

*Inadequate saving for retirement is fueling insecurity in our country. A dramatic decline in employer-paid, defined benefit pension plans has contributed to that insecurity. Human resources and benefits professionals, as well as business and industry leaders who do not provide employer-paid plans, can help change this situation by instituting automatic 401(k) plans that include features such as automatic escalation of savings amounts and automatic rebalancing of funds to help employees achieve a secure financial future.*

# How to Implement an Automatic 401(k) Plan and Increase Employee Contributions

by **Thomas C. Nelson**

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**F**or many people, confusion leads to inaction and this maxim is particularly true for financial planning. Many people are overwhelmed by the number of choices and feel ill-equipped to plan for events they view as too far into the future. They delay and keep delaying. The *2008 Retirement Confidence Survey* from the Employee Benefits Research Institute (EBRI) showed that less than half (47%) of working Americans at least 25 years old have cal-

culated their actual retirement needs and 48% have saved less than \$25,000. (See Figure 1.)

This often means they don't start saving for retirement until it's nearly impossible to catch up. Automatic 401(k) plans can make the most significant difference because they are, in a word, simple. Instead of asking employees to opt in to a 401(k) plan and make investment decisions they feel unqualified to make, employees are automatically enrolled in a

specific investment fund at a predetermined savings rate. There are no steps to take and no decisions to be made, although employees have the option of changing investment parameters or opting out.

Automating an employer's 401(k) plan has become easier, thanks to the Pension Protection Act of 2006 and the Department of Labor's 2007 rules on these investments. These actions, as well as the growing evidence of the benefits of auto-

matic 401(k) plans for both employees and employers, have sent the trend toward adoption of automatic 401(k) plans on a steep climb. A 2007 Wells Fargo study showed, for instance, that 66% of companies are or are planning to offer automatic 401(k) plans to new hires, up from 36% in 2006.<sup>1</sup>

Advantages of automatic 401(k) plans include: Participation rates typically soar to between 85% and 95%; employee satisfaction increases; and it is far easier for employers to pass nondiscrimination testing.<sup>2</sup> AARP's support of these plans prompted the organization to join forces with the Financial Industry Regulatory Authority (FINRA) and the Retirement Security Project (RSP) to form the Retirement Made Simpler (RMS) coalition, an unbiased resource offering original research and step-by-step guidance to make it easier for employers to implement an automatic 401(k) plan.

### The First Step—Implementing an Automatic 401(k) Plan

AARP has a defined benefit plan as well as a 401(k) plan for its employees. Five years ago, AARP knew its 401(k) plan participation rate was 76%, but thought that was not good enough. The group knew it was important not only to advocate for retirement security in the United States, but to act on that belief in its own workplace.

AARP put an automatic 401(k) plan in place in 2003 for new hires, and believes its eight-month implementation experience was fairly typical of most employers.

Since its start, the 401(k) participation rate has gone from 76% to 91%. AARP starts new hires at a 3% employee contribution level, which is fully matched, after 45 days of employment. Employees' contributions, unless they select otherwise, are put into age-appropriate target date funds.

AARP's results are in alignment with findings from an RMS survey ([www.retirementmadesimpler.org](http://www.retirementmadesimpler.org)) conducted in October 2007 that found that 98% of employee respondents who did not opt out of their company's 401(k) plans liked them, and 85% felt that it helped them to save more than they would have on their own. In the last five years, less than 1% of AARP new hires have opted out of the plan. And, despite the uptick in participa-

tion, AARP's administrative costs for the plan have not risen.

### Case Study: Evraz Oregon Steel Mills

Many other organizations have had similar, positive experiences with implementing automatic 401(k)s, as these RMS case studies demonstrate. At Evraz Oregon Steel Mills, for instance, when management evaluated the tradi-

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tional 401(k) plan in 2003, they realized that participation rates had sagged to about 40% in their union plan, and 50% in the nonunion plan. The company believed that most of the employees wanted to save for retirement, but because of the flood of choices and decisions involved in retirement plans, many put off signing up. To remedy this, Evraz decided to work with its 401(k) provider to set up an automatic 401(k) plan. Employees would be enrolled unless they declined, and their contributions and match would be invested in lifecycle funds.

Evraz's automatic 401(k) plan had two implementation phases: The first was for nonunion employees (in 2004), and the second was for union employees (in 2005).

The biggest concern Evraz had was a potential reaction from employees. To assuage these concerns, the company at first only enrolled new employees in the plan. Then, in 2006, Evraz educated eligi-

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#### Plans in Transition 2008: IOMA's Annual Defined Contribution Survey

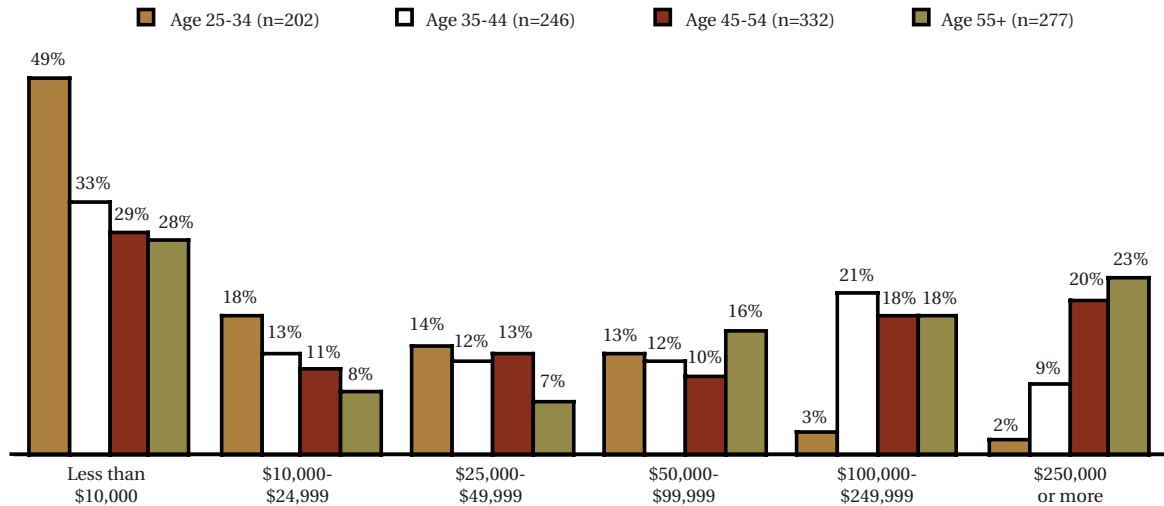
Rebecca Morrow and Louis Berney. IOMA. 74 pages. Item #8712. \$405 (I.F. Members \$395). For more book details, see [www.ifebp.org/books.asp?8712](http://www.ifebp.org/books.asp?8712).

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Figure 1

**Savings increase with age, but more than 1 in 3 aged 55 and over have less than \$25,000.**

In total, about how much money would you say you (and your spouse) currently have in savings and investments, not including the value of your primary residence? Please include savings, certificates of deposit, stocks, bonds, mutual funds, employer-sponsored retirement savings plans and other investments, but do not include the value of defined benefit plans. (Among workers providing information 2008: n = 1,057)



Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 1992-2008 Retirement Confidence Survey.

ble employees who weren't participating by mailing them letters detailing the automatic 401(k) process. Each person in the nonunion plan would be enrolled at a 4% savings rate with a 4% match in a lifecycle fund. As with all participants, they would be allowed to change the amount of money contributed to the plan, or opt out altogether. Only a handful of employees declined. In 2007, the company did another reenrollment of existing employees and upped the default settings to a 5% savings rate with a 5% match. Again, only a few opted out.

For the union plan, Evraz negotiated through its bargaining unit. They found the union accepted an automatic 401(k) plan as long as it included an opt-out feature. For this plan, they set the savings rate at 2% with a 1% match. Only a few employees declined.

Employee reaction to the new automatic 401(k) plan exceeded the company's expectations, according to company staff. Not only have participation rates skyrocketed to 97% for the nonunion plan and 75% for the union plan, but most employees have had nothing but good things to say about the plan. Employees are happy

to have a start in their retirement savings—and are now looking for ways to increase their participation. And for the few who opted out, life circumstances was the reason, rather than dislike of the plan.

Evraz is continuing to look for ways to keep its plan competitive, by upping default savings rates and continuing to match contributions. And the cost of managing the plan has been no more than its traditional plan, a point crucial to the smooth adoption of this new and improved way to save for retirement.

**Case Study:  
Ball Horticultural Company**

Ball, another early adopter of automatic 401(k) plans, is a leader in the horticultural industry and known for treating its workforce more like family than employees. When the company decided to switch 401(k) plan providers, it used the transition as an opportunity to review its current 401(k) package and take the pulse of their employees' satisfaction with their retirement plan offerings. In doing so, Ball noticed declining participation rates,

primarily due to newly eligible employees not opting into the current program.

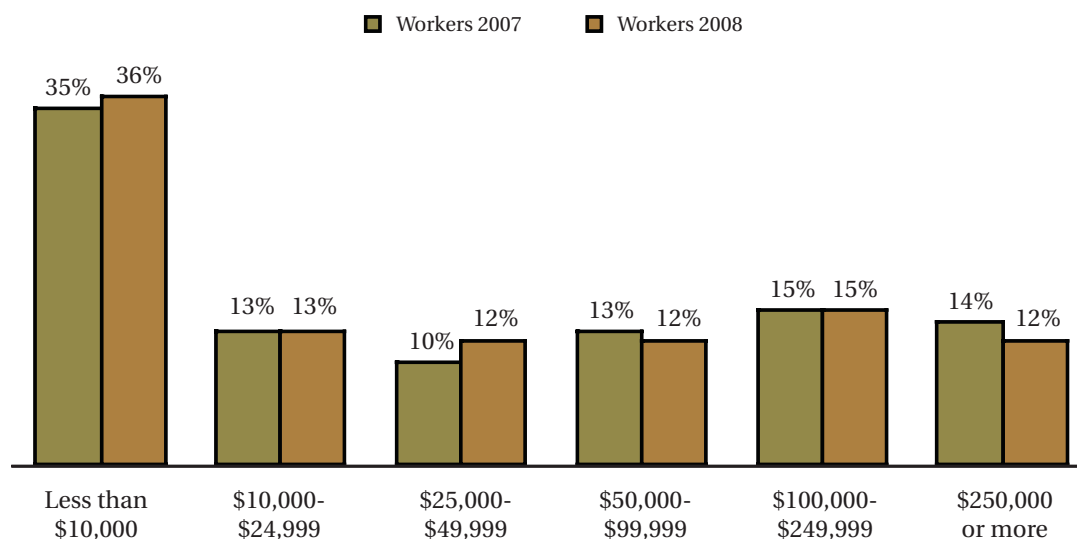
Ball's sense was that its employees were very interested in saving for retirement but either didn't take the time to sign up or were confused by the various options available in the plan. Soon after, Ball learned about automatic enrollment for 401(k)s. Working with its retirement plan committee (composed of members of the finance, operations and human resource teams), their new plan provider and a third-party consultant, Ball realized automatic 401(k)s were an opportunity to remove at least one of the major hurdles their employees ran into when trying to save for their retirement.

Ball followed many of the best practices recommended by automatic 401(k) experts.<sup>3</sup> They set the baseline savings rate at 4% to maximize the company match, and the default funds chosen were target retirement funds (similar to lifecycle funds) based on employee age, to ensure an appropriate mix of investments based on their retirement date. The decision was made to enroll only new employees due to feedback received from existing employees that were not participating in the plan.

Figure 2

### Total worker savings are modest and consistent with last year.

In total, about how much money would you say you (and your spouse) currently have in savings and investments, not including the value of your primary residence? Please include savings, certificates of deposit, stocks, bonds, mutual funds, employer-sponsored retirement savings plans and other investments, but do not include the value of defined benefit plans. (Among workers providing information 2008: n = 1,057)



Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 1992-2008 Retirement Confidence Survey.

From beginning to end, the entire process took less than a year.

Ball already had a process to educate new employees so it only needed to be adjusted for the new automatic enrollment process. A detailed communications plan was designed to educate new employees. Using informational letters, paycheck stuffers and worksite meetings, Ball worked to ensure each new employee was well aware of the new enrollment process and how it would affect them.

After Ball transitioned to an automatic 401(k) enrollment process, participation rates skyrocketed for newly eligible participants from between 60% to 70% to nearly 95%, according to company staff. And employees have completely accepted the changes. Most viewed the automatic enrollment process as a nonevent that required little to none of their time, and those who have provided feedback have been very positive about the experience.

### The Next Step— Automatic Escalation

For AARP, the successful start to the automation process led management to

consider what more could be done to help employees save for retirement. Though the participation rate had risen substantially, the employees' contribution percentage had stagnated—something believed to be commonplace with most employers. Once decisions are made about retirement savings, many people do not reevaluate or increase their deduction. Thus, AARP employees who were automatically enrolled at a 3% contribution rate often stayed at that rate, missing out on an additional 1% of matching contributions (AARP will match 50% of an employee's contribution between 3% and 5%).

Failing to maximize contributions and take full advantage of employer matching can have a negative effect on an employee's retirement security. (See Figure 2.) AARP decided to do more to help employees save. The organization tried several different approaches designed to educate the workforce about the need to increase savings, including workshops, educational seminars and periodic communications urging employees to save more. To spur increased contributions, AARP decided on a target audience and

focused on those employees who contributed less than 5% of their income to their 401(k).

Ultimately, based on available research, best practices and its desire to be a leader on this issue, AARP decided that automatically increasing contribution rates—or automatic escalation—was the single best way to get the job done. In terms of helping people save enough for retirement, automatic escalation is the next step in making automatic 401(k) plans a more meaningful retirement savings vehicle.

The switch to automatic escalation is new for AARP. In fact, the full roll out didn't occur until April 2008 and once again is on an opt-out basis. The goal at the outset is modest—just a 1% contribution increase per year until employees reach 5%. That way, even if employees make no other retirement planning decisions, they will receive the entire AARP match offered by the plan.

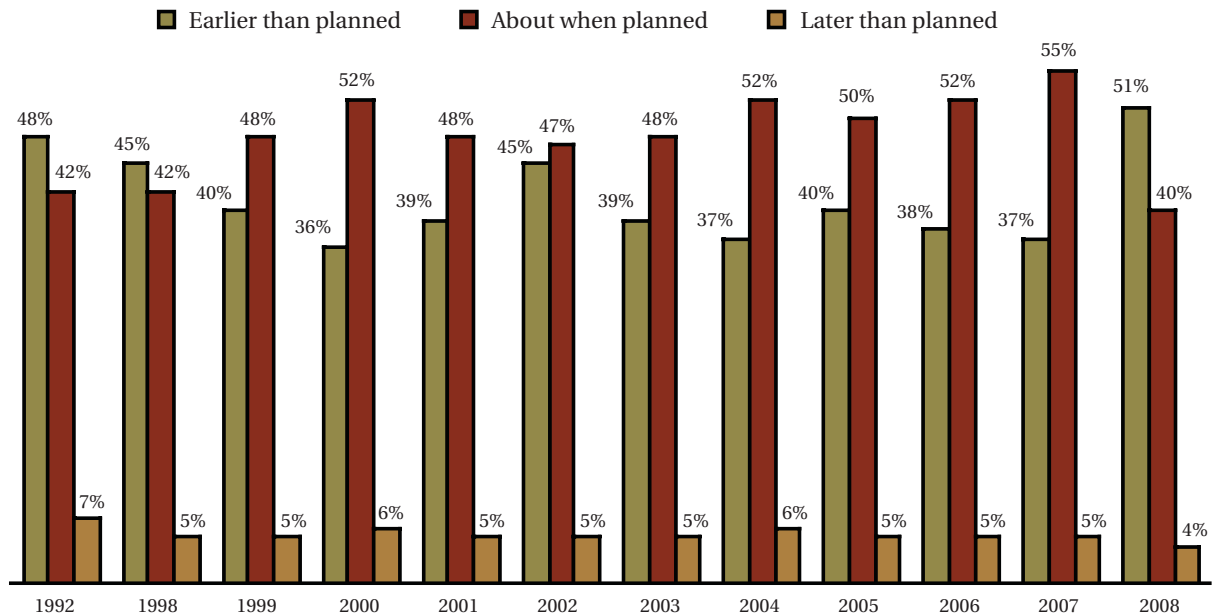
Because automatic escalation has just been introduced, there is no hard data on its results. However, existing research has

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## Half of retirees in the 2008 survey left the workforce before they had planned.

Did you retire earlier than you planned, later than you planned or about when you planned? (2008 Retirees n = 265)

Figure 3



Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 1992-2008 Retirement Confidence Survey.

shown that automatic escalation is a key way to help employees build their nest egg.<sup>4</sup> AARP also continues to look for new ways to build the strength of its retirement savings plan. The plan also offers several other features including automatic rebalancing and well-diversified target date funds as the default investment.

### Looking to the Future

Automatic 401(k) plans help people save more, and earlier, and they protect the most vulnerable among us. Women and low-income workers with little retirement savings can benefit greatly from a modest automatic 401(k) plan that helps them put away a bit more of what they earn.

Automatic 401(k) plans are a great first step, but for these plans to be truly effective, employees must maximize contributions and invest in funds that provide a reasonable return based on employee risk tolerance. This latter point was addressed by the Department of Labor's 2007 regulations that recommend that stable value

funds be used only as part of an investment mix, as opposed to being used exclusively.<sup>5</sup> Too many employees are over-invested in instruments that provide too low a return to adequately prepare employees for retirement.

Automatic escalation also is an important part of the equation. Increasing the savings rate for those enrolled does not increase the costs of administering the plan. It simply helps employees save more—and does so with no action necessary on the part of the employee.

AARP found that it was much easier to plan for all these features up front, so that the plan can be introduced to employees in its entirety. This saves unnecessary stress among employees resulting from frequent plan changes.

### Conclusion

There is no denying that today's economic climate is tenuous. Many people are asking if they can afford to save for retirement when there are bills that need to be paid today. Gasoline prices, infla-

tion, taxes, college tuition and rising health care costs make it difficult for everyone to make ends meet. But, inevitably, retirement comes and people must be prepared.

While many people think they will just work longer—29% expect to work past the age of 65 according to the 2008 EBRI Retirement Confidence Survey—half of those surveyed in that study left the workforce before they planned, most often due to health concerns or company downsizing. (See Figure 3.)

Individuals can decide to work longer, but it cannot be the only solution. That is why AARP is working with the Retirement Made Simpler (RMS) coalition to help companies implement automatic 401(k) plans. The goal is to provide unbiased information and best practices for putting these plans in place and equipping human resources professionals and their committees with the tools they need to make the business case for these plans. Once approved, RMS provides the communications templates companies need to introduce the new program to employees.

Simple solutions like an automatic 401(k) plan can make it easier to avoid the inadequate saving for retirement that continues to drive a quiet crisis across the United States. AARP and RMS believe that it is vital to help people be better prepared, to treat retirement as a joyous opportunity rather than a burden and a source of endless stress. Automatic 401(k) plans, along with automatic escalation and the right mix of default funds, are important steps that employers can take to help their employees save more, save earlier and be prepared for a more secure financial future. **B&C**

AARP Public Policy Institute: "Designing 401(k) Plans That Encourage Retirement Savings: Lessons from Behavioral Finance" at [assets.aarp.org/rgcenter/econ/ib80\\_pension.pdf](http://assets.aarp.org/rgcenter/econ/ib80_pension.pdf).

EBRI Notes: "The Expected Impact of Automatic Escalation of 401(k) Contributions on Retirement Income" at [www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_09a-20071.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_09a-20071.pdf).

Trends and Issues: "Capitalizing on Inertia: Automation Boosts Retirement Savings" at [www.tiaa-crefinstitute.org/research/trends/docs/tr060106.pdf](http://www.tiaa-crefinstitute.org/research/trends/docs/tr060106.pdf).

The Behavioral Economics of Retirement Savings Behavior at [assets.aarp.org/rgcenter/econ/2007\\_02\\_savings.pdf](http://assets.aarp.org/rgcenter/econ/2007_02_savings.pdf).

5. 29 CFR 2550. *Default Investment Alternatives Under Participant Directed Individual Account Plans; Final Rule.*

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## Endnotes

1. Wells Fargo's 2007 *Strategic Initiatives in Retirement Plans Survey*. [www.wellsfargo.com/press/20070927\\_401k?year=2007](http://www.wellsfargo.com/press/20070927_401k?year=2007).

2. [retirementmadesimpler.org/Benefits/index.shtml](http://retirementmadesimpler.org/Benefits/index.shtml).

3. [www.retirementsecurityproject.org/pubs/File/RSP-2pg-Auto401K\\_2.pdf?PHPSSESSIONID=3b1b008069b9a233f28b8a94a8920ef9](http://www.retirementsecurityproject.org/pubs/File/RSP-2pg-Auto401K_2.pdf?PHPSSESSIONID=3b1b008069b9a233f28b8a94a8920ef9).

4. Retirement Made Simpler About Automatic 401(k)s: [www.retirementmadesimpler.org/Whats401k/index.shtml](http://www.retirementmadesimpler.org/Whats401k/index.shtml).



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