60 Percent of You Adopted Automatic Enrollment Features. Did You Select the "Right" Defaults?

It is possible one very important default decision may have slipped past you.

By Jack Towarnicky

At least one expert suggests plan sponsors could have done better when implementing automatic enrollment – specifically, most used a default rate of 3 percent, most default only new hires, and automatic escalation applies in only one-third of plans.[1]

So, what did you decide?

- New hires and/or existing employees?
- Enroll once or perennially?
- Contributions of 3 percent or 6 percent or more?
- Qualified Default Investment Alternative (QDIA) of a target date fund, a balanced fund, or something else?
- Automatic escalation — yes or no?

PSCA's *60th Annual Survey of Profit Sharing and 401(k) Plans* (https://www.psca.org/60th_AS) suggests better results: "… Sixty percent of plans have an automatic enrollment feature. … More than half of plans have a default deferral in excess of 3 percent of pay. … The most common default investment option is a target date fund, used by 63.7 percent of plans … Three-fourths of automatic enrollment plans automatically increase default deferral rates over time. …" The PSCA survey also confirms that 50.6 percent of plans apply automatic enrollment only for new hires, 8.4 percent annually for all non-participants, and 6.9 percent one time for all non-participants.

In 2007, in my last plan sponsor role, we adopted automatic enrollment and perennially enrolled and escalated all who were not contributing at the target rate (ultimately 12 percent). By 2011, we perennially defaulted new hires and those who opted out at 6 percent to encourage a contribution that would receive the maximum employer contribution. We used a no-cost, fully transparent, target maturity model as the QDIA.[2]

But you ask, what was missed? What slipped past? It may have been Roth. I lost the debate on Roth vs. pre-tax and we defaulted to pre-tax contributions. Some say a Roth default might be tax advice. If so, how is a pre-tax default different?

Looking back to 2007, Roth probably would have been the better default choice for non-participating workers. Here's why:

- For today's workers, many, perhaps most affected by automatic enrollment will be lower paid, or short-service, or both:
  - In 2015, fully 61 percent of tax returns had Adjusted Gross Income (AGI) of less than $50,000, and the median was $39,275 — where workers paid an average federal income tax rate of just 3.6 percent.
  - Should a worker separate, and take a premature distribution, penalty taxes do not apply to Roth contributions.
  - They still have the option to opt-out, to change their contribution rate, or to change to pre-tax contributions.
- For tomorrow's retirees, Roth monies are not (currently) counted in Modified Adjusted Gross Income (MAGI) for Social Security benefit taxation purposes, or Medicare Part B and Part D income-based premiums.

It is never too late to prospectively change your automatic features — perhaps selecting defaults that enroll or escalate perennially, defaults which apply to all workers saving at less than a target contribution rate. If you make changes, remember to reconsider Roth. However, keep in mind that I don't personally know of a single plan that uses a Roth default.

Disagree? Got better automatic enrollment ideas? Send me your suggestions at jtowarnicky@usaretirement.org.

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[1] Nevin Adams, *What's Wrong With Automatic Enrollment,* ASPPA News, July 21, 2017, Accessed 3/19/18 at: https://www.asppa.org/News/Article/ArticleID/8877

[2] See Leadership Letter, "Defaults Is Not Mine — I Only Live Here", *Defined Contribution Insights Magazine,* Winter 2017,