

POSITIONING YOUR EMPLOYEES FOR FINANCIAL SUCCESS: IS NOW THE TIME TO INCREASE DEFAULT DEFERRAL RATES?



Have you considered increasing your retirement savings plan's default deferral rate, but are hesitant to act in fear of employee disengagement in the plan? Research suggests there's likely little need for concern in making the change.

Let's discuss auto-enrollment

So, how common is it to find auto-enrollment as a feature within a plan? Based on the latest survey from the Plan Sponsor Council of America (PSCA) which contained data points from 600 plans, including standalone 401(k) plans and 401(k) plans with a profit-sharing component, 60% of plans had an automatic enrollment feature. This is up nearly 20% from 2010 and on average resulted in a 6% increase in employee participation in the plan. Of these plans, just 35% of plans with fewer than 50 participants featured auto-enrollment as compared to 69% of plans with 200 to 999 participants.

Popularity of an annual auto-escalation feature is also gaining traction as the survey noted 75% of plans in 2019 contained such a feature compared to only 56% in 2010. This is coupled with a 36% increase in the number of plans with a 4% or greater auto-enrollment feature over the same time period.

Are participants electing to opt out?

According to a recent analysis performed by John Hancock that analyzed over one million participants across 1,100 plans, participants largely appeared to be unfazed by increases in higher default deferral rates. The study noted that the highest opt-out rates were seen in plans carrying a default deferral rate of 3%. The opt-out rate declined as the default deferral rates increased to 6% and even 8% signaling participants apparent comfort with such changes. It is worth noting, however, that this analysis did not evaluate the potential impact of plan demographics (i.e., employees who earn and can afford more will likely be more comfortable with higher default deferral rates).

What are the potential drawbacks?

An analysis performed by T. Rowe Price drew a similar conclusion to the John Hancock study but noted a couple cautionary tales. The study ultimately concluded that higher default contribution rates won't discourage employee participation. However, it did note that a slight decline in participation rates may occur at a rate similar to the increase in the default deferral rate (i.e., increasing the default deferral rate 1% could result in a 1% decrease in participating employees). Despite this possibility, it's important to consider the big picture and realize that a large portion of participants will benefit in the long run compared to those few who choose to opt out.

The second cautionary tale is that participants could wrongly assume that the fixed deferral rate is specifically designed for them and sufficient for their future needs. In reality, there's no one-size-fits-all default deferral rate due to many varying factors and individualized retirement goals of participants. For employees to receive the greatest benefit in retirement, auto-enrollment should accompany an annual auto-escalation feature. Furthermore, providing resources to educate employees on these matters is instrumental in gearing them up for continued success.

Key takeaway: Opt for your employees' future success

If you've hesitated to act in raising your plan's default deferral rate, contact your plan provider to discuss arranging an increase. This simple action could help aid your employees in achieving their financial goals for retirement.