

# Automatic Plan Features in Defined Contribution Plans: What's in it for Plan Sponsors?



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## A special thanks to the Save 10 initiative and their resource partners, including:

Millie Morales, Assurant, Inc.  
Eli Lehrer, R Street Institute  
Meenu Natarajan, Franklin Templeton Investments  
Steven Sauer, Tiller Corporation  
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## SUMMARY

*What's in it for Plan Sponsors?* seeks to offer a new perspective to plan sponsors who desire to implement or enhance automatic plan features in a defined contribution plan. Specifically, this paper highlights several potential benefits to the employer and profiles plan sponsors who have experienced these benefits. Additionally, DCIIA provides a roadmap for implementation that suggests strategies a plan sponsor may employ to implement automatic plan features over a multi-year period.

### **Selected Findings:**

- Some key benefits to the employer include improved employee satisfaction and engagement, as well as the ability to negotiate for lower fees, including reduced recordkeeping and asset management fees due to greater plan participation.
- Empowering employees to retire on their time schedule also facilitates workforce planning efforts.
- Sponsors reported that a benefits program which includes a generous stretch match can help attract and retain employees, which reduces rates of turnover and results in lower training costs.

**PART I:****BUILDING THE BUSINESS CASE**

There has been a great deal of research done on the correlation between the use of automatic plan features, such as automatic enrollment and automatic contribution escalation, and the resulting positive impact on defined contribution (DC) plan participation. Additionally, the financial services industry has worked to highlight these and similar findings for the DC community. To date, however, there has been little emphasis placed on examining the ways in which automatic plan features benefit plan sponsors.

In this paper, the Defined Contribution Institutional Investment Association (DCIIA) will focus on the potential benefits for employers of utilizing an outcome-oriented philosophy derived from the thoughtful use of a program containing automatic features. We have included commentary from several forward thinking DC plan sponsors who have realized the clear benefits from implementing such a program. This paper, which is segmented into two parts, has a dual objective:

1. To provide a framework outlining the benefits and considerations of automatic features
2. To showcase implementations of automatic features with positive outcomes

DCIIA believes that this framework can serve as a foundation for employer's internal discussions related to implementing or enhancing DC retirement plan benefits. While many plan sponsors are likely motivated to improve the retirement security of their workforce, providing a more comprehensive view on the benefits of implementing automatic plan features to the employer may serve to strengthen one's argument and therefore simplify the decision-making process.

To start, it is important to reinforce how automatic features, specifically automatic enrollment and automatic contribution escalation, can strengthen the retirement readiness of employees, which in turn, is crucial to understanding the potential benefits to the employer. Simply put, automatic features can help drive more successful retirement outcomes for participants, as outlined in the following table:

**Table 1**

Automatic Features	Direct Employee Benefits	
Help enroll employees into the DC Plan	Participants start saving earlier	→ <b>Increased Retirement Readiness</b>
Enroll employees into a diversified, professionally managed asset allocation strategy or managed account	Offers participants the benefits of diversification and professional portfolio construction	
Increase employee savings rates over time as a result of automatic contribution escalation	More funds available to finance retirement	

(DCIIA 2014)<sup>1</sup>

As shown above, the benefits to plan participants when automatic features are implemented can be easily seen and measured. Typical benefits include increased savings, better asset allocation, and better retirement preparedness. Because defining and measuring the benefits to the employer has been less clear-cut, however, we offer the following four-point framework with the expectation that it will enable employers to take a more holistic approach when making decisions about the implementation of automatic features.

**Defining a framework for automatic features decision-making**

In DCIIA's view, there are four important elements employers should consider:

1. Workforce Planning
2. Employee Satisfaction and Engagement
3. Financial Performance
4. Associated Expense

Increased retirement security through the implementation of automatic features has the potential to impact each of these dimensions.

**Workforce Planning**

An increasing number of workers are reaching the perceived "traditional retirement age," yet cannot afford to retire and must keep working to make ends meet.<sup>2</sup> This was particularly evident after the global financial crisis of

2008, which had a significant impact on those in the workforce closest to retirement. An October 2010 survey conducted by AARP found that one-third of older adults decided to delay retirement due to the economic effects of the recession.<sup>3</sup> While multiple factors may be contributing to workers deferring their retirement, employers can put themselves in a position to help their employees achieve their retirement goals in a timely fashion – and thereby facilitate workforce management.

Allowing for the planned retirement of employees can create advancement and career diversification opportunities for others, which can help a company retain and attract a talented workforce. Facilitating the timely retirement of employees not only allows for improved succession but also provides more flexibility to implement career development programs. Ultimately, by making it easier for those approaching retirement to retire according to plan, a company creates the opportunity for talent to be continuously deployed optimally across the organization. This is likely to result in a more efficient operation and superior execution, and may well also serve to increase satisfaction among high-value employees, which in turn may decrease the probability of employee turnover.<sup>4</sup> Delayed retirements may also reduce the employer's ability to hire new employees, reducing the flow of new ideas and talent into the organization.<sup>5</sup>

**“It was a matter of people being able to retire, and it was also about workforce planning. We asked, ‘What if people can’t retire when they are 65, or even 75? What does that look like for the company?’ We needed to think about the long term and the big picture.”**

— Sponsor of a \$20b+ 401(K) plan on how to view low savings and participation rates

## ■ USING AUTOMATIC FEATURES TO ATTRACT AND RETAIN MOTIVATED EMPLOYEES

**Steven Sauer, Chief Operating Officer,**  
Tiller Corporation

Tiller Corporation provides sand and gravel aggregates and hot mix asphalt to construction industries throughout the Minneapolis-St. Paul metro area.

### Plan characteristics:

- \$30 million in 401(k) assets
- 250 employees, with less than 2% annual turnover, annual tenure of 14 years and 100% plan participation
- Benefits include 100% coverage of the single/family medical premium, short-term/long-term disability, life, dental, Section 125 plan (Flexible Spending Account), vision and generous retirement savings matching

Tiller uses automatic enrollment in its 401(k) plan, at a default rate of 5%. “In our 401(k), we match 100% of the first 5% and have a 5% profit-sharing,” says Steven Sauer. “You put in 5% of your pay... we’ll put in 10%.”

Tiller Corporation uses a strong benefits program as a way to retain and attract employees. “We have found that the combination of retirement benefits and paying 100% family medical plan attracts the talent we are seeking,” Sauer notes. As a small company, Tiller views itself as paternalistic, and sees helping its employees save for retirement as an important objective. Tiller also engages a registered investment adviser to ensure that its investment menu includes the best options, and makes sure that the adviser is available to work with employees, to look at assets both in the firm’s 401(k) plan and outside it, so that employees can make the best decisions with the benefit of the context of all their assets and liabilities.

Tiller also regularly reviews its employees’ plan contributions. Sauer explains, “I pick up the phone and call employees who are contributing under 5% to let them know they are leaving money on the table [based on the matching program]. I haven’t had to make one of those calls during the last three years.”

Sauer shares his concluding thoughts: “Having an auto enroll program seems like a basic minimum these days. If you don’t offer it, I think you’re leaving yourself open to concerns you are not using best practices.”

There are a number of qualitative benefits for both the employer and employees when employees believe they are on a path to retirement readiness, and ultimately achieving their retirement goals. Both employer and employees benefit when there is an alignment of the employer's needs and priorities with those of its employees. Furthermore, productivity may improve when employees believe they will have retirement security. When, however, employees are unable to meet their retirement goals, they increasingly face work-limiting disabilities,<sup>6</sup> which can negatively affect productivity and employee satisfaction. This may manifest itself as absences from work, time spent performing personal tasks at work, or lower employee output due to distraction. It has been reported that 29% of DC participants miss work to deal with the emotional stress caused by their finances.<sup>7</sup> By helping address one aspect of employees' financial stress — their retirement — employers may see a reduction in the number of financially stressed employees, which may lead to improved productivity and lower healthcare costs.<sup>8</sup>

In sum, an organization's ability to attract, retain, and reward key talent may improve when it offers a DC plan designed around outcomes.

## EMPLOYEE SATISFACTION AND ENGAGEMENT

A robust auto features program can positively affect the employee-employer relationship over the long-term. Research shows that employers who promote an outcome-oriented view of their DC plan, instead of positioning the plan as a savings vehicle, can help employees begin to perceive the plan as the primary means by which the employer is facilitating the employee's income in retirement.<sup>9</sup> In essence, doing so implies a long-term relationship between the employer and employee, potentially leading to better outcomes for both parties. This theory is based on research conducted by Duke University behavioral economist Dan Ariely, who concluded that when employers take an outcome-oriented approach—thereby showing they are trying to maximize the probability of employees achieving their retirement

### ■ AUTO FEATURES FAVORED BY EMPLOYEES

#### Meenu Natarajan, Manager, Retirement Programs, Franklin Templeton Investments

Franklin Resources, Inc. is a global investment management organization operating as Franklin Templeton Investments.

#### Plan characteristics and other statistics

- Plan assets: \$1.25 billion
- Number of participants: 5,700
- Participation rate: 94%
- Average deferral rate: 11%
- Employer match of 75% up to IRS limits

Franklin Templeton Investments has been using automatic features in their plan since 2006. As early adopters, they chose to be conservative in their implementation, using a default rate of 3% of base pay for new employees only. At the same time, they also adopted automatic contribution escalation of 1% up to 15%, designed to take effect on the same day as fiscal year merit increases. "While we don't automatically 'sweep in' eligible employees who chose to opt out in a prior period, this could be a worthwhile consideration," says

Natarajan. "However, we recently re-evaluated this practice, and with a plan participation rate of 94% and average deferral rate of 11%, it does not seem necessary at this time."

Natarajan also views her firm's strong benefits offering, including the inclusion of auto features, as a useful tool when recruiting new employees. "In the recruiting process, being able to offer this program is a good selling point. Even part-time employees are eligible. Employees report satisfaction when they begin to receive their retirement plan statements after just a few months of employment." Natarajan also finds that their use of automatic features initiates positive savings behaviors by their employees. "We find that 80% of employees who have been defaulted in take active control of their retirement plan accounts after they have received their statement with those asset balances."

A few features companies can consider when evaluating auto-enrollment is to offer a higher default rate to encourage participants to take full advantage of their employer match and periodically sweeping existing [non-participating] employees into the plan to increase participation and engagement.

income goals--it changes the relationship between the employer and employee.<sup>10</sup> As Ariely's research suggests, this type of thinking may increase employee loyalty, and make employees want to extend themselves to the degree that corporations need today: to be more flexible, concerned, and willing to go out of their way to help out.<sup>11</sup>

GenXers (those born between 1965 and 1980<sup>12</sup>) in particular face a unique set of financial pressures: many provide support to adult children, and some also assist their parents financially. With the relatively flat compensation practices many companies maintain for the majority of their workers, these responsibilities can be challenging to address, even in an economic environment where inflation rates are low. To the extent that an employer can alleviate these employees' retirement savings pressures through such initiatives as automatic enrollment, worker productivity may increase.

As for Millennials (those born between 1981 and 1997<sup>13</sup>), a recent survey found that more Millennials than Baby Boomers (who were born between 1946 and 1964<sup>14</sup>) reported tracking their expenses carefully: 75% of the Millennials did, while only 64% of the Baby Boomers did. Furthermore, 67% of Millennials reported sticking to a budget, whereas only 55% of Baby Boomers did.<sup>15</sup> This supports the thesis that Millennial employees place value on financial security. Activities such as automatic enrollment are well-received by Millennials<sup>16</sup>, most likely because they demonstrate the employer's concern about these workers' financial well-being. Such auto features can improve Millennial employee engagement and satisfaction and potentially their workplace productivity and loyalty to their employer.

## FINANCIAL PERFORMANCE

In addition to enhanced workforce planning and higher employee satisfaction, there can be both short and long-term financial benefits and cost savings for an employer when it employees are able to retire as planned because they are financially able to do so comfortably.

- By implementing an auto features program, the DC plan is likely to attain greater assets, resulting in stronger negotiating power for plan-related fees.
- Implementation of automatic features can increase DC plan participation and/or contribution rates among non-highly compensated employees, potentially reducing the need for a non-discrimination testing safe harbor. DC plans that fail non-discrimination tests require additional and often complicated remedies to ensure compliance; this process may be burdensome and costly for the employer and an annoyance to employees who are restricted from maximizing their deferral amounts.
- Higher plan participation and/or contribution rates among non-highly compensated employees reduce the probability of the employer having to make unexpected qualified non-elective contributions (QNEC). When an employer must make QNECs, the amount must be large enough to allow the DC plan to satisfy the non-discrimination tests.

## ■ REALIZED COST SAVINGS

### Kelli B. Send, CFP®, M. Ed., SVP, Participant Services, Francis Investment Counsel

Francis Investment Counsel helps employers deploy and maintain retirement plans, and wanted to apply the same discipline and perspective to its own plans.

#### Plan characteristics:

- 17 participants with DC plan assets of \$5 million and a 93% participation rate and average deferral rate of 9.2%
- Benefits include traditional and Roth 401(k) plan auto enrollment with a 5% default deferral rate, an employer match of 50% up to 10%, and default automatic contribution escalation up to 10%
- Automatic contribution escalation is applied to all employees, even those not auto-enrolled

Send sees clear financial benefits from her firm's implementation of auto features: higher participation translates into greater economies of scale in the plan, which leads to lower asset management fees. Also, Send explains, "We have seen that a strong benefits program, especially our stretch match of 50% of employee contributions up to 10% of salary, helps us achieve a lower employee turnover rate. Lower turnover reduces the cost of employee training as well as the impact of lower productivity from newly hired employees. We measure the cost of employee turnover in terms of the length of time and resulting payroll costs incurred from the additional training time needed for the replacement team member. Although this obviously differs with each position, given the job functions within our company, we can easily estimate a minimum of three months of employee income--even longer for more technical positions." She notes that her viewpoints reflect "not just our plan, but our work as workplace retirement plan consultants who meet with thousands of plan participants annually."

Best practices: When meeting directly with participants, Send prepares an individualized message based on the average salary and savings of meeting attendees, and translates the deferral and match percentages into dollar terms. "Do your research when meeting with plan participants. Speak to them in terms of dollars saved –people get it." She also encourages her peers, "Be brave – auto enroll and escalate at the right level – people can always say 'no, thank you' and opt out."

When measuring financial performance, it should be noted that many plan features are designed to work over longer periods of time. As such, measuring the success or failure of the program should consist of both short- and long-term metrics.

If employees were automatically enrolled in a defined benefit (DB) plan, automatically enrolling them into a DC option offers a good strategy for the plan sponsor seeking to maintain the broadest possible coverage of participants; this may be particularly helpful for firms that are transitioning from DB to DC plans, as it may ensure a smooth and transparent transition, thereby mitigating employee concerns, resulting in greater satisfaction among employees.

It is evident that the vast majority of employees depend on employer benefits to provide financial security not only during their working years, but also throughout retirement. According to the 2014 Guardian Workplace Benefits Study, 74% of middle-income employees derived the majority of their financial security from the benefits they accumulated while in the workplace. Additionally, four out of five employees said that benefits are the deciding factor for them when deciding whether to take a new job or stay with their current employer.<sup>17</sup> Despite this reliance on employer benefits, however, employees find retirement decisions, such as determining appropriate savings rates and investment allocations, to be challenging. Employers have an opportunity to assist their employees with these decisions through the implementation of programmed features like automatic enrollment and automatic contribution escalation.

## ■ HELPING EMPLOYEES SAVE FOR A COMFORTABLE RETIREMENT

### Eli Lehrer, President, R Street Institute

The R Street Institute is a non-profit, non-partisan, public policy research organization (“think tank”).

#### Plan characteristics:

- DC plan funded in 2012 and added 3% employer contribution in 2014; <\$1 mm in plan assets
- 27 full-time employees, with 100% participation in the firm's 401(k) plan, with vesting on the first day of the next month of employment
- Benefits also include 100% family health care coverage, employer-paid full-life, disability, 1/3 premium for family dental, gym reimbursement, “tele-med” benefit (service providing telephone access to a medical professional)
- Average wages of \$100,000

*“We provide a 3% [non-discretionary] automatic contribution, regardless of whether employees contribute to the plan,” says Eli Lehrer. “We did this partly ... to make sure that everyone had some retirement savings. We absorb all plan fees as well and the overall [plan] costs are pretty small.” Lehrer does not use automatic plan features, noting that he “doesn’t really see a need. Participation was roughly 70 percent already and some of those not participating are either over 65 or have other mechanisms for savings.”*

Lehrer explains that R Street seeks to “pay the best wages and offer the best benefits compared to their peers.” Lehrer adds, “We were originally concerned that some [employees] weren’t saving at all. Given that we have done some work in the area of retirement income policy and the 2006 retirement savings reform bill [Pension Protection Act of 2006], we thought this was an important issue.”

While Lehrer doesn’t see the use of automation or a generous employer contribution as a driver of improved employee productivity, he agrees that, as part of a very competitive benefits package, it allows R Street to compete for talent, and “attract more productive employees in the door”.

Lehrer concludes, “We see our 3% contribution as an integrated part of offering the best benefits package across our peer group. Doing immediate vesting on day one gives everybody something for retirement savings but does not break the bank.”

## ASSOCIATED EXPENSE

While this paper focuses on enumerating the benefits for employers of auto features programs, we acknowledge that there are implementation costs associated with them. There are many plan feature considerations, which can be modeled to arrive at an optimal plan structure for each organization. Additionally, every employer should consider the DC plan’s goal and its relation to the employee total benefit package. The cost of deferred consumption via automatic enrollment and escalation should be done in a holistic manner, in the context of each employer’s benefits package and workforce management goals.

### Employer Matching Costs

- Employer matching costs will be influenced by different factors; these may include current plan participation, and employee working status, income levels, and turnover.
- While higher matching costs can certainly be challenging for a company, there are a number of creative ways to overcome this obstacle. Costs will be impacted by the types of automatic features being considered. To help identify the range of potential company costs, plan sponsors can model different automatic feature implementation scenarios. These scenarios often include:
  - Auto enrollment at varying contribution rates
  - “Stretching” the company match formula
  - Phased implementation schedules
  - Addition of automatic contribution escalation

Kelli Send of Francis Investment Counsel sees her firm’s stretch match of 50 cents on the dollar up to 10% to be a critical component of its benefits program. She notes that when the company was designing its plan in 2004, she took a hard look at her budget. Send considered what the firm could afford and what it could do to make the employer match meaningful. “We saw that [deferral] rates were stalled at 4%. We really wanted to encourage our employees to get to 10%; our strategy was to set the bar high to incent employees to get the full match. This approach has been effective at increasing the deferral rates within our population.”



### Addition of Automatic Contribution Escalation

Contribution escalation and default deferral rates should generally be considered in conjunction when designing an optimal design for each particular plan. For example, one large plan sponsor with DC plan assets in excess of \$20 billion was interested in implementing auto enrollment at a robust rate but was concerned about the cost of doing so. As a result, they initially considered starting participants' contributions at a fairly low rate within the plan, and auto escalating them to the rate at which they would maximize the match. Ultimately, however, they found that the cost difference with this approach, versus simply starting participants at an initial rate to maximize the match, wasn't that material, and therefore this plan sponsor recommended and implemented an 8% initial default deferral rate within the plan. Although some would suggest auto escalation could still play a role in this design, the plan sponsor was comfortable that the total annual contribution was sufficient to generate an appropriate level of replacement income in retirement.

In a similar situation, Assurant, Inc., a global provider of risk management solutions, reviewed multiple scenarios, including analyzing costs at various match levels, with and without the automatic contribution escalation feature, and with and without a sweep of existing employees who were participating with contributions under 3% of pay at the time of implementation. After projecting costs over time, with assumed compensation increases, across these various scenarios, this sponsor ultimately determined that its optimal path was to combine new-hire automatic enrollment with a sweep of existing employees. While many companies have elected to first roll out auto enrollment to new hires, and then sweep in existing employees at a later date, Assurant elected to sweep all active employees who were not participating, or participating at less than 3%. Though this was a cost to the company, it aligned with its goal of increasing retirement adequacy for all of its employees.

### Recordkeeping, Participant Communications, and Education Costs

**Participant Communications:** In-depth participant communications often accompany the rollout of new automatic features, in addition to any required participant notices. "Once you have achieved your participation and deferral rate goals, you can focus on targeted communications," says Meenu Natarajan of Franklin Templeton Investments. "You can focus less on the enrollment basics — or '401(k) 101,' — and bring your education program to the next level".

In sum:

- There may be additional payroll or recordkeeping costs associated with implementing automatic features.
- It is important to reach out to the appropriate plan vendors to identify expected costs.
- Some of these costs may be allocated to the plan itself, rather than to the employer.

### Time and Resources

Educating staff, committee members, human resources, and senior management may require additional time commitments and meetings.

While every employer is different, and the benefits and considerations outlined above will vary in degree and type for each company, the trend toward adopting an outcome oriented-approach and implementing automatic features is growing. According to the 2014 DCIIA Plan Sponsor Survey, the top reason plan sponsors elected to implement automatic contribution escalation was to help participants reach their retirement income goals, and the most important objective of plans sponsors was to increase participant savings rates.

It is important to keep in mind the potential costs to the company if the employees are not on an appropriate path to retirement readiness. While this figure can be more challenging to quantify, employers can identify the potential for these costs through the process of managing their workforce.

In conclusion, one plan sponsor makes the following recommendations:

- Do your homework, and leverage data to make your case to management.
- Think about cost, not just in terms of the company match expenditures, but also in terms of potential workplace planning issues.
- Understand the power of inertia, not just for new hires, but also for existing workers.
- Pair automatic enrollment with a robust communication campaign.

## INTERESTED IN LEARNING MORE ABOUT AUTOMATIC FEATURES

For more information on automatic features, please visit our website, [www.dciia.org](http://www.dciia.org), to download or print the following white papers:

**DCIIA's Best Practices When Implementing Auto Features in DC Plans** – Describes how to implement automatic features in DC plans in more robust ways to help achieve better outcomes for plan participants.

**DCIIA Plan Sponsor Survey 2014: Focus on Automatic Plan Features** – A 2014 study surveying over 450 DC plan sponsors on their use of automatic plan features including automatic enrollment, automatic contribution escalation, and re-enrollment since 2010.

**DCIIA plan sponsor survey on automatic plan features: Responses to selected webcast Q&A** – Provides clarification on common questions that plan sponsors and their advisors may have when putting automatic features into practice.

**Implementing Auto Features in Defined Contribution Plans: Answers to Frequently Asked Questions (FAQs)** – A 2014 FAQs document that offers responses to specific questions regarding implementation.

**Plan Sponsor Survey 2012: Action Needed to Drive Better Participant Outcomes** – a 2012 publication summarizing the findings from DCIIA's by-annual Plan Sponsor Survey on automatic plan features.

## PART II:

### ROAD MAP TO AUTO FEATURES IMPLEMENTATION: MAKING PLAN SPONSORS' GOOD INTENTIONS PAY OFF

Too often, auto features are implemented suboptimally in DC plans. Surveys show that plan sponsors commonly implement automatic enrollment with very low default contribution rates (e.g., 3% or 4%), and that they often focus only on new hires, excluding existing nonparticipating employees from auto enrollment. There are a number of reasons that contribute to suboptimal implementation, but the overarching one is that the plan sponsor has not established an outcomes-oriented goal for the DC plan, and as a result often does not have a road map for, or path to, a more robust approach. Additionally, even in instances where a DC plan has been designed to replace a targeted pre-retirement income replacement level, very few employers today set or recommend a savings rate based on an analysis of the plan's goal. One possible action that a plan sponsor could take would (should) be to ensure that participants, at least in aggregate, are saving the appropriate amount to accomplish that retirement income replacement rate.

#### A typical scenario:

*A Hypothetical, Well-Intentioned DC Plan Sponsor* manages a 401(k) plan with nearly 10,000 eligible employees and 4,500 participants with a balance in the 401(k) plan (45% participation). Workers tend to be lower paid, with high turnover, given that the company involved is a retailer. The plan matches 50 cents on the dollar up to 6% of pay—and the company has little capacity to increase company contributions.

Plan Sponsor decides to increase plan participation by using automatic enrollment, noting that the most common implementation across plans of similar size is to auto enroll new hires only, with a default contribution rate of 3% of pay.

This makes sense to Plan Sponsor, who believes that auto enrolling only new hires at that level keeps the cost of matching contribution reasonable; after all, she has heard that participation levels tend to soar under automatic enrollment to 80% or even 90% of eligible workers. The 3% default also appeals to Plan Sponsor because she believes that people will be less likely to opt out at that modest level, and that they will also be less likely to call the Benefits Center—or worse, her office—complaining about being enrolled in the plan. Plan Sponsor therefore proceeds to auto enroll new hires at a 3% default.

Fast forward one year: participation has indeed soared among new hires to more than 90% of eligible workers—but most of the auto enrolled workers have left their contribution levels at the initial default level of 3% of pay, which is not good news. Historically, very few plan participants had enrolled in the plan at such low contribution levels. In fact, prior to automatic enrollment, participants tended to contribute 7% or 8% of pay. Plan Sponsor does wonder how employees contributing just 3% of pay will ever be able to retire. And what might all these low contributors do to non-discrimination testing results?

Plan Sponsor also realizes that she has unintentionally created a workforce of “Haves” and “Have Nots.” The “Haves” are the new hires who are disproportionately saving in the DC plan, as new hires under auto enrollment typically opt-out at rates of 10% or less.<sup>18</sup> The “Have Nots” are those who happened to be hired prior to the implementation of automatic enrollment, and who are disproportionately not saving in the DC plan.

Plan Sponsor looks into the matter and elects to increase the default contribution rate to 4% of pay and implement automatic contribution escalation with a cap at 6% of pay—which is the threshold of the company matching contribution. She also models what would be involved in auto enrolling existing hires, but quickly realizes the cost would be too high for management to consider, so she reluctantly decides to proceed with new hire only automatic enrollment.

The new implementation goes well, and the opt-out rates are no higher under the 4% new hire automatic enrollment implementation than they were under the 3% implementation. Further, after several years, savings rates begin to rise nicely under automatic contribution escalation (which also has low opt-out rates). Five years into the program, Plan Sponsor again analyzes her results. She notes that under the new implementation, a lot of workers seem to be “stuck” at a contribution level of 6% of pay. She knows that the rule of thumb for saving adequately for retirement is to contribute 10-15% of pay throughout one’s career. Yet, even with a company match of 3%, many of the participants in the DC plan are not saving enough. What’s more, there is a large segment of workers that is getting close to retirement but has no savings in the plan, because they started working at the company before the implementation of auto enrollment, and were therefore never auto-enrolled.

With regard to these under-saving or non-saving workers, Plan Sponsor feels she is back at square one. Should she go to management and seek to obtain the costs of auto

enrolling existing hires? Should she also increase the cap on automatic contribution escalation—and if so, to what level? She wonders what other plan sponsors are doing. After all, she’d originally picked the implementation she’d used by looking at prevalence data. Her desire was to have a plan that fit the specific demographics, habits and patterns applicable to her company.

At this juncture, we will leave the Hypothetical, Well-Intentioned DC Plan Sponsor for a moment in order to dispel some myths about automatic enrollment implementation:

- **A 3% default is common, so it must be good.**

**False.** Just because something is prevalent, doesn’t mean that it is effective. The default contribution rate of 3% under automatic enrollment gained popularity early on, which has made it a prevalent, but not a particularly robust, way of implementing automatic enrollment.

- **A low contribution default will help minimize opt-outs.**

**False.** Research has shown that opt-out rates are no higher when the default contribution rate is 4% or 6% of pay<sup>19</sup>.

- **Using a higher default contribution rate and/or auto enrolling non-participating existing hires will be too expensive.**

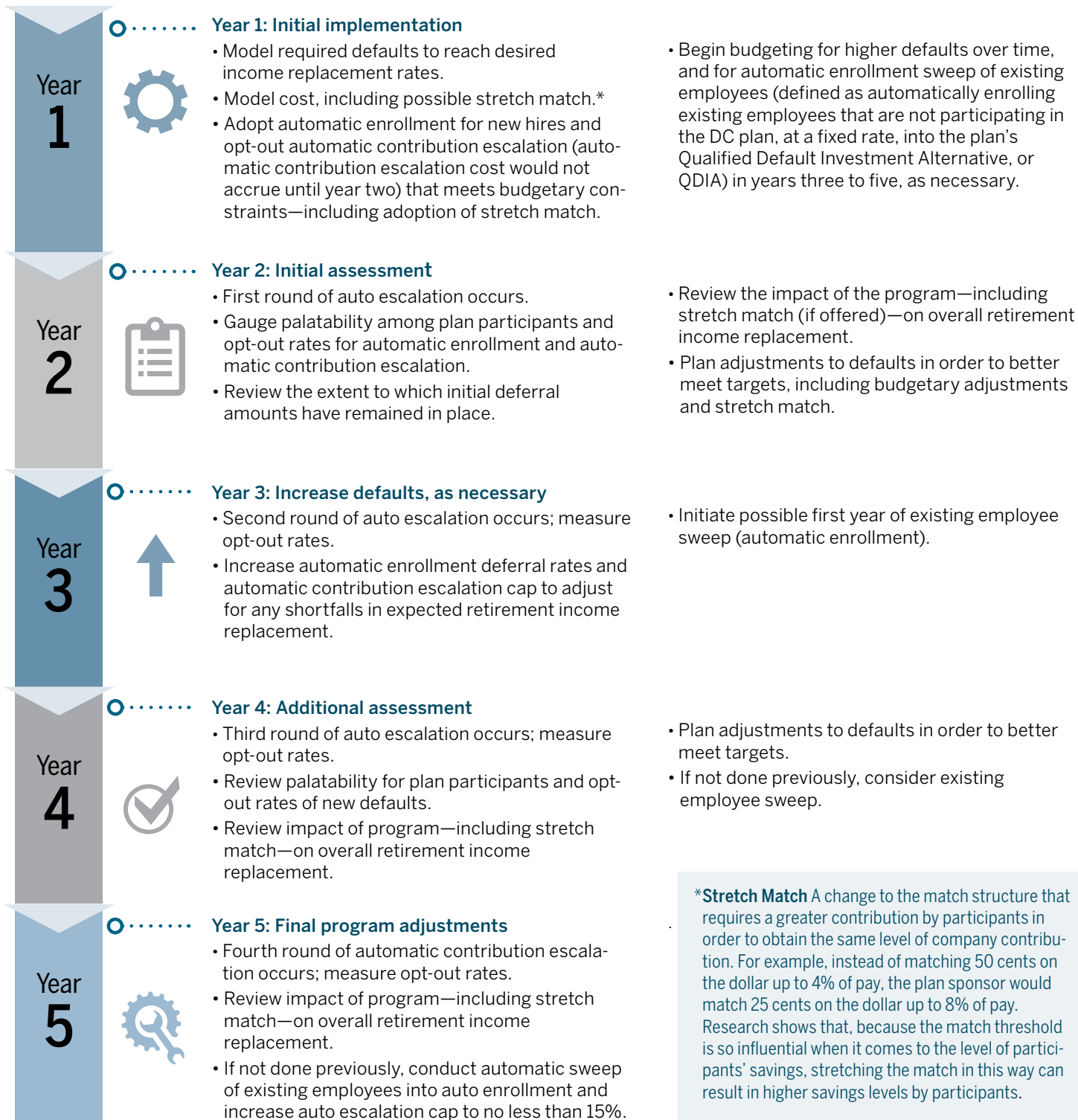
**Not necessarily.** Match formulas can be altered to incorporate changes in contribution patterns. Indeed, research shows that because automatic enrollment is such a powerful force, opt-out rates are not likely to materially change when a matching formula is altered. As such, the implementation of automatic features can be an opportunity for plan sponsors to reexamine the role of the company’s matching contribution in the plan. Can it be configured differently in order to accommodate the more aggressive defaults? If so, what would the impact be?

- **Participants will object to higher default contribution rates.**

**Probably not.** It is important for plan sponsors to remember that workers always have the opportunity to opt out of these programs, or to reduce the aggressive defaults<sup>20</sup>.

## Road Map to a Better Implementation Approach

In an ideal world, auto enrollment would be implemented for new hires and existing non-participating employees on day one, with opt-out automatic contribution escalation and a default deferral rate high enough to result in the majority of participants (80%) being able to replace most of their pay in retirement (80%) through a combination of the DC plan, Social Security, and other personal savings. Research, such as that conducted by the Employee Benefit Research Institute (EBRI) and DCIIA, and cited in their joint papers, “The Impact of Auto-enrollment and Automatic Contribution Escalation on Retirement Income Adequacy” and “Raising the Bar: Pumping Up Retirement Savings,” shows that achieving this goal requires an initial default deferral under automatic enrollment of 6% of pay, with annual increases of 1% up to 15% of pay. If this is not possible to do on day one because of cost or other considerations, a possible road map to follow is:



**\*Stretch Match** A change to the match structure that requires a greater contribution by participants in order to obtain the same level of company contribution. For example, instead of matching 50 cents on the dollar up to 4% of pay, the plan sponsor would match 25 cents on the dollar up to 8% of pay. Research shows that, because the match threshold is so influential when it comes to the level of participants' savings, stretching the match in this way can result in higher savings levels by participants.

## REVISITING HYPOTHETICAL, WELL-INTENTIONED DC PLAN SPONSOR

Now let's see how auto features implementation could have played out for Well-Intentioned Plan Sponsor if she had a specific implementation plan, or road map, like the one outlined above.

Plan Sponsor may, for instance, determine that, in order for employees to replace at least 80% of their income when they retire, they must save 9% of pay over the course of their career. She then calculates that if new hires were to be auto enrolled at 6% of pay, with contributions auto escalated 1% of pay annually to 9% of pay, the cost of the match would increase just over 10% annually over the next five years. She ultimately decides that this would be acceptable to management, which is eager to attract and retain employees through strong benefits. Unfortunately, though, the proposed program change still does not accommodate existing employees who had not enrolled either at, or subsequent to, their hiring.

She does not see how she can also auto enroll existing non-participating employees with the current match structure, given cost considerations. So she works with her plan's recordkeeper to model a stretch match that would contain both costs and allow for the inclusion of existing workers in automatic enrollment. It takes a few iterations, but the recordkeeper is able to demonstrate that a match of 33 cents on the dollar up to 9% might be palatable from a cost perspective. Plan Sponsor believes she can sell the entire proposal—auto features and stretch match—to management, provided that the automatic enrollment sweep does not occur until year three. That would give management time to budget in the new cost. Plan Sponsor's presentation to management also points out that the cost changes will be:

- Reasonably predictable
- Incremental, over a five-year period of time
- Part of a broader benefits restructuring process, with changes to the DB plan, if appropriate
- Necessary, for a range of reasons that have bottom-line implications such as worker satisfaction, potential higher worker productivity, and workforce management considerations

When management counters that the new match structure seems less competitive, Plan Sponsor notes that the plan still promises the same 3% company contribution to those who fully participate. She maintains that it can still be a competitive structure.

The program is approved, and Plan Sponsor begins to track the plan's results.

- In year one, new hire opt-outs are 15%, and plan participation increases from 49.5% to 52%. As expected, though, with all the new plan entrants, the average contribution rate falls slightly from 8% to 7.7%.
- In year two, participation increases to 55%. Auto escalation takes effect, and contribution rates rise to an average 8%.
- In year 3, the existing employee auto enrollment sweep takes place, and overall plan participation leaps to 80%.
- By year five, participation has increased to 85%, and the average contribution rate is 9%. The costs associated with these changes come in as expected.

Ultimately, Plan Sponsor is delighted to see that both the participation and savings levels in the plan are now more robust. She has noticed a boost in employee morale, especially among older workers who now feel better equipped to retire when the time comes. There has been little "noise" when it comes to either auto enrollment or the annual automatic contribution escalation. Indeed, the plan sponsor's greatest concern is that some workers may not even be aware they are saving in the plan. As a result, she begins a communication campaign to explain the benefits of being in the DC plan—and hopefully increase worker satisfaction as a result. While it is true that DC plan costs have risen, the employer increase was well-understood in advance, and occurred gradually over time.

## ENDNOTES

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## ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of American workers. Toward this end, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA members include investment managers, consultants, law firms, record keepers, insurance companies, plan sponsors and others committed to the best interests of plan participants.

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