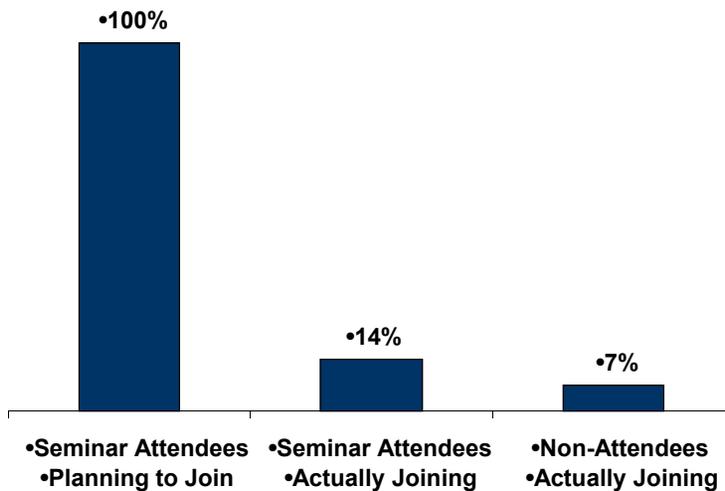
- **Psychological Barrier: Inertia**

- Newton's First Law of Motion: The property of an object to remain still or moving in its established direction unless acted upon by an outside force.
- Applies well to human behavior, too

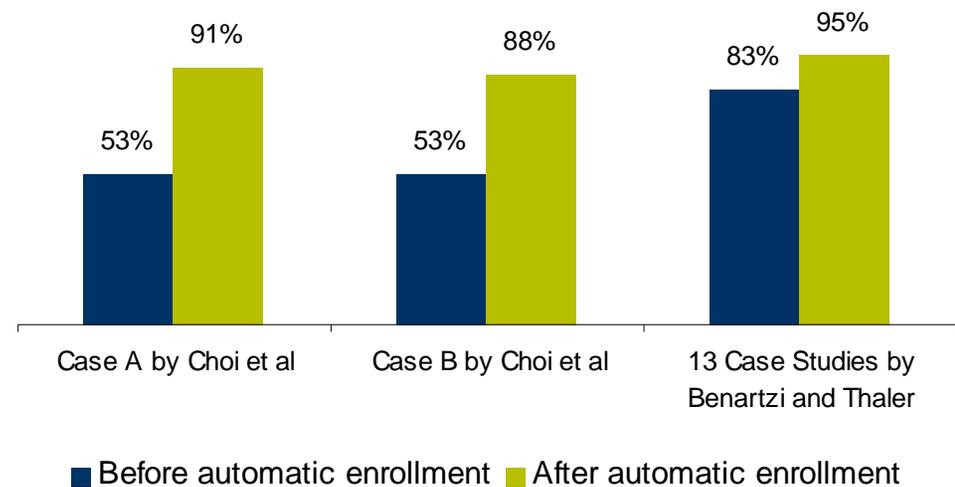
Tools Used to Increase Participation in Retirement Plans

- Education has had little impact on participant inertia
- Automatic enrollment uses inertia to improve participation in retirement plans

•Does Education Spur Action?



Automatic Enrollment Overcomes Participant Inertia

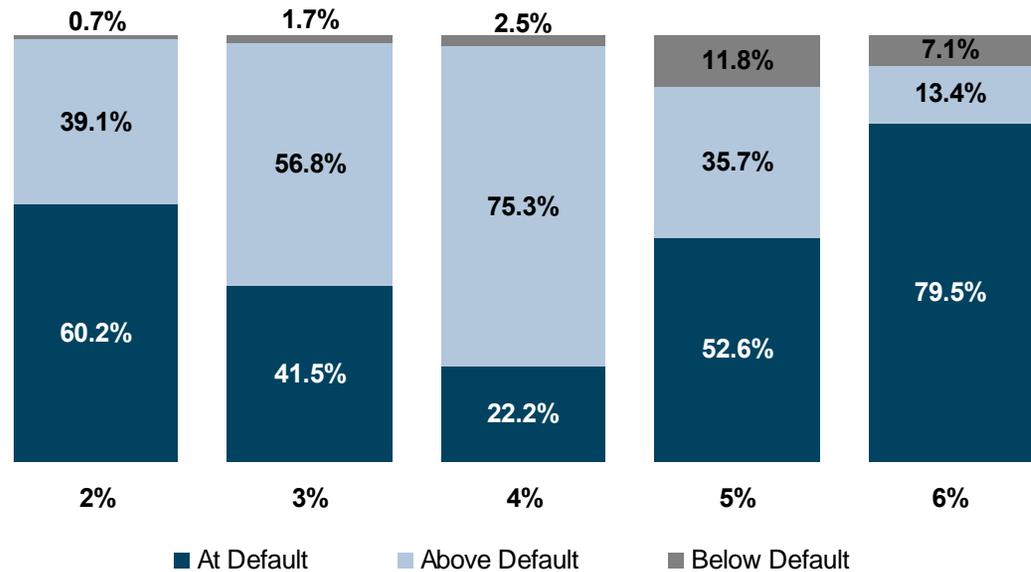


Source: Choi et al, Bernartzi and T. Rowe Price (2006)

T. Rowe Price Automatic Enrollment

- Adoption of auto enrollment continues to grow
- Majority of plans use a 3% default rate

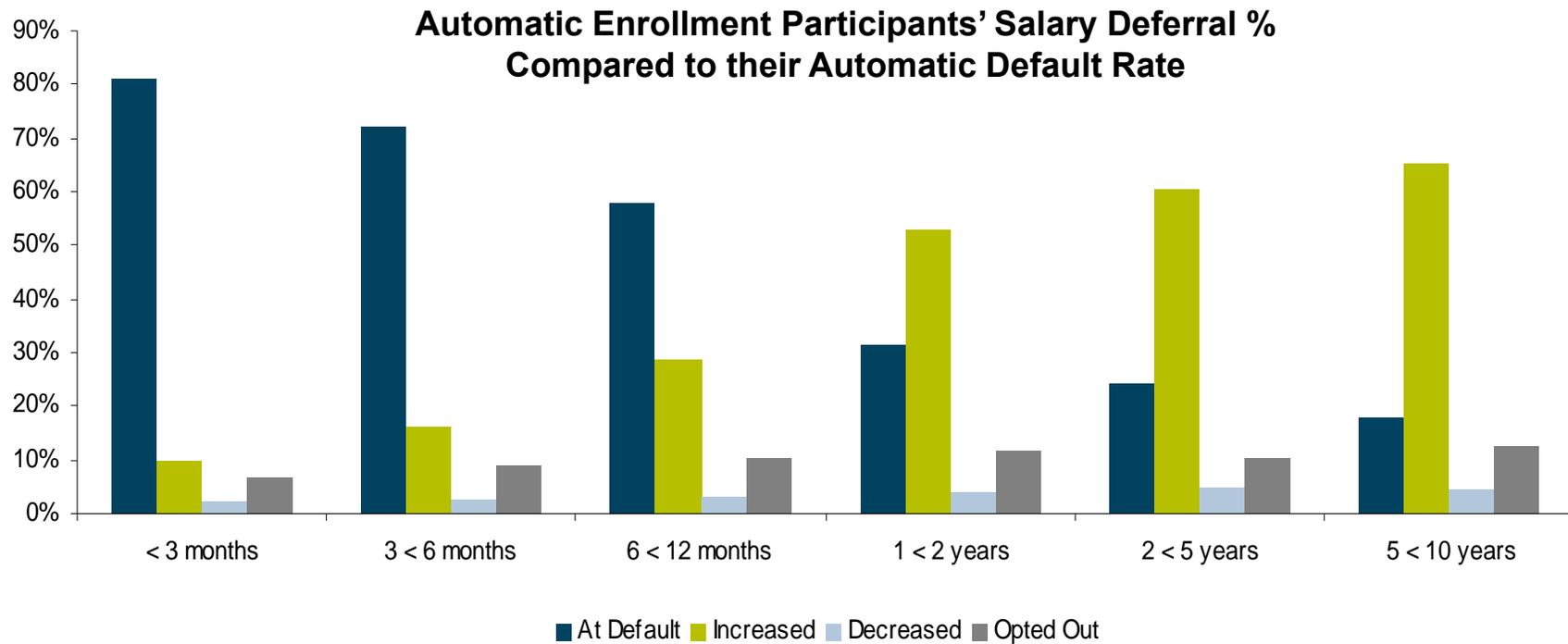
Percentage of Participants Saving At, Above, and Below the Plan Default Rate



- **53% of eligible T. Rowe Price clients use Automatic Enrollment**
 - 56% default @ savings rate of 3%; another 36% > 4%
 - 1/3 also apply it to existing nonparticipants
 - ~5% annually implement auto-enrollment for opt-outs

Participants at T. Rowe Price : Auto Enrollment Impact Over Time

- Opt out rates for participants do not change much for different participant populations
- Participants with deferrals above their default rate grow over time (due in part to auto services such as auto increase)

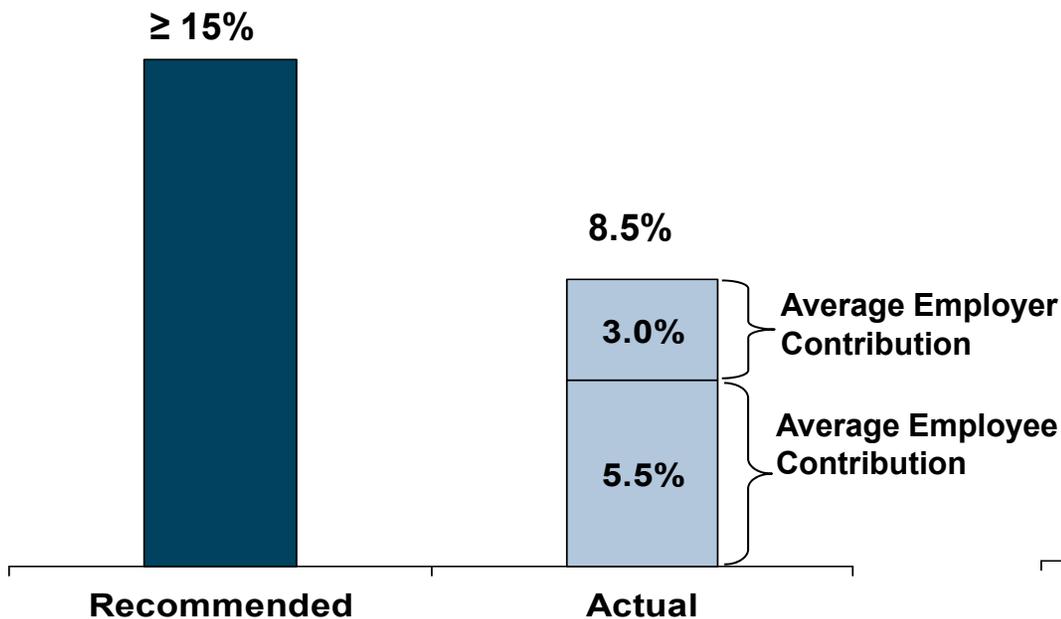


Source: T. Rowe Price (12/09)

Savings Rate and Hyperbolic Discounting

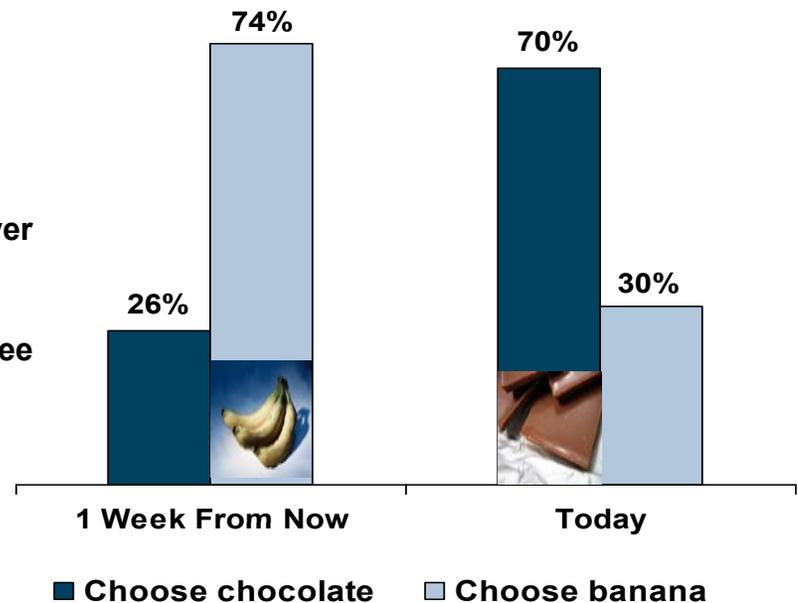
- Issue: Average Savings Rate is Low

- Even when combined with employer match, employees are not saving enough in 401K plans



- Psychological Barrier: Hyperbolic Discounting

- Immediate gratification is hard to resist
- Self-control restrictions are easier to accept if they take effect in the future
- Case in point: Bananas or chocolate?



Sources: PSCA 52nd Annual Survey, Read and Van Leeuwen (1998)

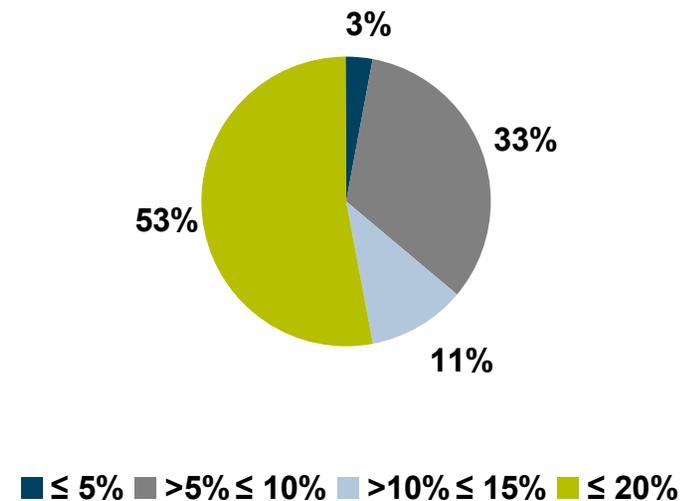
T. Rowe Price Automatic Increase

- Use of automatic increase in retirement plans is growing
- More clients are shifting the automatic increase percentage from 1% to 2%

- **Adopted but not optimized by clients**

- **82% of eligible clients offer Automatic Increase**
 - 77% as an opt-in solution (only 5.8% of participants opt-into service)
 - 23% as a default (opt-out) solution (70% of participants maintain default)
- **Rate of increase is shifting up – 43% of clients at 2% vs. 1%**
- **Majority set ceiling for contribution rates above 20%**

Percentage of Participants Saving At, Above, and Below the Plan Default Rate



Automatic Increase: Key Lessons

Opt-out Rate

Just 15% of participants would opt-out, 85% would remain in the program

Best Time to Implement

“Future date”; January - synchronize with pay raises

Annual Incremental Amount

Sign-up rates for 1% and 2% are virtually equal

Sensitivity to “Cap”

Signup rates are the same with a cap of 10% and 20%.

Summary

- **Automatic enrollment and automatic increase can help improve retirement outcomes of all employees by helping them overcome behavioral barriers**

- **Five Key Opportunities To Improve Employee Savings**
 - Utilize opt-out vs. opt-in
 - Adopt automatic enrollment for existing employees
 - Use default savings rate higher than 3% in automatic enrollment
 - Raise auto increase from 1% to 2%
 - Combine auto enrollment and auto increase and use inertia to improve participant behaviors

THANK YOU