

# **The Influence of Automatic Enrollment on 401(k) Accumulations at Retirement**

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# **Why is research into 401(k) participant behavior so important?**

- **Whether many individuals' 401(k) plan accumulations will provide significant income in retirement has become a public policy concern in recent years**
- **The validity of such a concern cannot be assessed by looking at the 401(k) accumulations of today's retirees because these individuals have not participated in 401(k) plans throughout their working years**

# **EBRI/ICI 401(k) Accumulation Projection Model**

- **Based on a 2.5 million individuals from the EBRI/ICI database with sufficient information to allow us to project their 401(k) accumulations to retirement age**
  - These are administrative records that allow us to know EXACTLY how the participants behave
- **This model examines how 401(k) assets *might* contribute to retirement income for future retirees**
  - Based on decisions workers make throughout their careers

# Methodology for Automatic Enrollment

- **Run new set of baselines for all eligible employees, not just the EBRI/ICI participants**
  - Create a set of synthetic observations with the characteristics of the EBRI/ICI participants
  - Assume they are not currently participating
  - Provide them weights based on Fidelity's Building Futures experience
    - Function of age and income
- **Each time a non-participant is simulated to change jobs, predict the new probability of participation based on the new age and income**
  - Simulate whether they become a participant on the new job based on the conditional probability
  - Once they become a participant, assume they remain in that status until retirement (assuming the employer sponsors a plan)

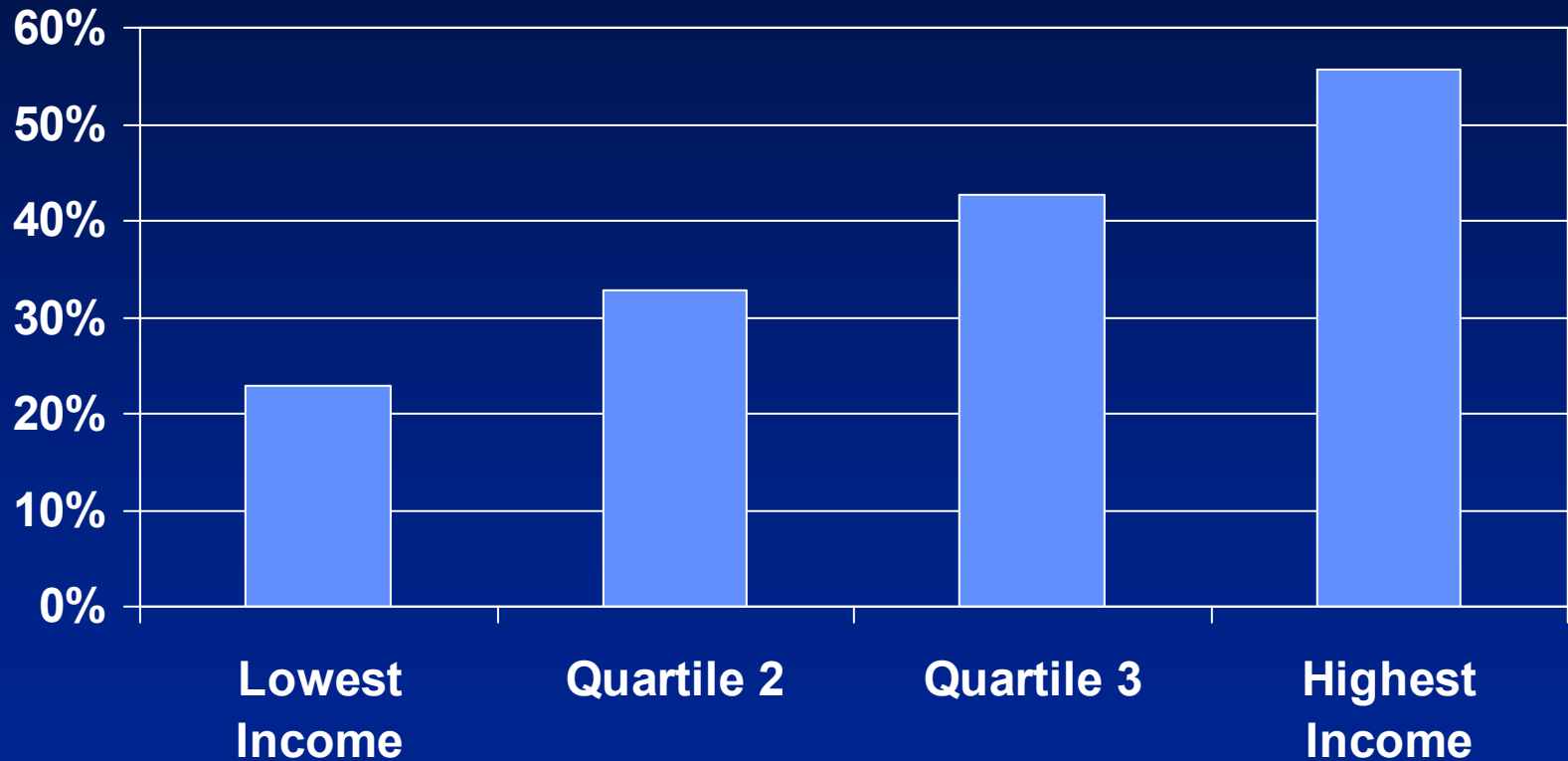
# Methodology for Automatic Enrollment (continued)

- **Assume automatic enrollment is immediately implemented in the year 2000**
- **Assume same defaults and same employee behavior as the health services company analyzed by Choi, et. al.**
  - Provides information on the percentage and type of employees likely to participate and use defaults
  - As well as the likelihood they will move away from the defaults with time
- **Conservative bias built in re the benefits of automatic enrollment**
  - Employees not assumed to learn from automatic enrollment experience
  - Currently no behavioral information available to parameterize such learning

# Results

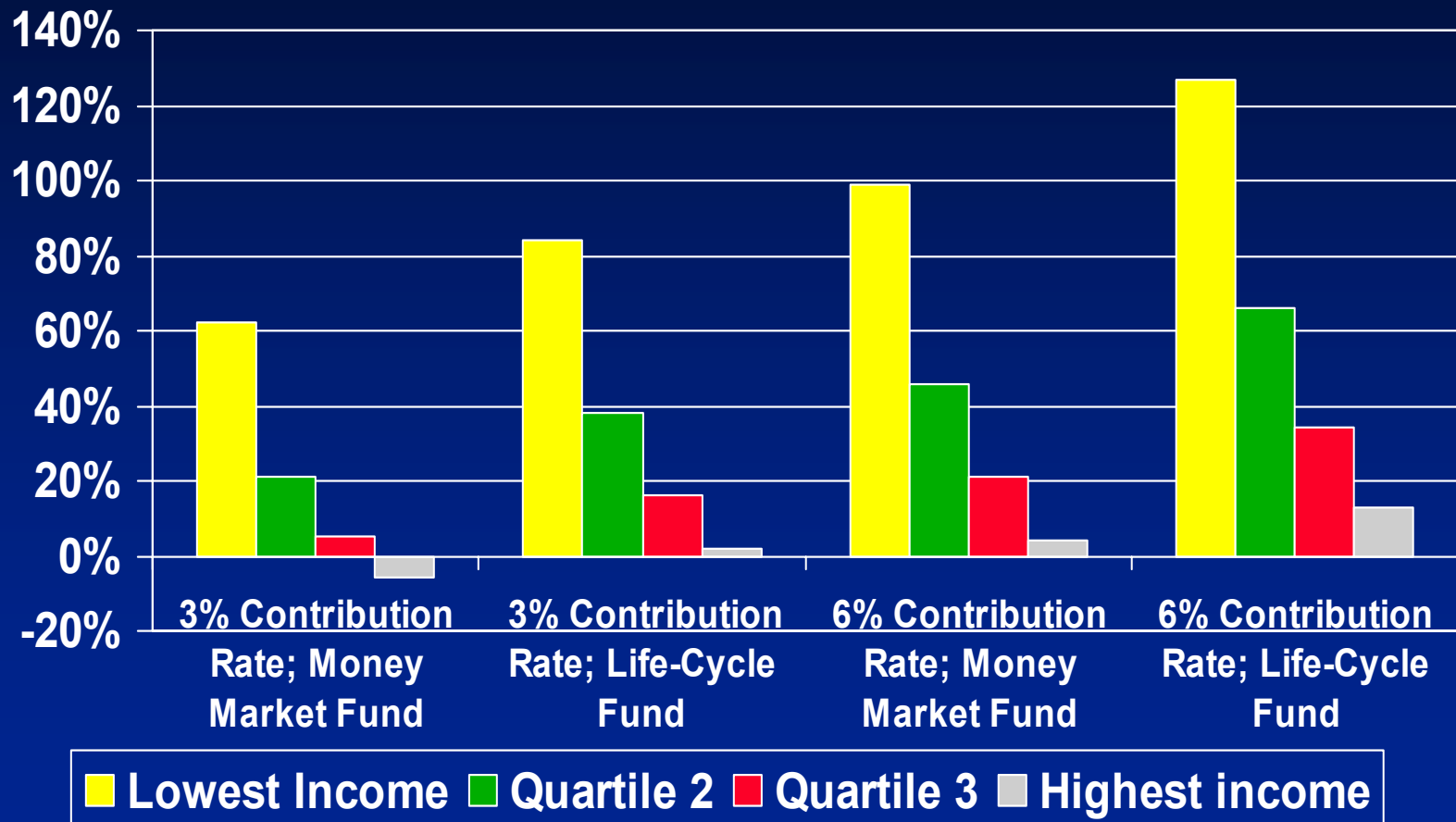
- **Model demonstrates that the effects of automatic enrollment on replacement rates at retirement depend heavily on the default contribution rate and default investment option that the plan sponsor selects**
  - Tradeoffs in increase in participation vs anchoring of relatively low contributions and relatively non-aggressive investment allocations
  - 58 pct of plans with automatic enrollment set the default contribution at 3 pct
    - Very low compared to what those that voluntarily contribute choose to put in:
      - Even the low income, young workers average 5.3 pct of compensation
      - Increases to 9.3 pct for high income, older workers

# Median Replacement Rates From 401(k) Accumulations for All Eligible Workers Turning 65 Between 2030 and 2039, by Income Quartile at Age 65: Without Automatic Enrollment



Sources: Tabulations from Holden and VanDerhei (2005)

# Impact of Automatic Enrollment: Increase in Median Replacement Rates From 401(k) Accumulations for All Eligible Workers Turning 65 Between 2030 and 2039, by Income Quartile at Age 65



Sources: Tabulations from Holden and VanDerhei (2005) and Automatic Enrollment Parameters from Choi, Laibson, Madrian, and Metrick (2001 and 2004)

# References

- Choi, James J., David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Saving For Retirement on the Path of Least Resistance." Originally prepared for Tax Policy and the Economy 2001, updated draft: July 19, 2004.
- . "For Better or For Worse: Default Effects and 401(k) Savings Behavior." Pension Research Council Working Paper. PRC WP 2002-2. Philadelphia, PA: Pension Research Council, The Wharton School, University of Pennsylvania, November 9, 2001.
- Holden, Sarah, and Jack VanDerhei. "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," ICI Perspective, Vol. 11, no. 2, and EBRI Issue Brief 283 (Investment Company Institute and Employee Benefit Research Institute, July 2005).