Should You Auto-Enroll Employees in your 401(k) Plan?

According to the Plan Sponsor Council of America (PSCA), more than half of all 401(k) plans enroll employees automatically. Yet just 19% of plans with fewer than 50 participants have this feature.[1] Might automatic enrollment be right for your organization?

What is automatic enrollment?

Simply put, automatic enrollment means that employees are automatically enrolled in the retirement plan upon hire (or at some other specified date) unless they specifically opt out. A designated percentage is then deducted from employees' paychecks each pay period and invested in a default investment on their behalf. According to the PSCA, the most common default contribution percentage is 3% (51% of plans), and the most common default investment is a target-date fund (75% of plans). Target-date funds are mutual funds that invest based on a targeted retirement year (e.g., 2035). As the date approaches, the asset mix in the fund typically becomes more conservative.[2]

What are the advantages to automatic enrollment?

The IRS reports that about 30% of workers who are eligible to participate in a retirement plan at work fail to do so. According to behavioral economist Richard Thaler, one of the primary reasons people don't participate is inertia — they simply don't get around to signing up. In Thaler's 2008 book *Nudge,* he describes the experience of one company that adopted automatic enrollment and saw its plan participation rate skyrocket from 65% to 98%. In the years since, similar results have been widely reported.

The benefits of automatic enrollment may have an even greater impact on those who need it most. One study found that more than 80% of college graduates with access to a 401(k) plan actually enroll, compared with only 69% of high school graduates and 61% of those without a high school diploma.[3]

"The lesson from behavioral economics is that people only save if it's automatic," Thaler said in a 2015 interview.[4]

Another potential benefit: Automatic enrollment can help employers pass their nondiscrimination tests (testing designed to ensure that a company's retirement plan does not favor key employees over the rank and file).

Are there any drawbacks?

Costs were cited as a concern by 18% of companies that do not offer automatic enrollment, according to the PSCA survey. Consider that your obligation to make matching contributions, if offered, would rise with participation rates. In addition, average deferral rates may remain low, as inertia-prone participants may not change from the default rate.

For more information, consult the IRS and Department of Labor publication *Automatic*

Enrollment 401(k) Plans for Small Businesses.

[1]58th Annual Survey of Profit Sharing and 401(k) Plans, PSCA, 2015

[2] The target date is the approximate date when an investor plans to withdraw the money. The principal value of a target-date fund is not guaranteed at any time, including the target date, nor is there a guarantee that a target-date fund will meet its stated objectives. The fund's return and principal value fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. No two funds with the same target date are alike. *For more information, investors should request a prospectus, which contains details about holdings, fees, and expenses, and should read the prospectus carefully before investing or sending money.*

[3]"The 401(k) Is Wreaking Havoc on Retirement," *Employee Benefit News,* August 24, 2016

[4]"Behavioral Economist Richard Thaler on the Key to Retirement Savings," *The Wall Street Journal,* November 29, 2015