WILLIS INVESTMENT COUNSEL
Principled Investing

August 2019

Retirement Plan Design:
Automatic Enrollment

As an employer offering a retirement plan, helping to ensure employees are making decisions today that will have a positive impact on their retirement outlook in 10, 20, and 30 years is a high priority. Unfortunately, saving for retirement can be challenging for employees, and in many instances, it is delayed. There are many reasons why employees are hesitant to save for retirement:

- It is difficult to defer gratification – people would rather spend the money they have “today”.
- Investing can be intimidating – deciding how to invest can cause decision paralysis, particularly for those with little to no experience in making investment decisions.
- There are other expenditures that consume a large portion of employees’ paychecks – student debt, mortgages, utility bills, children… all of these expenses take precedence.
- They just never get around to it – when employees enter the workforce, retirement is typically 40+ years away. They may feel there is plenty of time to save, but ultimately they never actually get around to saving, or it is too late to effectively save enough when they do.

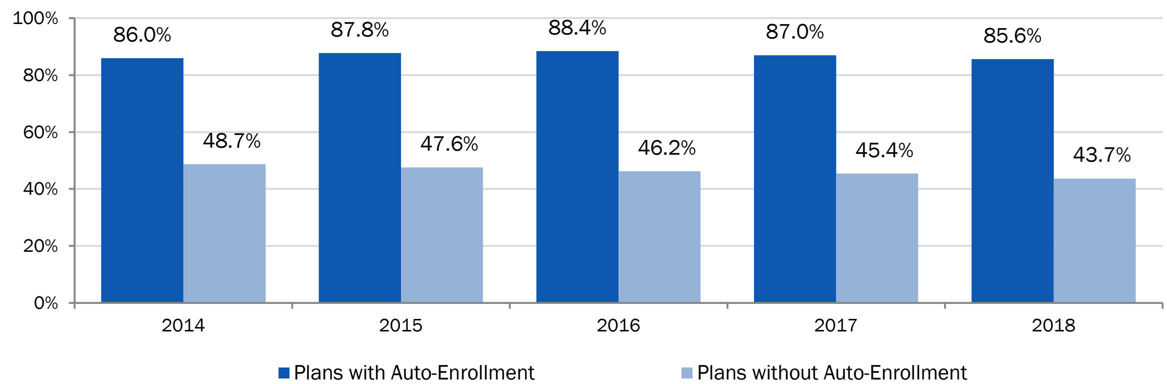
Automatic enrollment was designed to help employees save early and often, taking the decision-making out of the equation. Traditionally, employees had to decide if they wanted to *start saving* for retirement. For those retirement plans that use automatic enrollment, they have to make the decision to *stop saving*. In both instances, the employee does not have to do anything. However, the results of indecision, or lack of action, are vastly different. Inertia is a powerful force and can be equally positive or negative. Automatic enrollment ensures that “doing nothing” will not harm their retirement outlook, where they otherwise may be neglecting that important aspect of their overall financial wellbeing.

The adoption of automatic enrollment has continued to increase since 2004[1]. According to Vanguard’s *How America Saves 2019,* 48% of 401(k) plans on their platform use automatic enrollment. Among those plans, two-thirds automatically enroll participants, automatically increase their savings rate each year, <u>and</u> automatically invest employee balances in a default fund.[2] Not only are employers taking the decision-making out of whether or not to save for retirement, but they are also making the logistics of saving a no-brainer. Additionally, the most confusing aspect of retirement savings – deciding how much is saved and how that money is invested – is done automatically.

[1] According to Vanguard’s *How America Saves 2019*, only 2% of retirement plans were using automatic enrollment in 2004.
[2] Vanguard, *How America Saves 2019*

The continued growth of automatic enrollment has significantly impacted employees' retirement savings. According to T. Rowe Price, the average participation rate was almost 96% greater in automatic-enrollment plans on their platform in 2018[3]. Said another way, in plans that offered automatic enrollment, approximately 86 out of 100 employees participated, versus only 44 out of 100 for plans without that feature.

Participation Rates Among Employees



Source: T. Rowe Price, *Reference Point 2019*

Automatic enrollment plans require that employers set a deferral rate, which is the percentage of an employee's paycheck that is put into the 401(k) plan each year. Vanguard's *How America Saves 2019* estimates an average deferral rate of 6.7% for automatic enrollment plans in 2018. This figure is slightly below the deferral rate for voluntary enrollment plans of 7.1%, which could be attributed to the tendency for those participants to be more engaged in their retirement planning and decision-making. For plans that also offer an employer match[4], the average deferral rate coupled with the match helps employees achieve their annual savings goals.[5]

While automatic enrollment may not make sense for every 401(k) plan, it has significant benefits to employees and their retirement outlook, particularly for those companies that have relatively low employee turnover[6]. By taking the decision-making of saving out of the equation, employers are able to help their employees ensure financial well-being in retirement.

For more commentary, we invite you to visit our website at www.wicinvest.com.

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[3] Source: T. Rowe Price, *Reference Point 2019*

[4] An employer match is a set percentage that employers will contribute to the employee's 401(k) portfolio. For example, some plans match dollar-for-dollar up to a certain percentage of the employee's salary, and others match a certain percentage of the employee's contributions up to a limit. For example, the plan may say that it matches "50% of employee contributions of up to 3% of salary." It's also important to note that there are maximum annual contribution amounts, which could limit the amount of employee contribution or employer matching contributions.

[5] Many experts suggest employees save 10-15% of their gross salary each year.

[6] For plans that have high employee turnover, automatic enrollment may not make sense as it could result in a high number of inactive accounts with low balances.