



Automatic Enrollment, Reenrollment, and Retirement Outcomes

Combining automatic enrollment features can improve retirement savings adequacy.

November 2023

KEY INSIGHTS

- Automatic enrollment increases participation and contributions of employees who might not have otherwise saved.
- Successful retirement outcomes are often reliant upon starting to save early in one's career and saving persistently.
- Reenrollment can be an effective tool to reengage employees who have opted out of enrollment, have stopped saving, or need to rebalance their investment portfolios.

Millions of Americans who otherwise might not be saving for retirement have been enrolled by their employers into their 401(k) plans through automatic enrollment, and it has transformed the way that many Americans save for retirement. Plan sponsors have embraced the use of automatic enrollment as a means of creating employee engagement with retirement savings and promoting healthy financial behavior—saving for retirement. In the 17 years since the Pension Protection Act (PPA) was passed, T. Rowe Price has seen adoption of automatic enrollment increase by almost 80%, and roughly two thirds of the large market plans (>USD 25M) it recordkeeps have adopted it.

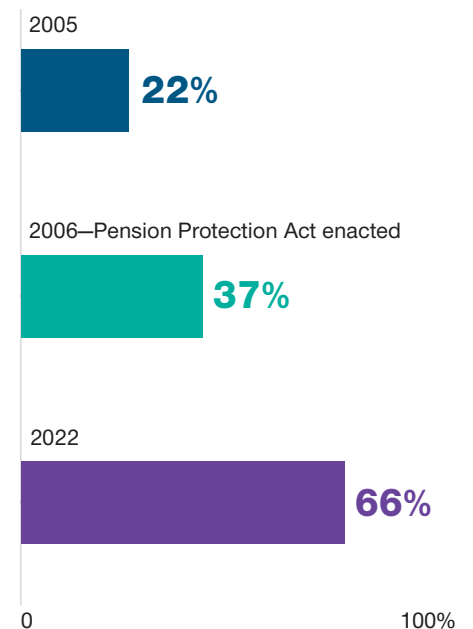
The default deferral percentage can also play a significant role in helping employees achieve financial security in retirement. When the PPA was enacted

in 2006, the most common default deferral percentage was 3%, which was used by 61% of the plans recordkept by T. Rowe Price. As of year-end 2022, only 27% of plans were still using a 3% deferral default. In contrast, employers adopting at least a 6% deferral default has risen from 4% in 2006 to 39% today.

Some may argue that the use of higher deferral defaults has been driven in large part by plan sponsors seeking to avail themselves of the safe harbor afforded to Qualified Automatic Contribution Arrangements. Despite the safe harbor, critics warn that higher default contribution rates lead to more participants choosing to opt out of plan participation. Our experience suggests that such concerns are unwarranted.

T. Rowe Price analysis of participants who were automatically enrolled in their employers' plans in 2022 reveals that only 5.4% opted out. Moreover, the percentage who opted out was similar

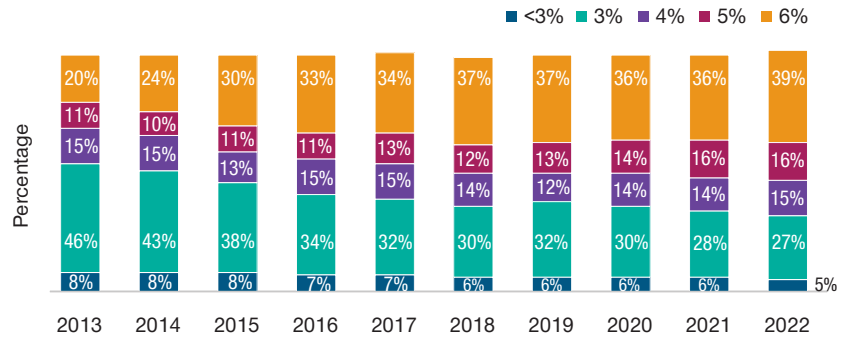
✓ Increase of Adoption of Automatic enrollment by 401(k) Plan Sponsors



Source: T. Rowe Price Retirement Plan Services.

Default Automatic Enrollment Contribution Rate in 401(k) Plans

(Fig. 1) Most employers have raised the amount from 3%



Source: T. Rowe Price Retirement Plan Services.

if the default was 3% or the default was $\geq 6\%$ of wages. Similarly, almost 88% of participants automatically enrolled in 2022 kept their investments in the Qualified Default Investment Alternative (QDIA) chosen by their employer. Collectively, these findings point to the power of nudges to influence behavior but raise the question of whether they go far enough or could serve a greater social purpose.

Who Benefits From Automatic Enrollment?

It is often assumed that everyone benefits from automatic enrollment, but research suggests that may not exactly be the case. Taha Choukhmane, Ph.D., a behavioral economist at MIT Sloan School of Management, sought to answer this question by analyzing T. Rowe Price recordkeeping data and comparing participant saving behaviors 12 months prior to and 36 months after implementation of automatic enrollment. He found that for most participants, automatic enrollment did not affect their long-term savings or wealth accumulation. For many, they simply catch up by saving more in the future. However, for lower paid and/or younger participants, the impact can be significant. For these participants who otherwise would not save, automatic enrollment helped to get them started (see Savings Rates: Automatic Enrollment vs. Opt In). By

saving earlier in their careers, they potentially benefit from additional years of saving and compounded investment returns.

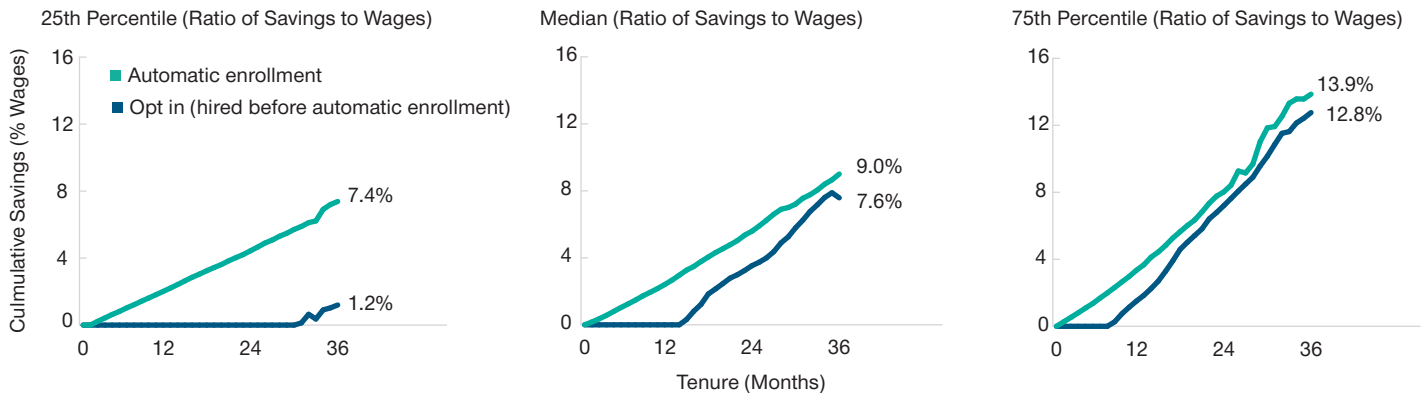
So if everyone is not benefiting equally from 401(k) plans or automatic enrollment, then who is being left behind and what can be done about it? To understand this, we must consider how automatic enrollment and other behavioral finance techniques might benefit groups that have historically had lower rates of access to 401(k) plans, lower levels of participation, or lower savings rates (as a percentage of wages).

Bringing an Equity Lens

T. Rowe Price analysis of the U.S. Census' 2023 Annual Social and Economic Supplement of the Current Population Survey found that both Black and Hispanic workers were less likely to have access to retirement plans than their white counterparts. Further, as part of its 2021 Retirement Savings and Spending Study, T. Rowe Price surveyed 401(k) participants and asked them when they first started to save for retirement. The data showed that white participants tended to start saving much earlier than their Black and Hispanic counterparts. In fact, 38% of white respondents claimed to have started saving before the age of 30 compared with 18% and 29% for Black

Savings Rates: Automatic Enrollment vs. Opt In

(Fig. 2) Automatic enrollment has primarily benefited those who would not have otherwise saved



Source: Analysis by Taha Choukhmane, Ph.D. (MIT Sloan School of Management), of T. Rowe Price recordkeeping data representing 600 firms that covered 4 million employees over the years 2006-2017. Most recent data available.

and Hispanic respondents, respectively. Worse, more than one-third of Black and Hispanic 401(k) participants didn't start saving for retirement until after the age of 40. Getting people to save early and often is clearly something automatic enrollment is well positioned to effect if one has access to a plan. Having access to a plan is the first step, but is it enough?

Reenrollment Complements Automatic Enrollment

It is often said that saving for retirement is akin to running a marathon. The key to finishing a marathon or saving for retirement is picking a pace that one can sustain to the finish line. Like running a race, saving enough for retirement is easier if you don't stop. Unfortunately, we learned in our 2021 Retirement Savings and Spending Study that not only do many 401(k) participants start saving late, but approximately one-third of the participants we surveyed either stopped saving or reduced their deferrals at some point. Automatic enrollment does a great job of getting people into the race but often falls short of helping them to finish it. To finish the race, we look to reenrollment.

Automatic enrollment and reenrollment are very similar as they both enroll participants in retirement plans at a

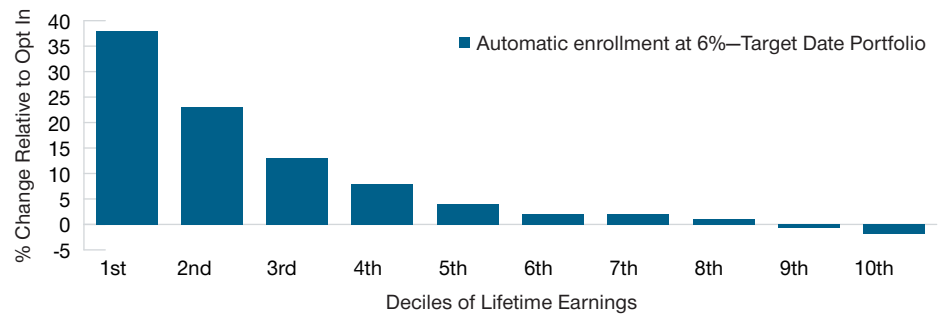
default contribution rate and investment fund. Where they differ is in practice. Typically, automatic enrollment engages workers as they become eligible for their employers' retirement plan. In contrast, reenrollment is very flexible and can be used to engage workers who have chosen not to participate or who could benefit from resetting their savings rate or investment allocations. Moreover, reenrollment can be used both tactically and strategically to affect specific groups of employees (e.g., nonparticipants) or the whole plan (e.g., QDIA reenrollment).

The Effects of Automatic Enrollment and Reenrollment Last a Lifetime

Saving for retirement is a long-term pursuit. Dr. Choukhmane's research suggests that engaging those who are least likely to save for retirement can have a significant effect on retirement outcomes. Using the safe harbor 6% default as the baseline, the research estimated lifetime wealth accumulation, factoring employment, taxes, personal preferences and biases, demography, and financial decision-making. It compared the data of those who were automatically enrolled in their employer's plan with those who had to proactively choose their contribution amount. The estimate assumed the default was invested in hypothetical target date

Effect of Automatic Enrollment Default Rate and Investment Choice

(Fig. 3) Lower-wage earners and nonparticipants can benefit from both automatic enrollment and reenrollment



Past performance cannot guarantee future results.

Source: Analysis and modeling by Taha Choukhmane, Ph.D. (MIT Sloan School of Management), of T. Rowe Price recordkeeping data representing 600 firms that covered 4 million employees over the years 2006–2017 and T. Rowe Price (glide path). Each bar corresponds to the model-predicted percentage difference between the sum of retirement and liquid wealth at age 65 under an automatic enrollment policy with an annual rate of 6% of compensation adopted by all employers compared with an opt-in regime with varying savings rates. Assumptions: The target date portfolio is represented by a hypothetical index portfolio. The hypothetical portfolio is composed of stocks (as represented by the S&P 500 Index) and bonds with a nominal yield of 3%, which follows the asset allocation of T. Rowe Price's proprietary glide path. (See Important Information for glide path allocation.) The model used to demonstrate the results shown was developed by Taha Choukhmane, Ph.D., and is not meant to serve as a recommendation for any specific action or investment decision. The projections or other information generated by the model are hypothetical in nature and do not reflect actual investment results. Index performance is for illustrative purposes only and is not indicative of any specific investment. Investors cannot invest directly in an index. Analysis is most recent available.

portfolios that replicate the asset allocation of T. Rowe Price's proprietary glide path.

The analysis showed that both younger and lower-paid workers can benefit from defaults and investing in a target date portfolio. More specifically, the workers who were automatically enrolled could hypothetically accumulate almost 40% more in lifetime wealth compared with those who proactively opted into their employer's plan.

While the benefits of automatic enrollment are less significant to higher-wage earners, the results highlight how both low-wage earners and those who have opted out of enrolling in their employers' plan could benefit from being reenrolled.

Using Plan Design to Effect Outcomes

The challenge employers face is that ideal 401(k) plan designs should reflect what's most effective for participants

throughout a working time horizon. However, employment tenures can be much shorter. Dr. Choukhmane's research sheds light not only on employee behavior, but also highlights the varying choices employers might consider to ensure that more employees could benefit from 401(k) plans by demonstrating the potentially beneficial effects of enrolling younger and lower-wage workers and ensuring persistent participation in 401(k) plans.

Since the passage of the PPA, there has been great focus on encouraging plan sponsors to adopt automatic enrollment and escalation. Unfortunately, the benefits and impact of reenrollment has taken a secondary position in the conversation. Reenrollment and its benefits of participation, adequate savings, age, and risk-appropriate investing can play an important and necessary role in pursuing the goal of 401(k) plans providing greater financial security to participants as they transition from working to retirement.

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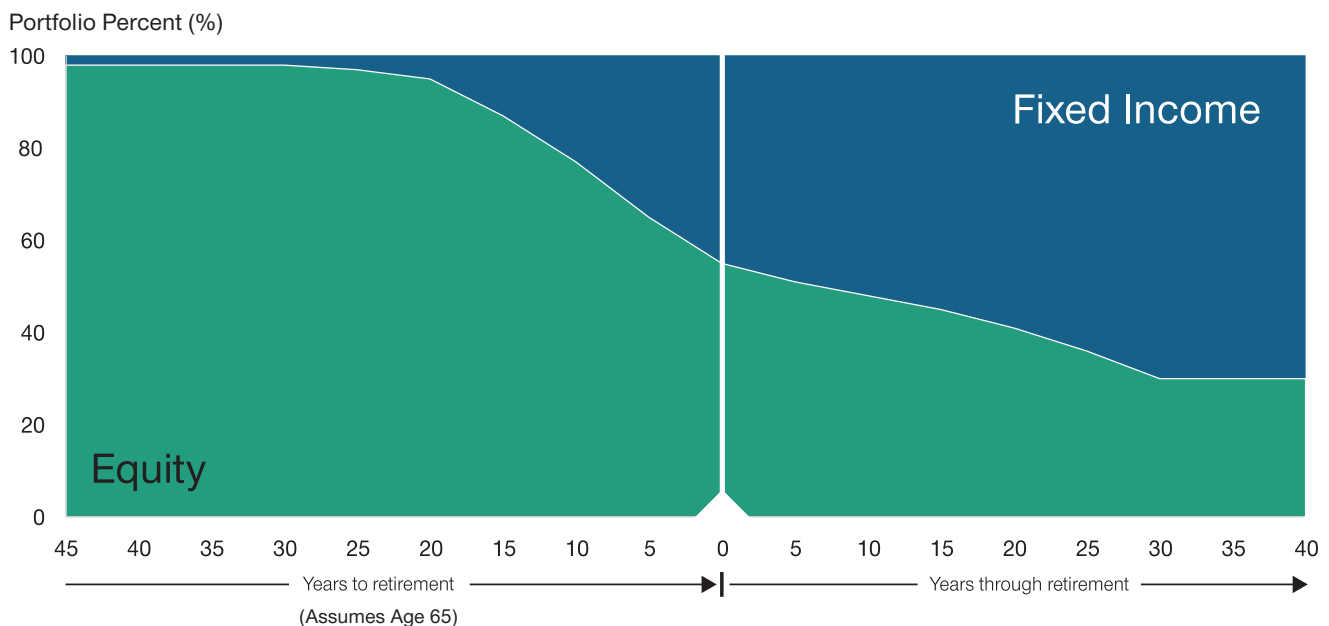
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T. Rowe Price Glidepath

Change in Equity and Fixed Income Exposure Over Time



Source: T. Rowe Price. Glidepath shown is for the Retirement Funds. For illustration purposes only.