

401(k) Automatic Enrollment Plans Boost Participation

By Lindsay Dattilio

When most investments are declining in value, as they have over the last 18 months, many employees understandably do not save for retirement with the same urgency that they would during boom years. Indeed, employees may delay enrolling in an employer-provided 401(k) plan or stop saving for retirement entirely when the value of their current retirement savings decreases. Nevertheless, investing when asset prices are low, as well as during boom years, is sure to provide a stronger retirement fund than investing only during boom years. To help their employees secure their financial futures and to counteract their natural inclinations to pull back from saving when the stock market is declining, many employers have inserted automatic enrollment and automatic escalation features into their 401(k) plans.

With an automatic enrollment feature, a portion of a new employee's salary is automatically contributed to a 401(k) plan, without the employee needing to elect to participate. While 401(k) automatic enrollment programs allow employees to withdraw from the plan, this option has not decreased enrollment. In addition, many 401(k) plans with an automatic enrollment feature also include an escalation feature, which gradually increases an employee's contribution the longer the employee remains with the company. Many companies set the initial contribution rate as low as 3 percent of an employee's salary, with 35 percent of companies offering an escalation feature. Thanks to the convenience and ease of automatic enrollment and escalation features, many people who ordinarily would not have enrolled in a 401(k) plan are now participating. Research also shows that few people withdraw from their 401(k) plan once enrolled.

Automatic enrollment 401(k) plans not only benefit the employees, but also assist employers with compliance and recruitment efforts, among other things. For example, every 401(k) plan must pass non-discrimination compliance tests set forth by the IRS. These tests investigate the percentage of salaries deferred into a 401(k) plan for employees at various income levels. To avoid significant penalties, companies must meet certain non-discrimination requirements by ensuring that a certain percentage of non-high salaried employees are enrolled in a 401(k) plan. On the other hand, companies that comply with non-discrimination standards reap yearly tax-preferred benefits. By implementing an automatic enrollment feature, companies are likely to have greater success retaining lower salaried employees as participants in a 401(k) plan and therefore have an easier time complying with the applicable regulations.

In addition, adopting automatic enrollment for their 401(k) plans gives companies the opportunity to show that they are interested in the futures of their staff. This is especially useful for recruiting skilled employees and retaining valued staff members. Employees feeling the loss of defined-benefit plans can also breathe a little easier about their retirement accounts, as 401(k) plans with automatic enrollment have similar features as defined-benefit plans, such as professional investment management.

Nonetheless, some employers are concerned about whether the benefits of automatic enrollment are outweighed by additional costs. This is especially true for companies that offer a matching contribution to employees who participate in a 401(k) plan. Companies should keep in mind that employer-matching contributions are tax deductible and therefore can lower their overall tax bill. Additionally, the majority of newly participating members of a 401(k) plan are those with low to moderate income levels, so the amount paid in matching contributions is considerably less.

Employers can also reduce costs by carefully choosing the features of an automatic enrollment plan. Many employers set a default contribution percentage that is lower than what the average employee would choose without an automatic enrollment feature, reducing the employer's matching costs. Employers can also reduce their matching costs by automatically enrolling only new employees, not current employees who did not opt into the plan before the implementation of an automatic enrollment feature, allowing the employers to exercise greater control over their matching costs.

Overall, 401(k) plans with automatic enrollment and escalation features provide an opportunity for employers to offer a more attractive compensation package and help employees take the initial step toward a stable retirement. In addition, both employers and employees stand to benefit from the tax benefits of 401(k) plans: employers by more easily meeting non-discrimination requirements and employees by deferring taxation of their income. With many companies reevaluating their compensation packages, now may be the time to consider updating your 401(k) plan features.