

A Closer Look at Automatic Plan Services: Plan Sponsor and Participant Behavior

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EXECUTIVE SUMMARY

Early empirical research highlighted the benefits of automatic plan services such as automatic enrollment and automatic deferral escalation programs. Although the research was limited, it was convincing and sparked considerable interest among service providers and retirement plan sponsors. Evidence showed that automatic enrollment effectively increased participation, but with an unintended consequence: Some groups of participants actually had selected higher savings rates when they were not automatically enrolled. Academic research also showed that coupling automatic enrollment with automatic increase programs helped overcome this shortcoming.

This research summary expands on existing empirical evidence related to automatic enrollment and automatic deferral escalation programs by reporting the results from an analysis of plan sponsor and participant behaviors in a sample of over 100 401(k) plans recordkept by T. Rowe Price.

Significant Findings

- The majority of automatic enrollment plans enroll newly hired employees (but not existing employees who are not participating).
- The most popular default savings rate is 3%, and the most popular default investment choice is target-date investments.
- Over 90% of automatic enrollment plans and nearly 75% of opt-in plans (plans that require employees to take action to enroll) offer an automatic deferral increase program.
- Nearly half of plans offering an automatic increase program automatically enroll participants in the service, most frequently with an annual one-percentage-point increase that tops out at 20%.
- Participation rates in automatic enrollment plans are dramatically higher than participation rates in opt-in plans, even when the default rate exceeds 3%. Participation is high even within lower-income segments of the employee population.
- Initial default contribution rates heavily influence participant savings rates. In every demographic segment

analyzed, except the one for people aged 65 and over, median savings rates are within one percentage point of the default savings rate.

- In plans with a default initial contribution rate of 3% or 4%, a majority of participants are saving at a rate that exceeds the default rate.
- In plans with higher initial default rates, participants are less likely to exclusively invest in the plan's default investment. This is particularly true for longer tenured employees in these plans.

Primary Implications

- Plan sponsors may wish to consider automatically enrolling all eligible employees (not just new employees) at higher initial default savings rates.
- Automatic increase programs may be more effective if participants are automatically enrolled in them.
- Over time, employees migrate away from default choices. Plan sponsors will want to continue to monitor participant behavior to determine effective steps to help employees reach their retirement goals.

INTRODUCTION

When the Pension Protection Act of 2006 (PPA) gave support to automatically enrolling employees into 401(k) plans and automatically increasing their contribution rates over time, limited empirical evidence of the effects of automatic features existed. Although automatic enrollment had been around since the early 1980s, it was not widely adopted until the beginning of this decade. The evidence that did exist was based on work by one academic team that had studied automatic enrollment at four companies, all of which were relatively large clients of one recordkeeping provider.¹ Similarly,

empirical evidence related to automatic increase programs was limited; it focused on implementations at two companies.²

Since enactment of the PPA provided support for automatic enrollment and automatic deferral rate escalation programs, more plan sponsors have adopted these plan design features. (See Figure 1.) Similar to the latest industry statistic in Figure 1, over 50% of T. Rowe Price's clients have now adopted automatic enrollment.³

FIGURE 1: History of Automatic Enrollment

	Regulatory Development	Plan Sponsor Adoption
2007		53.2% of plans with 5,000+ participants and 37.2% of all 401(k) plans have automatic enrollment (PSCA 2008)
2006	Pension Protection Act of 2006 provides statutory authority for automatic enrollment and automatic deferral escalation programs	41.3% of plans with 5,000+ participants and 26.0% of all 401(k) plans have automatic enrollment (PSCA 2007)
2004	IRS issues letter stating employee salary deferral amount not limited to 3%. Letter also acknowledged employee salary deferral amounts could automatically increase without a specific employee request (IRS Information Letter to J. Mark Iwry on March 17, 2004)	30.6% of plans with 5,000+ participants and 12.4% of all 401(k) plans have automatic enrollment (PSCA 2005)
2000	IRS ruling clarifies automatic enrollment can be used for current employees (Revenue Ruling 2000-8)	8.6% of 401(k) plans have automatic enrollment (PSCA 2001)
1998	IRS ruling allows automatic enrollment for newly hired employees at 3% of deferred salary with matching contribution (Revenue Ruling 98-30)	7% of 401(k) plans have automatic enrollment (Trends & Experience in 401(k) Plans, 2007, Hewitt Associates, 2008)
1997		4% of 401(k) plans have automatic enrollment (Trends & Experience in 401(k) Plans, 2007, Hewitt Associates 2008)
Early 1980s		McDonald's introduces automatic enrollment

¹ James Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Saving for Retirement on the Path of Least Resistance." 2006.

² Richard H. Thaler and Shlomo Benartzi. "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving." 2004.

³ Based on T. Rowe Price's full-service clients that outsource participant deferral rate recordkeeping.

ORGANIZATION

In this research, a sample of T. Rowe Price recordkeeping data is analyzed and reported on, providing additional information about how plan sponsors and participants are using automatic services. This research report begins with a description of the data set analyzed. A discussion of plan sponsor decision making related to designing automatic services follows. The report then focuses on the results from plan-level and participant behavioral analyses before ending with a summary that includes important implications for plan sponsors.

DATA AND METHODOLOGY

The analyses reported in this paper are based on participant data as of the end of April 2008 from over 100 401(k) plans of all sizes, most of which offer target-date investments as well as other investment options. A little over half of the plans (53%) automatically enroll eligible employees, and in all but one of these plans, contributions are automatically invested in the plan's age-appropriate target-date investment alternative unless participants have made other (i.e., active) choices.⁴ In total, over 500,000 individual records are analyzed in this research; nearly 60% of them from plans offering automatic enrollment. Throughout this paper, "participant" refers to an eligible employee who is actively contributing to the plan.

In virtually all of the analyses reported in this paper, only individuals who were hired after the last significant plan change are included.⁵ These individuals are referred to as the "new hire" group. This classification isolates the behaviors of eligible

employees who joined the plan after its design structure was essentially static, thereby reducing potentially confounding effects.

In some of the analyses below, the behaviors of automatically enrolled employees are compared with the behaviors of employees enrolled in opt-in plans, where plan participation requires people to make an active choice to enroll. Table 1 highlights the differences between these two "new hire" populations.

AUTOMATIC SERVICE DESIGN AND DEFAULT CHOICES

Perhaps the most significant aspect of implementing automatic plan features is establishing the default choices. The importance of this task cannot be overstated for at least two reasons: First, research has shown that employees view these default choices as implicit advice, and second, many participants tend to stick with these default choices for a long period of time. For example, researchers found that when automatic enrollment was the retirement plan default, 89% of subjects thought that the human resources staff believed employees should participate in the plan. However, when the default was non-automatic enrollment, only 6% of subjects in this case thought that the human resources staff believed employees should enroll in the plan.⁶ Other researchers have also highlighted the persistency of default choices, noting that even after three years in the plans studied, between 28% and 49% of automatically enrolled participants remain at the initial default contribution rate and invested in the default investment.⁷

TABLE 1: New Hire Populations in Data Set

	Opt-In Plan Participants (n=103,515)	Automatic Enrollment Plan Participants (n=112,367)
Median Age	34	29
Median Income ⁽¹⁾	\$28,110	\$20,023
Median Tenure	1 year	1 year
Median Balance	\$4,688	\$1,524

⁽¹⁾Income data are available for a subset of employees in the full data set.

⁴ Participants who are automatically enrolled in target-date investments become investors in the investment that most closely matches their retirement date at age 65. For example, the contributions of an automatically enrolled 30-year-old participant would be automatically invested in an investment with a stated retirement date of 2045, the investment that most closely coincides with the year in which he or she will turn 65.

⁵ By last significant plan change, we mean a change such as the adoption (or termination) of automatic enrollment or the addition of target-date investments, advice, or managed account services. In total, the "new hire" group included over 210,000 participant records.

⁶ Craig McKenzie, Michael Liersch, and Stacey Finkelstein. "Recommendations Implicit in Policy Defaults." 2006.

⁷ James Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Saving for Retirement on the Path of Least Resistance." 2006.

TABLE 2: Automatic Service Design Specifications

	Percentage of Plans*	Percentage of Employees**
Automatic Enrollment		
Employees Covered		
New Hires Only	67%	72%
All Eligible Employees	33%	28%
Initial Contribution Rate		
2%	8.5%	15.7%
3%	49.2%	54.9%
4%	17.0%	13.4%
5%	10.1%	5.7%
6%	15.2%	10.3%
Default Investment Choice		
Target-Date Investments	98%	99.6%
Managed Accounts	2%	0.4%
Automatic Enrollment Grace Period***		
None	1.7%	0.6%
14 Days	5.1%	1.4%
21 Days	1.7%	7.6%
30 Days	62.7%	72.0%
45 Days	23.7%	15.1%
60 Days	3.4%	0.8%
90 Days	1.7%	2.5%
Automatic Deferral Increase		
Participant Enrollment		
Automatic	47%	54%
Opt-In	53%	46%
Increase Percentage		
1 Percentage Point	73.1%	74.7%
2 Percentage Points	26.9%	25.3%
Default Savings Rate Cap		
5%	1.9%	0.8%
6%	18.5%	9.8%
8%	1.9%	0.1%
10%	7.4%	10.1%
15%	9.3%	36.9%
16%	1.9%	1.2%
20%	33.2%	26.0%
25% or Greater	25.9%	15.1%

*This represents the percentage of plans in the data set offering the service indicated with the default choice specified. In other words, 67% of automatic enrollment plans in the data set use automatic enrollment for newly hired employees only.

**This represents the percentage of employees in plans with the default choice indicated. In other words, 72% of all employees in automatic enrollment plans in the data set are in plans that only enroll new hires.

***The grace period is the time frame in which participants may opt out of automatic enrollment (before it becomes effective for them). For example, with a 90-day grace period, participants have 90 days to opt out of automatic enrollment. If they take no action during these 90 days, they will be automatically enrolled in the plan after the 90-day period has elapsed.

Table 2 reports automatic service design choices by sponsors of the plans included in the data set analyzed.

Several important observations can be made about how plan sponsors are designing automatic plan features and defaults.

PROSPECTIVE VS. RETROACTIVE ADOPTION

Although the Pension Protection Act of 2006 encouraged employers to adopt automatic enrollment for *all* employees, automatic enrollment for new employees has been the more popular approach. Two-thirds of plans in our sample have adopted automatic enrollment for new employees only. This approach helps overcome the inertia of employees when they join a firm, but fails to overcome the inertia that may account for a lack of participation among existing employees. Accordingly, unless employee turnover is high, plan participation rates may not increase as quickly as they could if automatic enrollment were implemented for all eligible employees.

Employer reluctance to automatically enroll existing non-participants may partially stem from a belief that these employees have made an active decision not to participate in the plan. While that may be true for some, it is most likely not the case for all; otherwise, higher opt-out rates would be observed. In addition, over 90% of automatically enrolled employees report a positive reaction to this plan feature.⁸ Employers may wish to consider this as they contemplate which employees to automatically enroll.

INITIAL DEFAULT CONTRIBUTION RATES

Nearly half of plan sponsors have selected 3% as the initial default contribution rate for their automatic enrollment plans, and almost 10% of plan sponsors have chosen an even lower rate. One may hypothesize, as many have, that early adopters of automatic enrollment anchored to the 3% mentioned in Revenue Ruling 98-30. Generally, the distribution of plan default rates in the data set is similar to those observed in T. Rowe Price's total population of automatic enrollment plans, except that the full population also includes plans with initial default rates of 7% and 8%.

It is obvious that a 3% total contribution rate will not lead to a comfortable retirement for most workers, even lower-income ones who begin saving at age 25—let alone older workers who have barely saved for retirement.⁹ As Figure 2 (from Ibbotson et al., 2007) shows, suggested total contribution rates for most people exceed 5%, climbing increasingly higher the longer employees wait to begin saving.

⁸ Retirement Made Simpler Employee Satisfaction Study 2008.

⁹ Because Social Security replaces a higher portion of lower-income workers' wages, their suggested savings rates are lower than those of higher-income workers.

FIGURE 2: Savings Rate for Various Income Levels with 80% Net Income Replacement and 90% Probability of Success



Source: National Savings Rate Guidelines for Individuals, Ibbotson, Xiong, Kreitler, Kreitler, and Chen, 2007.

AUTOMATIC DEFERRAL INCREASE PROGRAMS

It is possible that initial default contribution rates *must* be lower than the savings rates suggested by Ibbotson’s research. Participants may find the suggested rates too painful to accept and decide to save nothing at all. In fact, in the first studied implementation of an automatic deferral increase program, an advisor met personally with most participants, using a modeling program to solve for personalized suggested savings rates. However, he constrained the suggested rates to no more than five percentage points higher than participants’ current savings rates, suggesting that his intuition (and possibly his experience) led him to believe that employees were more likely to refuse savings rates that exceeded this threshold.¹⁰

Given that existing savings rates of many participants are too low and the possibility (or perhaps probability) that many participants have an upward bound on an acceptable savings rate that may be insufficient, complementing automatic enrollment with automatic increase programs is important. It is encouraging to note that slightly over 90% of the automatic enrollment plans in our data set offer an automatic deferral rate escalation program. However, over half of these plans offer it on an opt-in basis, requiring employees to take initiative to sign up for the service (and failing to overcome the powerful effects of inertia).

While plan sponsors may have “anchored” to the 3% initial contribution rates noted in early IRS guidance, they have not anchored on the three-percentage-point annual increase used

in the first implementation of an automatic escalation program studied by Richard Thaler and Shlomo Benartzi, the behavioral economists who conceived the program. However, plan sponsors may be anchoring on the contribution rate increases set forth in PPA (and subsequent guidelines). In fact, over 70% of plan sponsors in our data set that offer the service utilize an automatic increase of only one percentage point. Early behavioral research performed in conjunction with Professor Shlomo Benartzi found that participants were just as likely to actively join an automatic increase program when the periodic increase was two percentage points as they were when it was one percentage point, suggesting that this default choice of an annual increase of one percentage point appears to be more driven by plan sponsor perception than participant perception or behavior.

PARTICIPANT BEHAVIOR IN AUTOMATIC ENROLLMENT PLANS

Participation. Overall, participation in automatic enrollment plans is much higher than in opt-in plans. Although there may be some relationship between participation rates and plan default rates, participation is high in all plans—even within lower income segments in plans with higher default rates. Automatic enrollment plans with 5% and 6% default rates experience over 90% participation in the lower-income segments. Participation in plans using a 6% initial default savings rate is somewhat lower (across all age categories) than participation in plans with lower initial default savings rates, and the lower participation appears to be partially driven by tenure. (See Table 3.)

¹⁰ Richard H. Thaler and Shlomo Benartzi. “Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving.” 2004.

TABLE 3: Participation Rates in Automatic Enrollment Plans by Initial Default Savings Rates

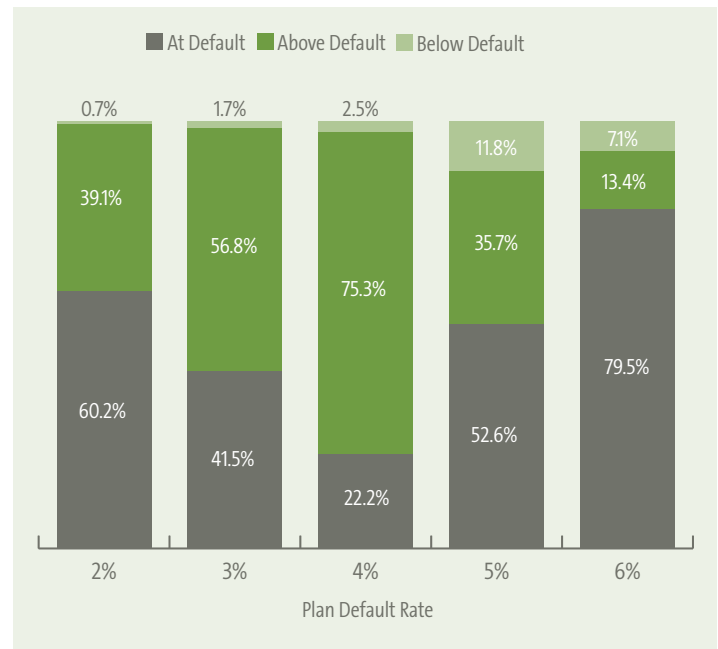
	2% Default	3% Default	4% Default	5% Default	6% Default
Overall	93.7%	91.7%	88.8%	93.0%	83.4%
Age					
Under 25	95.1%	92.1%	85.4%	94.1%	86.9%
25 to 34	93.2%	91.3%	90.4%	93.7%	86.9%
35 to 44	92.5%	90.8%	90.2%	91.9%	83.8%
45 to 54	93.2%	92.3%	92.2%	91.7%	80.6%
55 to 64	91.5%	90.7%	89.9%	91.7%	70.6%
65 and Over	60.0%	87.5%	78.9%	75.0%	57.1%
Tenure (in Months)					
Up to 9	94.4%	85.4%	88.6%	90.6%	65.0%
10 to 12	95.4%	94.6%	88.4%	91.8%	88.9%
13 to 15	92.6%	94.4%	90.9%	95.0%	86.8%
16 to 18	93.6%	95.3%	89.5%	96.2%	87.0%
19 to 21	92.6%	94.6%	86.6%	92.9%	91.1%
22 to 24	93.5%	93.7%	88.1%	93.0%	90.6%
25 to 27	93.8%	93.4%	88.0%	94.2%	94.8%
28 to 30	90.6%	93.8%	88.9%	92.6%	94.0%
31 to 33	96.2%	93.7%	86.9%	95.3%	93.1%
34 to 36	n/a	93.1%	88.9%	97.4%	94.2%
Over 36	n/a	92.2%	88.8%	92.5%	93.5%
Income⁽¹⁾					
Less than \$30,000	97.1%	95.6%	86.3%	92.6%	94.0%
\$30,000 to \$49,999	97.4%	94.6%	95.4%	95.7%	94.8%
\$50,000 to \$74,999	97.3%	95.7%	95.7%	95.3%	97.3%
\$75,000 to \$99,999	97.0%	93.4%	96.4%	98.6%	100.0%
\$100,000 or More	98.5%	97.6%	96.7%	93.8%	100.0%

⁽¹⁾Income data are available for a subset of employees in the full data set.

Savings Rate Behaviors. Plan default rates have a powerful effect on participants’ savings rates, with a substantial portion of participants saving at the default rate. Across the board, only a small percentage of automatically enrolled participants are saving at a rate that is less than the default rate. (See Figure 3.) Only in plans with a 5% default rate does the percentage of participants with savings rates lower than the default rate exceed 10%. Plans with a 6% initial default rate have the highest percentage of participants saving at this rate, most likely because 6% is also the maximum percentage of compensation matched by employers for most participants in this category. This same view by age,

tenure, and income shows that younger people are more likely to save at the default rate, and older people appear to be more likely to be saving at rates that exceed it. The same general trend is observed for tenure and income as well (savings rates are higher among longer-tenured and higher-income participants), with few aberrations.

FIGURE 3: Percentage of Participants Saving At, Above, and Below the Plan Default Rate



Note: Columns may not total 100% due to rounding.

Table 4 presents average and median savings rates by default rate and age, tenure, and income for automatic enrollment participants.

Compared to contribution rates in opt-in plans, the overall plan average and median savings rates are higher (4.4% versus 2.3% and 4.0% versus zero, respectively), but when only participants are considered (i.e., the zero savings rates of nonparticipants are excluded), the average and median contribution rates in automatic enrollment plans are lower (4.9% versus 7.5% and 4% versus 6%, respectively). Herein lies the beauty and the beast of automatic enrollment: It is effective at getting more people in the plan, but it leads to lower average savings rates for those participating. This explains why many believe that automatic enrollment (in the plan) must be accompanied by automatic enrollment in a program to increase participant savings rates over time.

TABLE 4: Average and (Median) Savings Rates of Participants in Automatic Enrollment Plans by Initial Default Savings Rates

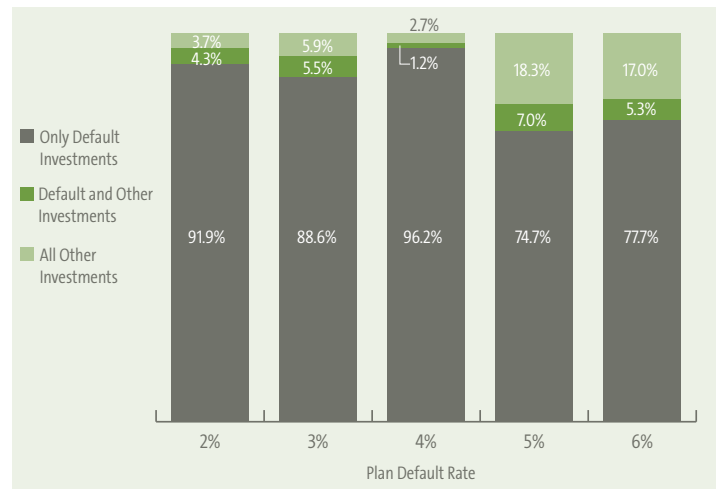
	2% Default	3% Default	4% Default	5% Default	6% Default
Age					
Under 25	2.9% (2.0%)	4.0% (4.0%)	5.0% (5.0%)	5.5% (5.0%)	6.2% (6.0%)
25 to 34	3.5% (2.0%)	4.6% (4.0%)	5.2% (5.0%)	6.4% (5.0%)	6.2% (6.0%)
35 to 44	4.4% (2.0%)	5.2% (4.0%)	5.3% (5.0%)	6.8% (5.0%)	6.5% (6.0%)
45 to 54	4.8% (2.0%)	6.0% (4.0%)	6.0% (5.0%)	6.8% (5.0%)	6.9% (6.0%)
55 to 64	5.3% (3.0%)	7.1% (4.0%)	6.2% (5.0%)	7.2% (5.0%)	7.6% (6.0%)
65 and Over	8.7% (9.0%)	7.7% (4.0%)	8.1% (5.0%)	7.7% (5.5%)	12.6% (8.5%)
Tenure (in Months)					
Up to 9	2.9% (2.0%)	4.1% (3.0%)	4.9% (5.0%)	5.6% (5.0%)	6.5% (6.0%)
10 to 12	3.5% (2.0%)	4.1% (3.0%)	5.2% (5.0%)	5.5% (5.0%)	6.3% (6.0%)
13 to 15	3.6% (2.0%)	4.9% (4.0%)	5.2% (5.0%)	5.9% (5.0%)	6.3% (6.0%)
16 to 18	3.7% (2.0%)	5.1% (4.0%)	5.6% (5.0%)	6.1% (5.0%)	6.6% (6.0%)
19 to 21	4.0% (2.0%)	5.2% (4.0%)	5.4% (5.0%)	6.4% (5.0%)	6.4% (6.0%)
22 to 24	4.2% (3.0%)	5.0% (4.0%)	5.5% (5.0%)	6.5% (5.0%)	6.4% (6.0%)
25 to 27	4.2% (3.0%)	5.5% (4.0%)	5.2% (5.0%)	6.8% (5.0%)	6.3% (6.0%)
28 to 30	4.6% (4.0%)	5.6% (4.0%)	5.3% (5.0%)	7.4% (6.0%)	6.6% (6.0%)
31 to 33	4.6% (4.0%)	5.6% (4.0%)	5.4% (5.0%)	7.2% (6.0%)	6.4% (6.0%)
34 to 36	n/a	5.6% (4.0%)	5.7% (5.0%)	7.5% (6.0%)	7.0% (6.0%)
Over 36	n/a	6.9% (5.0%)	5.4% (5.0%)	7.5% (5.0%)	6.7% (6.0%)
Income⁽¹⁾					
Less than \$30,000	3.3% (2.0%)	4.9% (4.0%)	5.2% (5.0%)	6.7% (5.0%)	6.4% (6.0%)
\$30,000 to \$49,999	4.2% (3.0%)	6.0% (4.0%)	5.4% (5.0%)	7.1% (5.0%)	6.9% (6.0%)
\$50,000 to \$74,999	5.9% (5.0%)	7.8% (6.0%)	6.0% (5.0%)	8.5% (6.0%)	8.1% (6.0%)
\$75,000 to \$99,999	6.9% (5.0%)	9.3% (7.0%)	7.8% (5.0%)	10.1% (10.0%)	9.8% (10.0%)
\$100,000 or More	7.4% (6.0%)	10.1% (10.0%)	8.5% (7.0%)	11.1% (11.0%)	9.7% (10.0%)

⁽¹⁾Income data are available for a subset of employees in the full data set.

Investment Decision Making. Overall, participants in plans with higher default rates are less likely to allocate their contributions exclusively to the plan's default investment, with the result appearing to be driven primarily by tenure. (The research finds that longer-tenured employees in plans with higher default savings rates are less likely to exclusively allocate their contributions to the plan's default investment.) (See Figure 4 and Table 5.)

The migration away from investment defaults may be surprising at first blush, especially since behaviorists have convincingly demonstrated that participants are plagued by inertia. However, it is reasonable that participants become increasingly engaged in how their money is invested as that amount grows and becomes more significant to them.

FIGURE 4: Investment Allocations of Automatically Enrolled Participants



Note: Columns may not total 100% due to rounding.

TABLE 5: Percentage of Participants Exclusively Allocating Future Contributions to Investment Default

	2% Default	3% Default	4% Default	5% Default	6% Default
Age					
Under 25	69.1%	54.8%	55.9%	66.7%	62.5%
25 to 34	70.4%	79.8%	81.3%	63.1%	71.7%
35 to 44	82.0%	76.3%	81.3%	63.7%	68.4%
45 to 54	82.2%	73.7%	77.8%	68.8%	67.7%
55 to 64	80.9%	68.4%	76.1%	69.2%	62.1%
65 and Over	100.0%	42.9%	56.7%	33.3%	25.0%
Tenure (in Months)					
Up to 9	95.4%	79.5%	98.0%	91.2%	90.9%
10 to 12	92.7%	91.4%	96.2%	93.0%	92.0%
13 to 15	92.0%	89.7%	95.8%	90.6%	92.5%
16 to 18	90.8%	88.9%	95.5%	78.8%	83.1%
19 to 21	89.5%	87.7%	95.5%	80.1%	89.6%
22 to 24	86.4%	89.2%	95.5%	81.4%	91.5%
25 to 27	88.2%	83.6%	96.1%	82.8%	91.4%
28 to 30	86.1%	84.5%	95.5%	73.7%	90.4%
31 to 33	86.9%	83.4%	95.5%	74.4%	81.1%
34 to 36	n/a	83.1%	96.4%	75.5%	47.9%
Over 36	n/a	69.5%	93.6%	38.5%	24.4%
Income⁽¹⁾					
Less than \$30,000	60.4%	69.9%	60.6%	52.2%	49.6%
\$30,000 to \$49,999	68.5%	67.6%	70.5%	42.6%	14.9%
\$50,000 to \$74,999	70.6%	57.9%	69.3%	41.5%	14.1% ⁽²⁾
\$75,000 to \$99,999	64.3%	55.2%	72.2%	41.4%	12.5% ⁽²⁾
\$100,000 or More	65.1%	46.6%	68.8%	26.7%	50.0% ⁽²⁾

Information is based on employee mix allocations.

⁽¹⁾Income data are available for a subset of employees in the full data set.

⁽²⁾Very small number of observations in these cells

SUMMARY AND IMPLICATIONS

Retirement plans with automatic features such as enrollment, contribution escalation, and investment are relatively new and will continue to evolve as empirical research illuminates how well these features are being utilized by both employers and employees. The goal of improving the retirement outcomes of American workers is a top priority at T. Rowe Price. In this research summary, the contribution of automatic plan design features toward that goal is explored. Implications for plan sponsors include the following:

1. Consider adopting automatic enrollment for existing employees. A majority of plan sponsors have adopted automatic enrollment for new hires only, suggesting that they may view current employees as having made an active decision to not participate in the plan. Past research shows that is simply not the case for all employees; behavior does not always follow intentions. Existing nonparticipating employees could potentially benefit from automatic enrollment as well.

2. Carefully consider the design of automatic service features. In this research, certain aspects of design structure may be partially driven by some of the same behavioral biases observed in participant decision making: status quo bias, anchoring on default savings rates in regulatory guidance not meant to be hard and fast rules, etc. These plan sponsor decision-making biases and heuristics have a significant impact on employees' retirement outcomes.

3. Evaluate the implications of higher initial default savings rates. Consider the research finding that people infer that default choices indicate what management thinks employees should do, and note that a significant portion of employees save exactly the initial default rate. The research also shows that automatic enrollment plans have higher participation rates than opt-in plans, even when the default savings rates are higher than 3%, signaling that plan sponsor fear of automatically enrolling participants at higher default rates may not be warranted. In many cases, a substantial percentage of employees save at rates that exceed their plan's default rate—evidence that many employees actually prefer higher savings rates.

4. Consider making automatic increase programs truly automatic. A majority of plan sponsors in this study have designed their automatic increase programs as an opt-in feature, requiring employees to make an active decision to benefit from the service. This fails to positively harness the power of inertia. Yet past research (as well as this research) has found that while automatic enrollment is highly effective at increasing savings rate, it also appears to result in lower savings rates in some segments of the workforce. Automatic enrollment in a program that increases savings rates over time helps to ameliorate this problem.

5. A “set it and forget it” approach to managing the default investments in automatic service plans may not be appropriate. In addition to changing their savings rates, participants tend to migrate away from default investments over time. Also, plan-wide circumstances impacting employees' paths to achieving their retirement goals change over time. Plan sponsors will want to continue to monitor participant behavior in these plans, making adjustments as necessary to help employees achieve their retirement goals.

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