



Enhancing 401(k) Value and Participation

Taking the Automatic Approach

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401(k)

Enhancing 401(k) Value and Participation

Taking the Automatic Approach



Executive Summary

With their growing prevalence over the last few decades, 401(k) and other defined contribution (DC) retirement plans have become a critical piece of the retirement puzzle for most private-sector employees today.

This is especially true in smaller companies and those of fairly recent vintage because 401(k)s are likely to be the only retirement program offered in these organizations. But, even in large and old-line businesses in which traditional defined benefit (DB) pension plans remain common, it's important for employees to take responsibility for their retirement planning and save for retirement in order to achieve targeted income replacement levels.

Because of the tax advantages of 401(k)s and the fact that many companies match employees' contributions in these plans up to certain limits, 401(k) plans represent an especially powerful way to save for retirement. Corporate America's ongoing shift in emphasis from DB to DC retirement plans

only heightens the need for employees to take maximum advantage of the 401(k) saving opportunity.

Having a 401(k) plan is a high value benefit for employees for a variety of reasons. The plans provide a tax-effective way to save for retirement efficiently via payroll deductions, provide a clear “account balance” of savings, provide a benefit that is “portable” and can be transferred as employees change jobs, and also in most cases enable the employee to manage their investments based on their needs.

Nevertheless, a sizable percentage of those eligible to invest in 401(k)s—on the order of three out of ten employees, according to some studies—do not choose to participate in these programs. Research also shows that many of those who do contribute to 401(k)s don’t save enough to meet their likely retirement income needs. When employers match employees’ contributions, employees who fail to participate are, in effect, leaving significant employer dollars on the table. As a result, many working Americans risk having insufficient savings for retirement in an era when people are living longer than ever before, and health care costs continue to increase at rates far in excess of overall levels of price inflation. As a result, these trends are creating increased challenges for government insurance programs including health care and Social Security. The need for enhancing retirement funding has never been greater.

Employers have plenty of reasons to be concerned about employee understanding of and participation in 401(k) plans. Research into employee attitudes shows that retirement benefits, including DC plans, can be a powerful factor in attracting people to an organization. With increased competition for skilled talent and the focus at companies on innovation and customer service, this is an issue that is top of mind. And, when employees are given the chance to tell their employers what rewards they value most, they often emphasize the importance of the DC plan employer match. But to leverage the value that employees see in 401(k) plans, employers must count on employees to take action; that is, to participate in the 401(k) and manage their DC investment portfolios with care.





When employers match employees' contributions, employees who fail to participate are, in effect, leaving significant employer dollars on the table.

Concerns about low levels of 401(k) participation and the need to make these plans more valuable to support a range of key workforce and rewards goals have prompted some employers to begin adding automatic features to their plans in recent years. Automatic enrollment is one example. With this feature, the default option is for employees to be enrolled in the plan at a minimum contribution level when they first become eligible. Participation is automatic but not mandatory; employees who do not wish to participate may opt out of the program. Automatic enrollment—along with other “auto” features such as

automatic rebalancing of investments, “lifecycle” funds and automatic increases in employee contribution levels—are designed to overcome employees’ inertia or lack of knowledge about saving and investing for retirement. These are the common barriers that prevent some workers from getting into the 401(k) saving habit. In a sense, these features mimic the more “automatic” attributes of traditional DB pension plans to help employees make prudent financial choices today to prepare for tomorrow’s retirement. (See page 4 for an overview of some key differences between 401(k) plans and traditional DB pensions.)



The DB–DC Evolution and the Importance of ‘Automation’

The continuing shift from traditional defined benefit pension plans (DB) to 401(k)s and other defined contribution (DC) arrangements has been well documented over the years. The primary form of retirement benefits offered by U.S. companies as recently as 20 or 30 years ago, DB pension plans now cover only about half as many U.S. workers in private industry as 401(k)s, according to the Bureau of Labor Statistics’ National Compensation Survey.¹ National Compensation Survey data from 2006 shows 21% of private sector workers had access to DB plans, while 54% had access to DC plans. Recent instances of major U.S. companies closing their DB plans to new hires or terminating them altogether point to even lower levels of pension plan participation in coming years.

One of the primary differences between DB and DC plans is that DB plans are, in a sense, automatic. Employees in jobs covered by traditional pension plans participate in those plans automatically after working long enough to meet the plan’s eligibility requirements. Their

“pension money” is invested for them by the plan sponsor and typically paid out in equal installments when they retire according to an automatic benefit formula set by the plan.

In the typical 401(k) plan, by contrast, nothing is automatic and active employee involvement is critical. In fact, the employee usually has the option of whether to participate in the plan at all. The employee must make proactive choices about how much to save in the plan, how those savings are invested, and when and in what amounts payments are received. For employees who find these choices confusing, if not overwhelming, automating plan participation and putting ongoing investment decisions on auto-pilot via features like automatic re-balancing can mean the difference between a secure retirement and no retirement savings at all. The government continues to shape the future direction of retirement programs with new regulations implemented or being considered. This leaves a key open question as to what will be the best mix of employer action or new government rules to close the growing gaps.

In the typical 401(k) plan, nothing is automatic and active employee involvement is critical.

According to research by Deloitte Consulting, however, only about a quarter of large private employers in the United States offered automatic 401(k) enrollment as recently as 2006.² Concerns about added 401(k) costs and potential liability for participants' investment losses were among the considerations that have discouraged many employers from adding automatic features to their 401(k)s until recently. With the enactment of the Pension Protection Act (PPA) of 2006, Congress offered new encouragement to companies interested in taking the automatic approach by clarifying employers' fiduciary liability and providing some "safe harbors" that plan sponsors can follow in designing automatic enrollment features to limit their potential liability.

To help employers better understand recent trends in 401(k) design and the pros and cons of automating 401(k) participation, AARP asked Towers Perrin to review the published research on 401(k) prevalence, participation and design and to analyze Towers Perrin's own proprietary data on employer and employee views of 401(k)s and other reward components. The research team also conducted in-depth interviews with a number of U.S. companies to get an up-to-date view of employers' thinking and current approaches to enhancing 401(k) participation. Among the key research findings:

- Despite the continuing challenges involved in maximizing 401(k) participation, U.S. companies recognize the growing importance of 401(k) plans and are focusing increasing attention on boosting their 401(k) participation rates to address a range of key business and workforce objectives.
- U.S. employees, for their part, also show growing awareness of the pivotal role that 401(k) plans play in their total reward package. Indeed, according to data from Towers Perrin's latest *Global Workforce Study* involving more than 60,000 U.S. employees, competitive retirement benefits, including a 401(k) plan, are among the top 10 considerations for today's employees in choosing an employer—and are even more important to workers age 50+ and to employees in certain industries.
- Towers Perrin's research on behalf of individual employers suggests that employer contributions to 401(k)s typically offer a larger, positive return on investment (ROI) that can sometimes exceed the ROI for spending on other key reward elements, such as pay and bonuses. This high ROI is likely due to employees increasing focus on retirement savings and security.

To maximize the employer's return on 401(k) investments, however, it's critical for employees to participate in the plan at a meaningful level of individual savings and to manage their savings carefully over time. Adding automatic 401(k) features offers a solid payoff in this regard. In fact, one study by the Employee Benefit Research Institute, conducted in July 2005, projects that automating 401(k) participation can bring a significant increase in retirement savings at all income levels and more than double the income replacement rate for employees in the lowest income brackets.³

Here's a closer look at Towers Perrin's research findings.

Setting the Stage: The Current 401(k) Landscape

A review of the published literature and Towers Perrin’s own data show that 401(k)s today are far and away the most common form of retirement benefit offered to private sector workers in the United States—and the only retirement benefit being offered to many employees. According to a 2006 study by the Investment Company Institute (ICI), the number of U.S. employees participating in 401(k) plans (47 million) is more than double the number in traditional DB pension plans (21 million), while total 401(k) assets (\$2.4 trillion) now exceed the combined assets held by DB plans (\$1.9 trillion).⁴

Statistics from Towers Perrin’s Employee Benefit Information Center (EBIC) database (which comprises almost 800 Fortune 1000 and equivalent companies in a range of industries) reveal that some form of a DC plan, including 401(k) or other types of savings plans are almost universal—97% of the EBIC companies offer the plans. By contrast, as of January 2007, just over half (55%) of the

Towers Perrin EBIC companies continue to offer DB plans that are open to new hires.

In midsize and small companies, 401(k) plans may not be universal, but smaller organizations are more likely than larger ones to offer a 401(k) as the only retirement benefit program provided. According to the ICI study, of approximately 350,000 employers surveyed, 90% of the small and midsize companies (50 to 10,000 employees) nationwide offered a 401(k) as a stand-alone retirement plan in 2002.

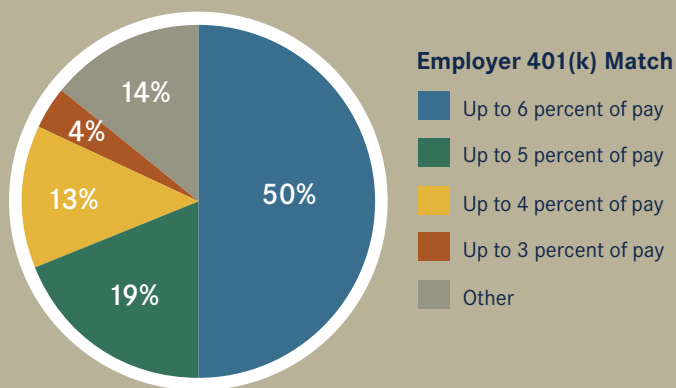
Towers Perrin’s EBIC data also shed light on typical practices with regard to employer contributions to 401(k) plans and waiting periods for eligibility among larger and midsize organizations. More than 93% of the EBIC companies make some form of contribution to their employees’ 401(k) accounts, the vast majority on some type of matching basis, in which the company matches all or part of the employee’s contributions up to certain limits. As **Exhibit 1** shows, matching various fractions of employee contributions (half of the employee contribution is typical) up to 6% of pay is the most common approach.

Although pre-enrollment waiting periods of three months, six months and one year remain fairly common among the Towers Perrin EBIC companies, the recent trend among employers is to eliminate waiting periods and allow employees to begin participating in 401(k) plans immediately upon hiring. Almost one in three (30%) of the EBIC companies now allow immediate 401(k) participation within one month or less.

In terms of the choices available to 401(k) participants for investing their savings, data from Towers Perrin’s EBIC shows that the median number of investment options offered by major employers has leveled off

Exhibit 1

Most Common Employer Match Percentages



Source: Towers Perrin Employee Benefit Information Center data on 794 large U.S. employers (i.e., Fortune 1000 companies and equivalents); percentages shown are based on the 733 companies that make matching 401(k) contributions; ©Towers Perrin 2007

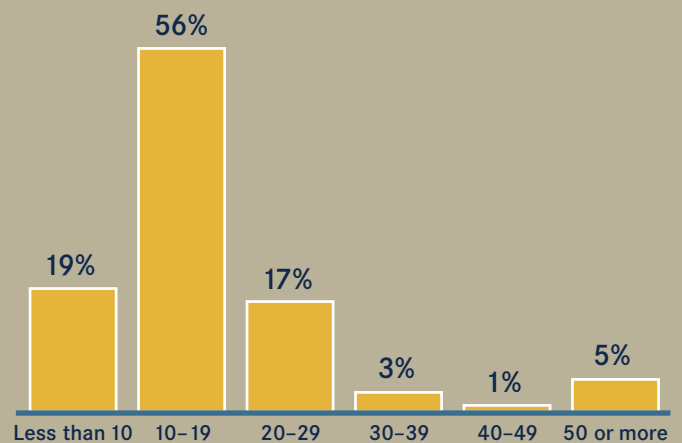


at 14. However, a study of 638 401(k) plans conducted by TIAA-CREF suggests that the average 401(k) participant invests in only a limited number of funds, typically no more than three or four.⁵ **Exhibit 2** shows the breakdown of investment options offered by the companies in Towers Perrin’s EBIC database as of January 2007.

Despite the wide availability of 401(k) plans and wide array of investment choices offered to employees, the published research continues to show that many employees fail to take advantage of this important opportunity to save for retirement. For example, according to Hewitt Associates’ data covering 1.8 million employees participating in 401(k) plans offered by 65 large U.S. employers, about 30% of those eligible

Exhibit 2

Number of 401(k) Investment Options Offered by Large Employers in 2007



Source: Towers Perrin Employee Benefit Information Center data on 794 large U.S. employers (i.e., Fortune 1000 companies and equivalents); percentages shown are based on the 791 companies that offer 401(k) plans; ©Towers Perrin 2007

did not contribute to their plans in 2005.⁶ And even many employees who do contribute don't save the maximums allowed by law or even the amounts required to receive the maximum matching contributions from their employers. The study also found that

Simple procrastination and lack of financial literacy are among the reasons often given by employees who don't participate in their employers' 401(k) plans.

employees who do not contribute to their 401(k) plans can anticipate as little as 52% replacement of their annual pre-retirement income. In contrast, employees who do contribute to their company's 401(k) plan can expect to replace 98% of their annual pre-retirement income, through a combination of 401(k), pension and Social Security income.

Why the inertia? Simple procrastination and lack of financial literacy are among the reasons often given by employees who don't participate in their employers' 401(k) plans. "Can't afford to save" is another common rationale. A TIAA-CREF study summarizes research that has been conducted by behavioral finance experts who have linked low participation and savings rates to behaviors such as procrastination and inertia.⁷ Indeed, the TIAA-CREF study cited above confirms that those employees who don't contribute tend to have lower levels of formal education



and lower incomes than active 401(k) participants. Perhaps most telling, a 2006 Towers Perrin Benefit Strategy survey of more than 2,300 employees in midsize and large U.S. companies found that low-income workers, defined as earning less than \$50,000 total household income, are aware of the need to save for retirement but are far less likely to actually be saving than high-income earners. Almost half (48%) of the low-income earners said they were considering saving more in company retirement plans but, for various reasons, just weren't doing so.

401(k) Value and ROI

Despite the fact that not all employees are currently participating in 401(k) plans, it's also clear that the 401(k) savings opportunity represents an important part of the total reward package for most U.S. employees. As a consequence, 401(k)s play a key role for employers in attracting and retaining employees in an increasingly tight labor market. For example, in Towers Perrin's latest *Global*

Among 26 possible choices, competitive retirement benefits ranked number six for the U.S. population sample as a whole.

Workforce Study, respondents were asked to identify the factors they consider most important when choosing an employer. Among 26 possible choices, competitive retirement benefits ranked number six for the U.S. population sample as a whole. In most industries, a competitive retirement package carries particularly high significance, and generally ranked in the top 10 most important factors when joining an organization.

Exhibit 3 shows more specifically where retirement benefits rank among other factors in the select industries: utilities and banking.

Clearly, in today's environment, providing enhanced 401(k) features can give an organization a leg up in recruiting scarce talent. This is especially true with regard to mid-career hires. Other AARP/Towers Perrin research shows that competitive retirement benefits rank second only to health care coverage as a driver of attraction for U.S. employees age 50+.⁸

Towers Perrin's research also points to the powerful role that enhanced retirement benefits can play in retaining needed talent. Among the employees surveyed as part of the firm's *Global Workforce Study*, those who viewed their organization's retirement benefits as above average were far less likely to be looking for another job or to be open to job offers from other employers than were those employees who viewed their retirement benefits as below average (see **Exhibit 4**).

Exhibit 3 Top 10 Drivers of Attraction

DRIVER	RANK IN TOTAL U.S. POPULATION	RANK IN INDUSTRY	
		ENERGY/UTILITIES	BANKING/FINANCE
PAY			
Competitive base pay	1	1	1
Salary increases linked to individual performance	5	6	4
BENEFITS			
Competitive health care benefits	2	2	3
Competitive retirement benefits	6	3	8
LEARNING AND DEVELOPMENT			
Career advancement opportunities	4	4	2
Learning and development opportunities	10	9	10
WORK ENVIRONMENT			
Work/life balance	3	5	5
Challenging work	7	7	7
Reputation of the organization as a good employer	8	8	6
Organization's financial health	–	10	9
Caliber of coworkers	9	–	–

Source: Towers Perrin's 2005 *Global Workforce Study*. Energy/utilities data comprise 1,101 employees in the energy/utilities industry; 3,612 employees included in finance/banking data. ©Towers Perrin 2007

Moreover, as **Exhibit 5** shows, saving via 401(k) plans is what comes to mind first for most employees when thinking about preparing for retirement.

Towers Perrin’s research with clients has found that organizations can generate a significant ROI from enhancements to their 401(k) programs. In some cases, improvements in 401(k) matches or other features have the ability to produce a higher ROI than company investments in other, more costly compensation programs. To estimate the ROI of changes in reward investments, Towers Perrin first surveys employees to determine how much relative value they place on different reward elements and the trade-offs they are willing to make.

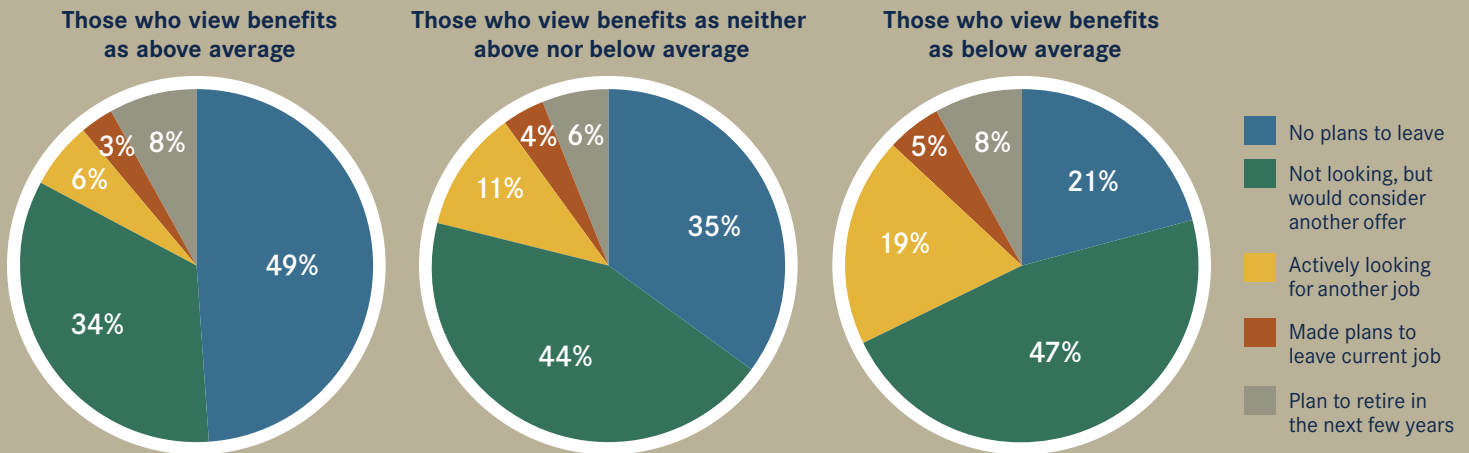
Enhancements to the 401(k) match routinely appear as some of the most highly valued reward improvements an organization can make. Towers Perrin also identifies the relationship between these kinds of changes and specific employee attitudes and behaviors: likelihood of joining an organization, remaining with a company and making the



maximum contribution of time and energy. Each of these behaviors, in turn, has a measurable financial implication for the organization. For example, increases in employee retention can produce dramatic cost savings. The cost of replacing an employee such as an executive or highly productive individual contributor can range up to multiples of

Exhibit 4

Link Between U.S. Employee Views of Retirement Benefits and Employee Commitment



Source: Towers Perrin’s 2005 *Global Workforce Study*. © Towers Perrin 2005.

annual salary. Likewise, engagement (which Towers Perrin defines as willingness to put in discretionary time and effort beyond the minimum required for an employee to keep his or her job) can produce sizable economic returns for a company. Over a broad spectrum of analyses in various industries, we have identified a ratio of approximately 5:1 between increases in engagement and improvement in financial performance, usually measured as an increase in earnings. This is due to a combination of higher revenue growth at companies with an engaged workforce relative to their relevant industries, as well as lower cost of goods sold. While this

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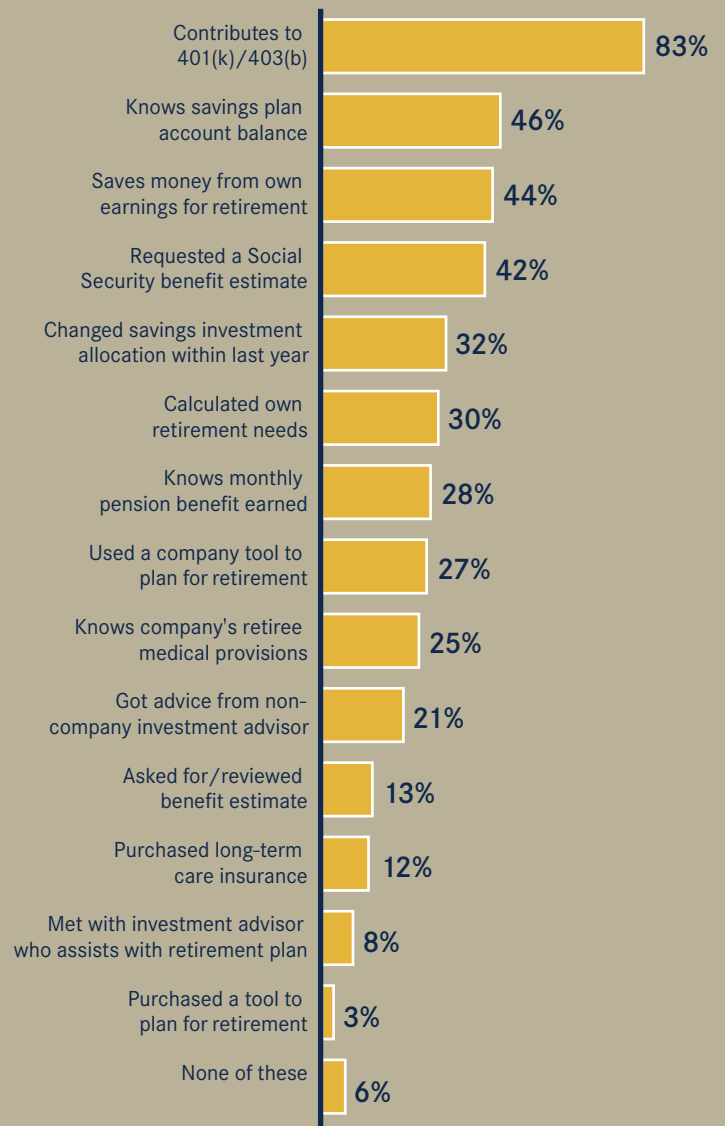
result varies across companies and industries, the pattern between employee engagement and increased financial performance is consistent.

When Towers Perrin has compared the cost of an organization’s investment in enhanced 401(k) features against the value produced from increased employee retention and engagement, the results are often striking. In one organization, for example, the analysis showed that enhancing the company’s 401(k) plan (specifically, providing a company match equal to 6% of pay) was likely to produce a 95% return on investment as a result of the expected increase in employee engagement. By

Exhibit 5

How U.S. Employees Are Preparing for Retirement

Actions taken by employees as part of retirement planning



Source: Towers Perrin's Retirement Preference Index, based on a 2004/2005 survey of 3,500 employees working full time for midsize and large U.S. companies in a range of industries. Multiple responses were allowed. © Towers Perrin 2007



comparison, a 5% increase in merit pay would be expected to produce only a 28% return on investment, and a 10% larger bonus would produce a predicted return of only 5% of the projected cost.

These findings, which are generally consistent with those of total rewards optimization studies at other companies, should be of interest to companies thinking about investments in 401(k) benefits and automatic 401(k) features. Given growing employee concerns about retirement security today, plus the ability of employees to see clearly

the value in their 401(k) accounts, company investments in these plans can usually be expected to deliver a positive return for the employer.

In addition to optimization research, other studies support the notion that auto 401(k) features are viewed favorably by employees and employers. According to Deloitte's 2005/2006 Annual 401(k) Benchmarking Survey, 73% of plan sponsors that were surveyed reported either a favorable reaction or no issues from participants regarding automatic enrollment.⁹ Research conducted for the Retirement Security Project by The Tarrance Group, also found that 68% of registered voters favor automatically enrolling employees in a retirement plan at work, 66% favor automatically investing the funds in a prudent way, and 67% favor automatically increasing contributions over time. Overall 71% favor automatic 401(k)s.¹⁰

Studies support the notion that auto 401(k) features are viewed favorably by employees and employers.

What's Driving the 401(k) Automation Trend—The Employer Perspective

Employers moving to make 401(k) participation more automatic typically take a combination of the following approaches to help overcome employee inertia and remove some of the guesswork and uncertainty that mark many employees' efforts to save and invest for retirement:

Automatic enrollment: With this feature, the default option is to have new hires enrolled in the company's 401(k) plan when they first become eligible unless they affirmatively opt out. The most common default contribution rate among companies offering automatic enrollment in 2004 was 3%, according to the Profit Sharing/401(k) Council of America's (PSCA's) 48th annual survey of more than 1,100 profit sharing and 401(k) plans.¹¹ That survey also found that the most common default investments for automatic contributions tend to be in such options as balanced funds (29% of the plans surveyed),

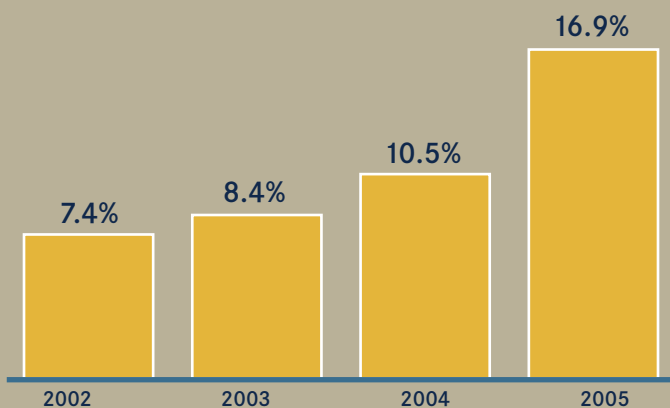
stable-value funds (27%) and money market funds (24%). The sidebar box on page 15 describes the implications of fund choice on the fiduciary responsibilities of employers under recently enacted pension legislation. As of 2004, almost one in three plans (30%) with 5,000 or more participants offered automatic enrollment, according to the Profit Sharing/401(k) Council's survey. According to PSCA, 19% of plans with less than 1,000 participants and 24% of plans with between 1,000 and 4,999 participants have automatic enrollment. **Exhibit 6** shows the growth in automatic enrollment in recent years.

Automatic contribution increases: Some companies that have implemented automatic enrollment also automatically increase the level of employees' contributions over time; for example, by 1% of pay each year until a certain threshold (e.g., 6%) is hit. As of 2004, about 30% of the plans that offered automatic enrollment had also implemented automatic escalation, according to the Profit Sharing/401(k) Council survey. Automatically increasing employee contribution levels may be needed to help employees build adequate retirement savings over time. A 2006 study by Hewitt Associates found that most automatically enrolled employees tended to stay at the default contribution rate and had less diversified portfolios than more active 401(k) participants.¹²

Automatic rebalancing: With this feature, participants' accounts are automatically rebalanced periodically to restore the original level of targeted investment in various asset classes (e.g., large cap stocks, small cap stocks, fixed income investments, cash

Exhibit 6

Percentage of 401(k) Plans Implementing Automatic Enrollment, 2002–2005



Source: Towers Perrin Employee Benefit Information Center data on 794 large U.S. employers (i.e., Fortune 1000 companies and equivalents); percentages shown are based on the 791 companies that offer 401(k) plans; ©Towers Perrin 2007



“We are shifting investment philosophy to one that focuses on an investment strategy, rather than a name brand fund...this makes more sense to our employees.”

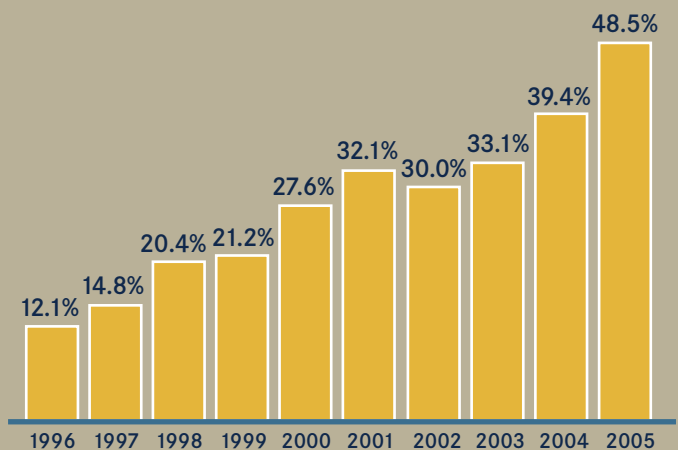
equivalents). This enhancement addresses the fact that most 401(k) participants tend to be passive investors who don’t review their investments regularly. Over time, even an appropriately diversified portfolio can become unbalanced because of the varying performance characteristics of the underlying investments. A 2006 Hewitt Associates survey found that about one in four (27%) of 220 large U.S. companies offered this feature last year.¹³

Making investments easy: To help employees invest their 401(k) balances appropriately, a growing number of companies offer so-called “lifestyle” and/or “lifecycle” accounts—premixed investment funds designed to fit a range of risk tolerances or for employees in different stages of their lives. A lifecycle fund, for example, would typically offer a higher allocation to equities for a young worker and shift the mix more toward fixed-income and cash equivalents designed

for preservation of capital as the employee approaches retirement age. As **Exhibit 7** shows, almost half of the plans surveyed by the Profit Sharing/401(k) Council offered these kinds of funds in 2005.

Exhibit 7

Percentage of 401(k) Plans Offering Lifestyle and/or Lifecycle Funds, 1996–2005



Source: Profit Sharing/401(k) Council of America 2005 Annual Survey of Profit Sharing and 401(k) Plans

Among the considerations holding some companies back from adopting features like automatic enrollment have been concerns about the employer's fiduciary liability and even the legality of automatic enrollment under state wage garnishment laws. Enacted last September, the Pension Protection Act (PPA) of 2006 addresses these concerns by providing new guidance regarding automatic enrollment. (See box.) More recent IRS guidance provides even more encouragement for aggressive automatic enrollment programs by clarifying that default contribution rates may be any percentage permitted under the plan (i.e., no maximum limit) and that automatic contribution increases

“PPA rules are opening up employers thinking about 401(k) plans and how to use them differently than in the past.”

are specifically permitted. Regulations implementing the PPA have been proposed but not yet finalized.

As a result of PPA, the number of companies offering these features is expected to continue to grow rapidly in coming years. This is reflected in the results of a survey of 126 financial executives working in midsize and large U.S. companies that Towers Perrin conducted immediately after the PPA was enacted last fall. Some 42% said their companies are now more likely to introduce automatic enrollment.

Pension Protection Act of 2006

Key Provisions for 401(k) Sponsors

Automatic enrollment

Effective upon enactment, the law supersedes all state laws that place restrictions on automatic enrollment (e.g., state garnishment laws).

Effective for plan years beginning after December 31, 2007, the law provides a new **safe harbor** that automatic enrollment features must conform to in order for the plan to be exempt from nondiscrimination testing requirements. Under this safe harbor, automatic contributions must be at least:

- 3% of pay during the first year of plan participation;
- 4% of pay during the second year;
- 5% of pay during the third year;
- 6% of pay in the fourth year and thereafter.

Also, non-highly compensated employees must receive:

- a 3% non-elective contribution from the company, or
- a 100% match on the first 1% of elective employee contributions plus a 50% match on the next 5% of elective employee contributions.

Employer safe harbor contributions must fully vest within two years, and employees must receive a notice explaining their right to opt out and how contributions under the arrangement will be invested.

Why the strong employer interest in introducing 401(k) enhancements that will cost most plan sponsors money in added contributions? To get a better sense of what's driving employers' thinking, Towers Perrin interviewed senior HR leaders at a number of leading organizations (see box on page 17 for a list) on a range of issues related to maximizing 401(k) value. Of the companies interviewed, three-quarters already have automatic 401(k) enrollment, and the rest are seriously considering it.

The most common reasons for introducing automatic 401(k) features were (in order of importance for the interview group):

- Enhance the perceived value of the program among employees.
- Help support a culture of shared responsibility with employees for financial security in retirement.



“I am a true believer of auto-enrollment and with the PPA, this will help employers a lot knowing that there is support and regulation around the plans.”

- Help ensure the level of financial security necessary to enable employees to retiree.
- Strengthen the company's value proposition to employees and help brand the company as an employer of choice.
- Enhance employee retention.

Given today's tight labor market, especially for key skilled employees, companies have a

strong business rationale for reward investments that can play a meaningful role in attracting and retaining needed talent. It seems clear from these recent interviews that introducing automatic 401(k) features ranks near the top of the list today in terms of broad-based reward program enhancements that many companies are embracing. One employer interviewed noted that after introducing enhancements to their 401(k) plan including automatic enrollment, their voluntary turnover went from 18% to 2%.

“Even with auto-enrollment, we need to regularly communicate with our employees to actively participate in the plan including increasing participation and diversifying investments.”



Among the sample of organizations interviewed, for example:

- Half of those that have implemented automatic enrollment also automatically increase the level of those employee contributions over time.
- The majority has already implemented lifecycle investment options, and the others are now planning to implement lifecycle funds.
- A small, but growing, minority of those interviewed are considering going beyond automatic enrollment of new hires to automatically enroll existing employees who don't contribute to their 401(k) plans.

Other moves under consideration among this group include changing 401(k) waiting periods and eligibility criteria (e.g., offering eligibility to part-timers) to increase employee participation and savings, among others.

All employers interviewed noted the use of targeted communication to reach employees that are not participating or employees that are not participating to the maximum employer match. One employer said that “targeting education and awareness messages has been the best way to increase employee participation and is an absolute must for employers.”

Organizations Interviewed

ACUITY	Adecco
Citigroup	CIGNA
Dupont	FM Global
Hoffmann La-Roche	International Paper
New York University	PlastiPak
Time Warner	Trinity Health

The Payoff of Making It Automatic

Both the available research and the experience of the organizations interviewed for this report confirm that making 401(k) participation more automatic can have a beneficial impact on employees that provides a positive return for employers on a range of key business and workforce issues, including recruiting and retention.

Among the organizations interviewed, for example, virtually all of those that have implemented automatic enrollment have seen their 401(k) participation rates increase measurably, while three-quarters have seen increases in the overall level of employees' 401(k) contributions and most report improvements in their ability to recruit needed talent. Other outcomes reported by some of

Key benefits reported by the companies interviewed include increased participation, improvements in ability to recruit, and help with passing nondiscrimination testing.

those interviewed include decreased turnover, reductions in 401(k) loan levels, and increases in average 401(k) account balances. Also, about half of the organizations interviewed said automatic plan features have improved their ability to pass the 401(k) nondiscrimination tests, which have a series of rules to ensure that a sufficient number of employees at all income levels are benefiting from 401(k) plans.



Assessing the impact on a broader group of companies, officials of the Profit Sharing/401(k) Council of America report that automatic enrollment boosts employee 401(k) participation levels from the low- to mid-70% range in most companies to approximately 90%.¹⁴ This is consistent with what happened within a year after J.C. Penney Co. introduced automatic enrollment, according to a report in *The Business Journal of Milwaukee*.¹⁵

Of course, it's important to keep in mind that no single 401(k) enhancement is likely to be successful in every organization. Moreover, no matter what steps plan sponsors take, there will always be a subset of the employee population who decline to take all the action they could to prepare for retirement.

Also, making 401(k) participation more automatic is not a panacea, since the automatic contribution levels typically adopted can fall short of the amounts needed to ensure an adequate level of retirement savings for employees. Indeed, for 401(k) plans to provide adequate levels of retirement financial security—especially when offered as an employer's only retirement program—it's

critical for employers at the same time to take the steps needed to ensure greater employee participation and shared responsibility in planning for retirement needs. These steps may include various resources such as offering access to ongoing financial education, or communication and modeling tools to assist with retirement planning.

In addition to introducing automatic features, most employers are also trying to help employees achieve more successful 401(k) outcomes through targeting communications to nonparticipating employees and those contributing less than the maximum or the amount needed to receive the full employer match. These types of targeted communication messages illustrate retirement savings potential that the employee may miss out on if they don't contribute to the plan. These communication efforts have been successful in increasing participation a percent or two.

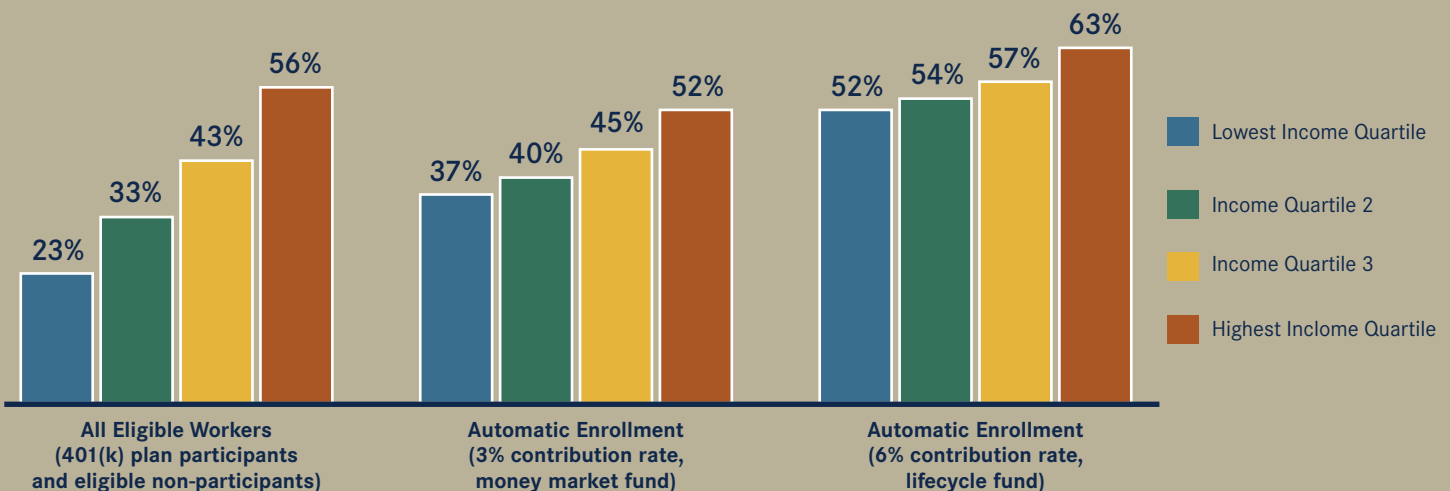
“401(k) plans are a happy benefit...employees really like their savings plans.”

Nevertheless, the growth of automatic 401(k) features clearly represents a step in the right direction, especially for low-income and younger workers who are least likely to begin saving for retirement. As **Exhibit 8** illustrates, a combination of automatic contributions of 6% of pay invested in a well-designed lifecycle fund can be expected to produce higher income replacement levels across the income spectrum—and more than a twofold improvement for the lowest income groups.

Clearly, for a growing number of companies today, making 401(k) participation automatic appears to be an idea whose time has come.

Exhibit 8

Median Replacement Rates* from 401(k) Accumulations** for Workers Turning 65 Between 2030 and 2039, by Income Quartile



*The replacement rate is the portion of pre-retirement income (as a percentage of final five-year average salary) that a worker is projected to be able to replace by drawing from his or her 401(k) balance beginning at age 65. **The 401(k) accumulation includes 401(k) and rollover IRA balances and assumes continuous employment, continuous 401(k) plan coverage and investment returns based on average historical returns between 1926 and 2001. Source: Employee Benefit Research Institute/Investment Company Institute 401(k) Accumulation Projection Model (see Holden and VanDerhei, 2005)

About This Study

Compiled in early 2007 by a team of consultants and associates in Towers Perrin's HR Services business, the findings presented in this report were drawn primarily from the following sources:

Towers Perrin's proprietary data

Information on 401(k) prevalence and provisions in large organizations was drawn from Towers Perrin's Employee Benefit Information Center database of plan provisions for 794 midsize and large U.S. companies (midsize employers being 500 to 15,000 employees). Information on employee engagement and the drivers of attraction among U.S. workers was derived from Towers Perrin's 2005 *Global Workforce Study*, which was based on a survey of approximately 60,000 employees working full time in midsize and large U.S. companies in a wide range of industries. Information on employee views of retirement and their preferences among retirement and other reward components was drawn from a number of Towers Perrin surveys, including the firm's 2004–2005 *Retirement Preference Index*, involving a survey of more than 2,000 U.S. employees. Information on U.S. employers' plans to implement automatic enrollment and third-party investment advice in the wake of the Pension Protection Act comes from a September 2006 Towers Perrin survey of financial executives in 126 midsize and large U.S. companies (see Towers Perrin's white paper, *The Pension Protection Act of 2006: Expected Impact on Retirement Plan Financing and How Employers Are Likely to Respond*, September 2006). For additional information about Towers Perrin's proprietary research and published reports, visit www.towersperrin.com.

Other previously published research

Information on broad 401(k) trends and levels of participant savings and participation comes from an extensive review of the available academic and technical studies and published research by U.S. government agencies and other organizations, including the Profit Sharing/401(k) Council of America, Employee Benefit Research Institute, Hewitt Associates, Deloitte Consulting and others.

Employer interviews

To gain a deeper understanding of employers' thinking and the latest trends and issues in 401(k) plan design and management, the research team interviewed representatives of 12 major organizations in industries including financial services, pharmaceutical, manufacturing, insurance, media and health care. AARP and Towers Perrin would like to express their appreciation to these individuals who gave so generously of their time and insights. At the interviewees' request, the results of those interviews are reported here only in the aggregate.

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Endnotes

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